

## ABSTRACT

Title of dissertation: THE BIG ISSUE OF SMALL BUSINESSES:  
CONTRACT ENFORCEMENT IN THE NEW RUSSIA

Elena Vinogradova, Doctor of Philosophy, 2005

Dissertation directed by: Associate Professor Meyer Kestnbaum  
Department of Sociology

The dissertation explores the problem of institution-building in nascent capitalist economies, with the emphasis on the role of culture in the genesis of new institutional forms. To help better understand the nature of the post-communist transformation in Russia, I address the questions of organizational adaptation and change in business practices resulting from the changing role of the state in the economy and society, focusing specifically on the problem of contract enforcement among small firms. The main source of data was the empirical research that I conducted in St.Petersburg, Russia, where I interviewed owners and/or managers of forty-five firms in 2001 and 2002.

When firms perceive state institutions as unable to guarantee the enforcement of contracts and property rights, they rely on alternative (non-state) ways of enforcing their agreements. My research shows that these strategies can be either based on a given firm's own resources (financial or social), or come from various agencies that offer enforcement services for sale, which vary from government licensed private courts to criminals. Non-state enforcement strategies are rooted in preexisting institutions and cultural practices, and develop in response to specific kinds of state failure to provide contract enforcement.

My research findings demonstrate a proliferation of non-state strategies of contract enforcement and dispute resolution, as well as the significance that state contract

enforcement institutions have for economic exchange and building of market institutions. The lessons concerning the powerful structuring role of enforcement institutions which my dissertation draws from Russian experience have wider implications not only for analysis but also for policy, and contributes to the literature on the role of the state in capitalist development, and cultural neo-institutionalism. The evidence that I have collected contradicts the neo-liberal belief in the sufficiency of self-regulating markets for the smooth functioning of an economy. It supports an argument that that the capability to provide independent enforcement services for businesses is an indispensable feature of the modern state, and essential to the creation of successful modern capitalism. This is an argument of central importance not only for developing and “transition” countries, but for the long-term future of developed societies as well.

THE BIG ISSUE OF SMALL BUSINESSES:  
CONTRACT ENFORCEMENT IN THE NEW RUSSIA

by

Elena Vinogradova

Dissertation submitted to the Faculty of the Graduate School of the  
University of Maryland, College Park in partial fulfillment  
of the requirement for the degree of  
Doctor of Philosophy  
2005

Advisory Committee:

Associate Professor Meyer Kestnbaum, Chair  
Associate Professor R. Patricio Korzeniewicz  
Professor Peter Murrell, Dean's Representative  
Associate Professor Alan Neustadt  
Dr. Leonid Polishchuk

©Copyright by

Elena Vinogradova

2005

To my family

## ACKNOWLEDGMENTS

I owe thanks to many people who assisted me in this project with their ideas, information and moral and financial support. When I embarked upon this project in 2000, I was looking for factors that would explain why newborn Russian capitalism is so different from what American advisors and the Russian government intended. At that time I was talking a lot with my friends who manage businesses in Russia. At that early stage of the project my close personal friend Natalia Ostan'kovich provided invaluable insight and insider information on the peculiarities of business exchange in Russia that helped me articulate research questions and thus gave direction to the whole study. Later, during the fieldwork, she facilitated access to a diverse range of firms which was essential for the success of the project.

This dissertation could never have been written without the gift of information that my respondents gave me during the field stage of my research. All my respondents are very busy people managing demanding careers as well as families, and I am very grateful to them for the time that they found to meet and talk with me and for their honesty and sincere desire to help. The importance of their input cannot be overemphasized.

A number of organizations provided financial assistance which enabled me to complete this project. The field research was supported by the National Science Foundation (Doctoral Dissertation Improvement Grant #0221100, July 2002); the Cosmos Club Foundation (Dissertation Grant, January 2002); the Havron family (Milton Dean Havron Social Sciences Award, October 2001); and the Sociology Department of

the University of Maryland (Research Grant, May 2001). I did my best to justify their investment.

I also would like to thank the faculty of the Sociology Department of the University of Maryland for years of moral and financial support for my dissertation project, and my committee for invaluable intellectual contributions. I would like to extend special thanks to my advisor, Meyer Kestnbaum, without whom I would have never made it to the dissertation defense. Throughout seven years of my PhD studies, Meyer skillfully steered my intellectual curiosity so I could find my own way as a scholar. Thank you for being an excellent mentor and friend.

And finally, I would like to thank my family for always being there for me during all the ups and downs of my graduate studies. My husband Neil helped me a lot by proofreading, and contributed the one most important sentence in my dissertation: the title. His unwavering support made it possible for me to focus on the dissertation during difficult times. And our two wonderful kids, Larion and Eimear, have been a joy and an inspiration, albeit a much loved distraction, too. I dedicate my dissertation to them.

# TABLE OF CONTENTS

TABLE OF CONTENTS.....	iv
LIST OF FIGURES: .....	vi
LIST OF TABLES:.....	vii
INTRODUCTION .....	1
Chapter 1: THEORETICAL FOUNDATION.....	10
Introduction: the problem of post-Soviet transition.....	10
Setting up the Puzzle: NIE and Transaction Costs Analysis .....	15
1.2. Understanding Non-State Enforcement: Network Analysis of Economic Sociology .....	22
1.3. Digging for the Roots: Neo-Institutionalism in Organizational Analysis .....	25
Chapter 2:	
RESEARCH PROCEDURES AND DATA DESCRIPTION.....	28
2.1. General methodology.....	28
2.2. Research procedures and data.....	31
2.2.1. <i>Research site, sampling, sample bias</i> .....	31
2.2.2. <i>Data collection and data management</i> .....	33
2.2.3. <i>The data: problems and virtues</i> .....	36
2.3. Study subjects: Population of small and medium-sized firms in St.Petersburg ....	40
2.4. Data description .....	44
2.4.1. <i>General description of the studied firms</i> .....	44
2.4.2. <i>Socio-demographic characteristics of the respondents</i> .....	46
2.5. Explanatory factors .....	51
2.5.1. <i>Overview of the explanatory factors</i> .....	51
2.5.2. <i>Sector</i> .....	54
2.5.3. <i>Size</i> .....	57
2.5.4. <i>Time of founding</i> .....	59
2.5.5. <i>Soviet-era managerial experience</i> .....	66
2.5.6. <i>Criminal involvement</i> .....	69
Chapter 3: WORKING AROUND THE STATE: CONTRACTS AND THEIR ENFORCEMENT IN THE RUSSIAN CONTEX.....	73
Introduction.....	73
3.1. Contracting among small firms.....	75
3.2. Why is it a problem? .....	86
3.3. In search for solutions.....	95
Conclusion .....	104
Chapter 4: FIRM-BASED ENFORCEMENT STRATEGIES .....	105
Introduction.....	105
4.1. Information and closed exchange networks.....	108
4.1.1. <i>Networks in action</i> .....	108
4.1.2. <i>Origins</i> .....	119
4.1.3. <i>Usage of networks enforcement strategy among studied firms</i> .....	122
4.2. Threat of violence by criminals .....	126
4.2.1. <i>Criminal groups in post-Soviet Russia</i> .....	126



4.2.2. <i>Origins of the strategy</i> .....	129
4.2.3. <i>The patterns of the strategy operation</i> .....	132
4.2.4. <i>Usage of the strategy among studied firms</i> .....	139
4.3. Arbitration by mutually agreed upon powerful individuals.....	142
4.4. Threat of punitive actions by state officials.....	145
4.5. Financial tools.....	151
Conclusion .....	155
Chapter 5: EXTRA-FIRM ENFORCEMENT STRATEGIES.....	159
Introduction.....	159
5.1. Professional associations .....	161
5.2. Private protection firms.....	164
5.2.1. <i>The beginning of private protection firms</i> .....	164
5.2.2. <i>Private protection agencies as contract enforcers</i> .....	167
5.2.3. <i>Usage of the Private protection firms strategy among studied firms</i> .....	173
5.3. Private arbitration (treteiskii) courts .....	176
5.4. State arbitrazh courts.....	179
5.5. Complementarities among strategies, and summary of their use .....	185
Conclusion .....	201
Chapter 6: ENTREPRENEURS AND THE RUSSIAN STATE .....	206
Introduction.....	206
6.1. Attitudes of Russian small entrepreneurs to the state .....	211
6.2. The Russian past as a factor in shaping attitudes to the state .....	225
Conclusion .....	230
CONCLUSION.....	231
Research Findings.....	231
Theoretical contributions of the study .....	235
Future Research .....	237
APPENDIX 1: QUESTIONNAIRE .....	240
APPENDIX 2: LUBA’S STORY .....	258
APPENDIX 3: Explanation of the coding technique.....	271
REFERENCES .....	276

## LIST OF FIGURES:

<b>Figure 2.3.1.</b> Types of businesses in Russia, by share of all enterprises, and by share of all the employed in 2002, in %. (Resursnyi Tsentr 2003) .....	42
<b>Figure 2.4.1.</b> Position of respondents within firms (n=45), in %.....	46
<b>Figure 2.4.2.</b> Respondents' position in a firm by gender (n=45), in %.....	48
<b>Figure 2.4.3.</b> Distribution of respondents by age groups (n=45), in %.....	48
<b>Figure 2.4.4.</b> Age groups by position of respondents (n=45), in %.....	49
<b>Figure 2.4.5.</b> Comparison of education of all respondents, owners only, and official statistics for 1999 (n=45), in %.....	49
<b>Figure 2.5.1.</b> Sector distribution of the studied firms (n=45), in %.....	56
<b>Figure 2.5.2.</b> Cumulative growth of the studied firms (n=45). .....	57
<b>Figure 2.5.3.</b> Distribution of studied firms by size (n=45), in %.....	59
<b>Figure 2.5.4.</b> Studied firms by three periods (n=45), in %.....	61
<b>Figure 2.5.5.</b> Soviet-era experience of the management and the sector of the economy the firm is in (n=45), in % .....	68
<b>Figure 2.5.6.</b> Soviet experience of the management by the founding period (n=45), in %.....	68
<b>Figure 2.5.7.</b> Criminal involvement of the management and the time of founding of a firm (n=40), in %.....	71
<b>Figure 2.5.8.</b> Criminal involvement of management and the size of firms (n=40), in %.....	71
<b>Figure 3.1.</b> Problems with contracts experienced by respondents (n=45), in %. The total is over 100% since multiple choices were possible.....	75
<b>Figure 3.2.</b> Firms' revenue undeclared to tax authorities (n=45), in % from all studied firms.....	82
<b>Figure 3.3.</b> Contract enforcement strategies available to small Russian firms.....	98
<b>Figure 4.1.1.</b> Strategies used by studied firms toward a new supplier or a new customer (n=45), in %.....	117
<b>Figure 4.1.2.</b> Usage of Information and closed exchange networks contract enforcement strategy among studied firms (n=44), in %.....	123
<b>Figure 4.2.1.</b> Usage of Threat of violence by criminals as a strategy of contract enforcement, among studied firms (n=44).....	140
<b>Figure 4.4.1.</b> Usage of Threat of punitive actions by state officials contract enforcement strategy among studied firms (n=44), in %.....	149
<b>Figure 4.5.1.</b> Usage of Financial tools contract enforcement strategy among studied firms (n=44), in %.....	153
<b>Figure 5.2.1.</b> Usage of Private protection agencies as a strategy of contract enforcement, among studied firms (n=44).....	173
<b>Figure 5.4.1.</b> Perceptions of effectiveness of state courts by respondents from studied firms, in % (n=38).....	181
<b>Figure 5.4.2.</b> Perceptions of corruption of courts officials among the respondents from studied firms (n=37), in %.....	181
<b>Figure 5.4.3.</b> Usage of State <i>arbitrazh</i> courts as a strategy of contract enforcement, among studied firms (n=44).....	183
<b>Figure 5.5.1.</b> Number of contract enforcement strategies used by firms over their lifetime, among studied firms, in % (n=45).....	186

<b>Figure 5.5.2.</b> Number of contract enforcement strategies currently used by studied firms (n=45).....	187
<b>Figure 5.5.3.</b> Overlapping of contract enforcement strategies.....	196
<b>Figure 5.5.4.</b> Comparison of use of contract enforcement strategies among studied firms, in the past and in the present time, in % (n=45). ....	197
<b>Figure 6.1.</b> Perceptions about state services being received for taxes, among the respondents from studied firms (n=43), in % (multiple choices were possible). ....	212
<b>Figure 6.2.</b> Perceptions of police effectiveness among the respondents from studied firms (n=45), in %.....	218
<b>Figure 6.3.</b> Perceptions of police corruption among the respondents from studied firms (n=44), in %.....	218
<b>Figure 6.4.</b> Perceptions of level of corruption among state officials by respondents from studied firms (n=42), in %.....	221
<b>Figure 6.5.</b> Perceptions of the Russian state's efforts to create favorable conditions for the development of small business by respondents from studied firms (n=42), in %....	224

**LIST OF TABLES:**

<b>Table 2.4.1.</b> General description of the studied firms.....	44
<b>Table 4.1.</b> Summary of characteristics, origins and implications of firm-based enforcement strategies.....	158
<b>Table 5.5.1.</b> Usage of contract enforcement strategies by studied firms (n=45).....	191
<b>Table 5.1.</b> Summary of characteristics, origins and implications of extra-firm enforcement strategies.....	203

# INTRODUCTION

One of the most profound changes to occur in Europe or Asia in the past century was the fall of communism and the subsequent transition to capitalism of the former Soviet countries. Transformation of this magnitude raises a host of compelling questions for the social sciences, most especially about the character of capitalistic organization and development.

To understand the Russian way of transformation, I address the questions of organizational adaptation and change in business practices resulting from the changing role of the state in the economy and society. I focus on the web of small individual enterprises, and in particular on relationships between Russian small firms and their trading partners, and the Russian state, because these micro-level relationships formed in everyday transactions constitute the essence of nascent market relations, and thus shape the future of Russian capitalism.

The question of the role of the state institutions and, in particular, state contract enforcement institutions, in the processes of post-communist transformation drives this study. In developed western countries a legal system and public authority guarantee protection of property rights and contracts, and are largely taken for granted. In the planned socialist economy, however, the problem of enforcement of contracts and protection of property rights did not exist at all: all the property of firms was state-owned, the contracts were assigned by command-administrative means, and dispute resolution was governed by the needs of the Plan. In the beginning of the 1990s, as the Russian government launched free market reforms, it relinquished a significant portion of its

control over economy by allowing private ownership of firms. However, the state enforcement institutions in post-perestroika Russia are not as reliable and trusted as in developed market economies; we can observe much uncertainty and variation with regards to state provision of basic protections (Frye 2000, 2001; Greif and Kandel 1995). As a result, during the past decade private firms have been attempting to conduct capitalist exchange in an environment where it is not clear whether their contracts will be fulfilled by partners and protected by the state.

Faced with this challenge, Russian firms have little choice but to develop new, non-state strategies to enforce their business agreements as well as safeguard their private property. These strategies – their origins, operation and impact on the newly emerging market economy in Russia - are the focus of this dissertation. In particular, I am addressing the following four questions:

1. Non-state forms of contract enforcement exist in all economies, but their reasons and significance vary. What factors caused small private firms in Russia to realize the need to develop non-state ways of enforcing their business agreements, and to stay away from the ones suggested by the state?
2. What particular institutional forms do these non-state contract enforcement strategies take, and where do these forms come from?
3. To what degree do the answers to the questions 1 and 2 shed light on the effects that non-state contract enforcement strategies have on inter-firm relationships, state/firm relationships, and the development of market institutions?
4. What determines the choices of individual firms with regard to strategic solutions of their enforcement problems?

I propose that enforcement is more than just a part of transaction costs, but in fact it can, and does, (re)define the structure of relationships between state and business, and between firms, influencing the form of capitalist relationships existing in a society. Building upon the propositions of new institutionalists and economic sociologists, I put forward the following arguments:

A. With the introduction of free market reforms in 1991 and 1992 in Russia, which included among other things the beginning of a far reaching rapid privatization process, legislating for the rights of individuals on private property, and allowing individuals to establish small private firms, state control over the economy began to crumble. This process, combined with the underdeveloped and inadequate legal infrastructure and poorly written laws resulted in the inability of the state to provide consistent, reliable and impartial law enforcement. On the other hand, the crisis of legitimacy of the Russian state among the general population exacerbated the problem by further alienating private entrepreneurs from state institutions. Contentious relations between private entrepreneurs and the state are deeply entrenched in the Soviet legacy of prosecuting private entrepreneurship, reinforced by the current climate of rampant corruption and lack of accountability among officials of various state regulatory agencies, and result in an enormous gap between the world of small businesses and the state. As a result, entrepreneurs perceive state enforcement as both unreliable and untrustworthy, and develop their own means of enforcing their business agreements.

B. Particular institutional forms of non-state enforcement strategies are determined by such factors as preexisting value orientations, norms, practices,

attitudes and perceptions, and develop in response to the specific kinds of state failure to provide contract enforcement.

Including state courts, I differentiate between two types of contract enforcement strategies that firms can use: those that are internal to a firm and based on its own resources, and those that are external to it and come from various agencies that offer enforcement services for sale. Strategies internal to firms include:

- Information and closed exchange networks;
- Threat of violence by criminals;
- Arbitration by mutually agreed upon powerful individuals;
- Threat of punitive actions by state officials;
- Financial tools (prepayment, 'hostages').

External strategies include:

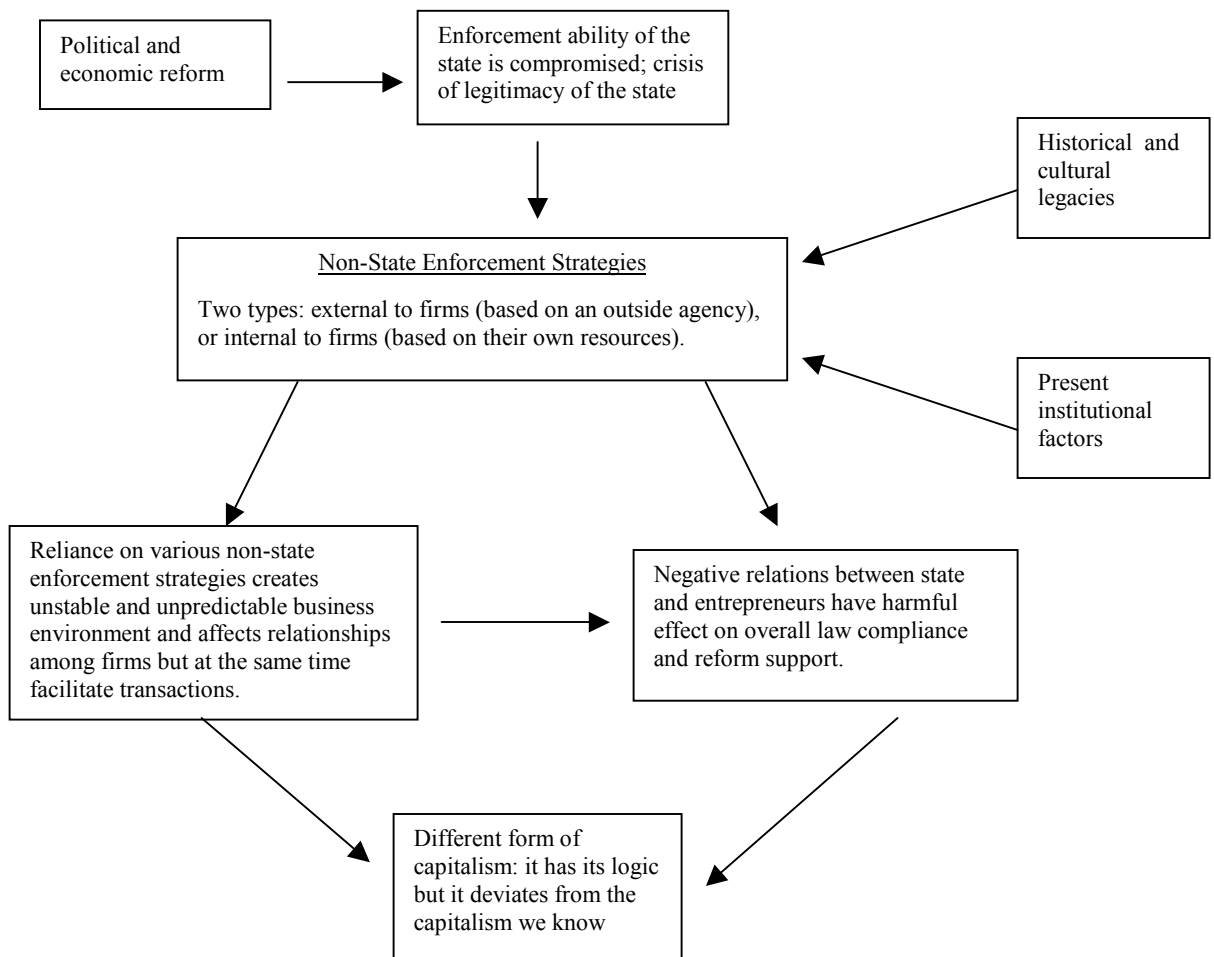
- Professional associations;
- Private protection firms;
- Private arbitration courts;
- State *arbitrazh* courts.

C. Non-state contract enforcement strategies have a dual effect on the business environment: on the one hand, they facilitate transactions by giving them additional security; on the other hand, they constitute barriers to entry; they contaminate the business environment with illegal practices; and increase general unpredictability.

D. On the level of individual firms, I propose to consider five factors that may help explain why firms prefer certain contract enforcement strategies over

others. These are certain attributes of firms that describe firms' need for contract enforcement strategies, and firms' resources to pursue their enforcement needs. Three out of five explanatory factors offered are reflective of firms' internal resources (connections to criminals, connections to old Soviet networks, and the time of founding), one is an indicator of a firm's needs in enforcement (area of business) and one is an indicator of both (size of firms). Firms' need for contract enforcement determines whether or not a firm would develop a specific strategy or strategies for dealing with contractual problems, while the available resources largely shape the response the firm chooses.

Graphically, the argument looks like this:





The main source of data for the dissertation was the empirical research that I conducted in St.Petersburg, Russia. I interviewed owners and/or managers of 45 firms (63 qualitative interviews: 18 open-ended and 45 semi-structured interviews), over the period of six months in 2001 and 2002. I then used qualitative methods of analysis to provide a “thick” description of studied cases, and quantitative methods of analysis to look across cases for broader patterns which could have wider relevance.

Small firms<sup>1</sup> were chosen as subjects of the study for a number of reasons. First of all, for small firms forming a monopoly is a much less likely answer to state enforcement deficiencies than for large enterprises, and they typically lack resources necessary to keep legal advisor on staff, like large enterprises frequently do. Second, small businesses comprise a growing share of the Russian economy, and thus are important to study. Finally, most small firms are started from scratch and in comparison with old Soviet enterprises they carry little, if any, Soviet legacy of organizational routines, norms and ties, and are more open to innovation and change. As Peter Murrell pointed out,

... it is the experience of capitalist societies that large organizations are often quite unresponsive to new circumstances. As Arrow (1974, pp.56-9) emphasizes, new organizations are often essential for change, because established ones are likely to have an irreversible commitment to existing arrangements. In capitalist societies, in new industries and in existing industries where the technology is new, new firms are of enormous importance for these very reasons (Mansfield et al. 1977:16 and R.Nelson 1981:1051-2). (Murrell 1992)

The central concept of my research is *contract enforcement* that is understood as the process of constraining the transacting parties to ensure fulfillment of contracts and

---

<sup>1</sup> Elsewhere I define study subjects as both small and medium-sized firms. Here, I talk about both of them as “small firms” because their needs and capacities are much more similar than those of large, typically post-Soviet enterprises.

business agreements. Throughout the dissertation, the term *contract* is used in relation to a written document that records an agreement between two or more parties regarding terms of a transaction. Verbal contracts are referred to as *business agreements*. Although verbal contracts are not accepted in the Russian court of law, both terms are used in the dissertation, because formal written contracts frequently describe only part of the deal, and the rest is agreed upon verbally. While enforcing such contracts, parties typically look for the enforcement of the deal in its entirety, including its unrecorded part. As chapter 3 will show, the usage of the term “contract” in itself in Russia is far from straightforward, and many different types of agreements are described as “contracts” by economic actors. Thus, the usage of this term is consistent with how it is used in Russia, rather than in western economic literature.

By *state enforcement institutions* I mean state courts, including their enforcement branch, and police forces that are supposed to prosecute unlawful behavior on the part of various economic actors. By *non-state strategies of contract enforcement* I understand various ways and means outside of the state legal system that entrepreneurs resort to in order to achieve a goal of enforcing business agreements with their partners. Actors deliberately develop their enforcement strategies given their predispositions and preferences, their needs and available resources, and their understandings of the actions of other actors, both inside and outside of the business community.

Finally, I frequently use the term *institution*, and since it is understood differently by representatives of different schools of thought in sociology and economics, I feel that it needs clarification upfront. Throughout the dissertation, *institution* means a set of normative and cognitive rules regulating a particular aspect of social life as recognized

and culturally accepted modes of thought and action that are routinely reproduced through habitual activities of members of a society. *Formal institutions* are such rules that are upheld by the force of law paired with some monitoring and enforcing organization. *Informal institutions* are such rules that are supported by commonly held beliefs and practices only. *Institutionalization* is a process of acquiring this rule-like status.

Much of the present work consists of a “thick description” of enforcement strategies on the basis of information obtained from field research and secondary data analysis. Such description is inevitably necessary when our knowledge of the processes on the ground is as limited as that of contemporary Russia. Analytical claims about various relationships on the ground are not organized by chapters, but instead are made in stages across the dissertation. For example, the question of relations between the state and contract enforcement is raised in chapters 1, 3 and 6, while chapters 4 and 5 provide necessary information for the understanding of these relations.

The dissertation is organized in the following way. Chapter 1 discusses three theoretical paradigms that equip me with conceptual tools to address the puzzle of contract enforcement, and presents the state of the debate on transition processes in post-Soviet countries with regard to the role of state in these processes. Chapter 2 first outlines the general methodology used in the study and data collection method, and gives the description of the study subjects. It then discusses the virtues of, and problems with the data, the demographic characteristics of respondents, and five explanatory factors that were selected prior to the main stage of data collection as having the potential to impact the choice of strategies of contract enforcement used by a firm. Chapter 3 examines the

types of problems with contracts experienced by the participants of my study, discusses historical and institutional roots of the perceived incapacity of state institutions to guarantee contract enforcement, and finally outlines various strategic responses developed by small firms. It addresses the first research question of the dissertation by examining what factors caused small private Russian firms to realize the need for non-state contract enforcement. Chapters 4 and 5 present an analytical description of contract enforcement strategies developed by small Russian firms in the 1990s, on the basis of the field research data, and attempt to answer the second, the third and the fourth research questions. In these chapters, I look closely at how each contract enforcement strategy operates on the ground, what its institutional and historical roots are, and assess the role of the explanatory factors in the choice of contract enforcement strategies by individual firms. Finally, chapter 6 describes the relations between the state and entrepreneurs as a context in which contract enforcement strategies get formed and employed, thus bringing the discussion back to the first research question.

# **Chapter 1: THEORETICAL FOUNDATION**

## **Introduction: the problem of post-Soviet transition**

In addressing the puzzle of contract enforcement under the conditions of failing state institutions I use the insights of a few theoretical paradigms. First, in the introduction I outline the present state of the debate on transition processes in post-Soviet countries with regard to the role of state in these processes. Then, in the subsequent three parts of the chapter I discuss three theoretical paradigms that provide me with the conceptual toolkits to examine different sides of the problem of contract enforcement in contemporary Russia. Specifically, the new institutionalism literature (NIE and Transaction costs institutionalism in sociology) helps me identify contract enforcement as a crucial component of the institutional structure of a society, pivotal for capitalistic exchange. Then, conceptual tools and insights of network analysis of economic sociology are used to explain how non-state strategies of contract enforcement operate. Finally, neo-institutionalism in organizational analysis is used to understand the cultural and historical roots of non-state strategies of contract enforcement.

One can identify three dominant approaches to post-communist transformations in Eastern Europe and FSU in the academic literature of the past decade with regard to the role of the state institutions. At first after the collapse of communism neo-liberalism prevailed, especially among the economists. Various arguments were put forward in

support of rapid restructuring and the withdrawal of the state from the economy, giving way to the powerful forces of the market to naturally develop capitalistic relations. The neoliberal approach tended to disregard the unique institutional makeup of each country in transition, and apply similar SAP-looking generic policies that were only half-heartedly implemented by governments under the threat of withdrawal of financial support, in a form of high-interest loans, for new democratic regimes (Wedel 1998, Murrell 1996, Murrell and Yijiang 1993, Gustafson 1999, Stiglitz 2000). One of the major shortcomings of the neoliberal approach was that it took the state for granted, which is dangerous because it assumes that “states in all times and places have had a similar potential or ability to achieve their leaders’ intentions; the varying roles states have played in different societies may be lost” (Migdal 1988, 17).

Early in the 1990s, after the first alarming evidence of the failure of the neoliberal strategy nearly everywhere in the region (particularly so in Russia), a strong political backlash against neoliberal governments and a swing of popular support toward neo-communists, some scholars proposed to reconsider the role of the state in the restructuring process (Amsden et al. 1994; Kochanowicz 1994; Burawoy 1996, 2001a). They claimed that the market cannot be both the means and the ends, and that after all it is the task of the state to establish the new capitalistic organization of the economy. The main downside of this approach was the confusion that appeals to a ‘strong state’ seemed to provoke. While most neostatists depicted the strong state as resembling modern capitalist democracies of the West<sup>2</sup>, their claims were often perceived as either

---

<sup>2</sup> “Historically, the ‘West’ (Western Europe, North America, Australia, and New Zealand) developed a unique pattern of a strong state – one that does not consist of a strong executive and a weak society, but of a high legitimacy and functional cooperation between the state and civil society. Informal habits and customs

advocating the state's unnecessary overextension and interventionism, or as wishful thinking, since it is just as difficult to transform weak states into strong ones as to organize market exchange where there are no markets (Stark and Bruszt 1998). Throughout this work, I refer to the strong state in Weberian sense, in a definition of J.Migdal: "it is an organization, composed of numerous agencies led and coordinated by the state's leadership (executive authority) that has the ability or authority to make and implement the binding rules for all the people as well as the parameters of rule making for other social organizations in a given territory, using force if necessary to have its way" (Migdal 1988, 19).

As an alternative to both lines of argument came Stark and Bruszt's (1998) claim that we don't have to choose between market and hierarchy, and should better instead resort to networks among firms – powerful and pervasive remnants from the Soviet era – as a solution to the shortage of state capacity. This argument is based on Evans's concept of embedded autonomy. Evans (1992, 1995) on the basis of studying East Asian countries built a claim that a Weberian-type state bureaucracy, through embeddedness in private capital, can get accurate and timely information about necessary state actions to facilitate economic development. While application of this model to Eastern European countries raised a certain amount of criticism (Burawoy 2001b), it is clearly inapplicable to Russia, because of her state's lack of two pivotal characteristics that a state should possess according to Evans – autonomy and capacity. Having a patrimonial state with a historically weak legal tradition, Russia displays neither a strong formal institutional

---

and historical traditions are as important for the functioning of this social order as legal arrangements." (Kochanowicz 1994, 201).

structure, nor a significant civil society capable of keeping state corruption in check. In the 1990s, economic policies have been heavily influenced by a few oligarchs who created alliances with political elites (Klebnikov 2000, McFaul 1997). The Russian state can be viewed as a predatory rather than a developmental one in Evans's definition, rendering Stark and Bruszt's argument powerless to explain the Russian case.

Recent works in sociological literature on the processes of change in Eastern Europe and the former Soviet Union are focused on the diversity of socio-economic institutions, and the recognition of the various forms and faces that contemporary capitalism may take (Eyal, Szelenyi, and Townsley 1998; Stark and Bruszt 1998). Authors analyze how the divergent paths of post-communist transitions shaped by institutional legacies of the Soviet era lead to distinctively different capitalisms, thus asserting the existence of multiple capitalisms coming from different origins.

The comparative capitalisms perspective undoubtedly opens new horizons to studying post-communist transformations. However while providing valuable insights about elites in post-communist Eastern Europe, few of the current works study transition processes on the level of individual firms. Those authors who do so tend to concentrate on the most influential actors (Stark 1997; Stark and Bruszt 1998; Guseva and Rona-Tas 2001), and rarely notice the less powerful majority whose choices are also important (Hass 1999; Burawoy and Verdery 1999).

In the present work, I focus my attention on the "little people" in the transformation process, whose strategic choices get largely shaped by their interaction with, and perception of the state and its agents, and who are intimately involved in the development of the new institutions of market capitalism. Many of the arguments that I make in



subsequent chapters, as well as the information provided by the interviewees, support the claims made by scholars from the neostatist camp in the middle of the 1990s, as a critique of the neoliberal approach. Finally, my argument that failure of the state institutions to provide consistently reliable contract enforcement impacts the form that Russian capitalism takes is certainly consistent with the propositions of authors of the comparative capitalisms perspective.

## **Setting up the Puzzle: NIE and Transaction Costs Analysis**

New Institutional Economics (NIE) and Rational choice institutionalism in sociology view individuals as purposeful actors, whose attempts to maximize returns on their exchanges are shaped by various transaction costs and the bargaining power of actors, and whose rationality is bound by the environment, circumstance and available information (Levi 1991, Williamson and Winter 1991). Institutions are defined here as formal rules and informal constraints that govern human behavior (North 1990). Rational choice institutionalists analyze choices made by individuals under the conditions of scarcity, interdependence, and as a response to a preexisting system of incentives. Hardcore rational choice institutionalists view actions as both rational and strategic, and as being constrained by conditions of incomplete and costly information.

Scholars of NIE and rational choice institutionalism are particularly preoccupied with the problem of reduction of transaction costs. Institutions structure social interactions, and transaction costs are the costs of these interactions. Transaction costs are defined as costs of information, decision-making and enforcement (Coase 1988, Williamson 1985). In the real world to make exchange possible economic actors have to purchase information about products and business partners, spend time and money on decision-making, and provide enforcement for the transaction. Attempts by economic actors to decrease transaction costs in the world of imperfect markets and incomplete information bring about institutional change (North 1990).

New institutional theories postulate that economic growth depends upon the existence of a favorable institutional environment (North and Thomas 1973, North 1990).

The constraints imposed by the institutional framework define the opportunity set and therefore the kinds of organizations existing in this institutional framework and determines the direction of organizational development: “Institutions, together with the standard constraints of economic theory, determine the opportunities in a society. Organizations are created to take advantage of those opportunities, and, as the organizations evolve, they alter the institutions” (North 1990, 7).

This framework of analysis is very helpful for the discussion of an environment in which economic activity occurs, in particular, one characterized by the presence of institutions of authority and enforcement, drawing attention to the role of the state. According to North (1990), over the course of human history economic exchange evolved from *personalized exchange* (small-scale production and local trade, present even in stateless societies) to *impersonal exchange* (the parties are constrained by kinship ties, bonding, exchanging hostages, or merchant codes of conduct) to *impersonal exchange with third-party enforcement*, where the state generally takes on the function of enforcement as an impartial third party that can act as a coercive force able to monitor property rights and effectively enforce contracts. Together with formal institutions, like legislation, and informal constraints, like culture-specific normative patterns, state enforcement comprises the institutional matrix of any society which defines how economic organizations operate, and their performance.

While transaction cost institutionalists draw attention to the importance of enforcement for economic exchange, they do not generally analyze it as a *variable*. The analysis of the role of enforcement in capitalist economies remains largely on a theoretical level which shows how much the enforcement system is taken for granted in

developed market economies. Even those scholars who point out the variability of state enforcement fail to discuss the implications of its failure.

New institutional theories and troubles which former socialist countries experienced in their transition to capitalism encouraged many scholars, especially economists and lawyers, to turn their attention to the problem of contract enforcement in nascent market economies. In the end of 1990s a number of works have been published which addressed the problem of contract enforcement faced by enterprises in transitional economies. Some of these works draw attention to non-state mechanisms of enforcement developed by enterprises to supplement or substitute state enforcement. I roughly divide the work on enforcement in Russia into two camps: theoretically grounded works that use mostly secondary data, and empirically rooted studies. The two works analyzed below present rich description and analyses of mechanisms of contract enforcement used by Russian enterprises, and advance our understanding of how economic exchange works in Russia after the beginning of free market reforms in 1991.

The paper by Greif and Kandel (1995) on enforcement problem in Russia in the beginning of the 1990s undoubtedly belongs to the category of ‘theorists’. The authors describe the institutional setting for economic exchange left over from the collapse of the Soviet system and demonstrate its inadequacy to handle contractual relationships. They argue that the issues of contract enforcement are inherently linked to the question of property rights in both legislation and the public consciousness, and that the process of change from socialist to capitalist realities is slow. The decline in political and economic

power of the state increased uncertainty and further undermined the security of property rights.

Greif and Kandell describe non-state enforcement mechanisms developed by medium to large enterprises in the beginning of 1990s, as the first aftermath of the withdrawal of the state from the economy. They found three main groups of mechanisms: *self-enforcing contracts* (large industrial enterprises which remained monopolies in their respective industries - a position of exclusivity guarantees enforcement; smaller enterprises use reputation as a means of enforcement); *binding arbitration* (introduction of commercial courts for resolving disputes); and *private enforcement by force* (for a fee, the Mafia provides physical force to ensure enforcement and protection against extortion by other criminals). Self-enforcement works by linking current and future economic transactions, binding arbitration is indirectly supported by the legal system, and private enforcement by force is based on the coercive power of parties other than the state.

While this account presents historical background of the enforcement problems which large and medium enterprises in Russia experienced in the beginning of 1990s, its lack of empirical evidence does not allow authors to deepen their description of the informal enforcement strategies practiced by enterprises at that time. It also fails to identify important consequences of non-state enforcement for economic development. Another criticism which can be made is that this analysis does not address specific problems of contract enforcement faced by small businesses. Authors do point out, however, that it is small businesses that drive the changes that take place in the Russian economy, and that it is important to study how they ensure contract enforcement.

Interesting, although incomplete, Greif and Kandel's work constitutes a valuable introduction to the analysis of the contract enforcement problem in Russia.

An example of the opposite – empirically grounded – approach is a work by Hendley, Murrell, and Ryterman (2000), who make the first attempt to evaluate the relative importance of various non-state mechanisms of enforcement in Russia, on the basis of survey data collected in 1997 from 328 industrial enterprises. Reflecting on the “significance of relational contracting, self-enforcement mechanisms, social networks, and legal institutions”, the authors' main conclusion is that much like their Western counterparts, Russian managers tend to use combinations of different strategies to enforce contracts. Hendley, Murrell, and Ryterman develop a classification of seven mechanisms used by Russian enterprises to enforce contracts, ranging from the most personal and informal, to litigation in state courts. They also identify complementarities between transactional strategies, showing how the usage of different strategies correlates.

This work is significant not simply because it unveils the mysteries surrounding business relationships in Russia (which many westerners assume to be incompatibly different from those in western countries), but also because it makes an important conclusion about the active presence of state institutions in economic relations.

However, the work also has some limitations, which are better understood if we look at qualitative follow-up research done by one of the authors, Kathryn Hendley (2001). She conducted a case study of six Russian industrial enterprises attempting to understand the logic of their behavior when dealing with non-payments. Her general conclusions support those of the survey, but she makes it clear that while the behavior of Russian and

western managers may seem similar in certain respects (like their common unwillingness to take disputes to court), it in fact has different reasons. She identifies that law and lawyers play a different role in Russian business and that competition in the Russian environment of uncertainty often leads to inefficient decisions. In her words, concerns of US managers are

qualitatively different from those facing virtually any Russian manufacturer. Russian managers do not have the luxury of worrying about profitability; they are obsessed by mere survival. Thus, all of the case study enterprises are preoccupied by short-run bottom-line concerns, irrespective of the level of competition. While the contours of the behavior might seem similar, when we look below surface, the explanations are radically different. In the Russian context, the driving force is desperation. As desperation increases, enterprises are less likely to push through to litigation, and more likely to settle for whatever they can get. (Hendley 2001, 21)

Just like Greif and Kandel, Hendley, Murrell and Ryterman limit their analysis to large, ex-Soviet enterprises. Small firms which entered the market during the past decade, remain outside their survey.

The following table summarizes the typologies of alternative mechanisms of enforcement given in above-describe works:

<b>Hendley, Murrell, and Ryterman (2000)</b>	<b>Greif &amp; Kandel (1995)</b>
1. relational contracting (trust, informal contacts)	1. self-enforcement (linking current and future economic transactions: large enterprises use their sectoral position, small use reputation)
2. self-enforcement (financial tools: prepayment, barter, “hostages”)	
3. third-party enforcement (networks as a third party, reputation)	2. binding arbitration (private enforcement, but relies on state enforcement institutions)
4. private enforcement (private courts, security firms, mafia)	
5. state administration (old connections, associate with previous state ownership)	3. private enforcement by force (Mafia, private security firms)
6. shadow of the law (threat of state enforcement)	
7. litigation (state enforcement)	

<p><u>Critique:</u></p> <ol style="list-style-type: none"> <li>1. This analysis does not discuss origins of these enforcement mechanisms, or the consequences of their usage.</li> <li>2. It does not ‘dig below the surface’: how each strategy translates into actual contract enforcement.</li> <li>3. It does not include small firms into the analysis; does not recognize that small firms may have a different enforcement experience because they lack the social and financial capital which large and old enterprises enjoy.</li> </ol>	<p><u>Critique:</u></p> <p>The categories described in the analysis are too general and uneven. For example, self-enforcement includes a great variety of mechanisms of enforcement, while binding arbitration is very narrow and rarely used (survey of Hendley, Murrell, and Ryterman, 2000, does not find many examples of its use). Deep historical analysis does not seem to compensate for the lack of empirical evidence.</p>
---	--

Regardless of their limitations, these works provide extremely valuable information for understanding how Russian enterprises conduct economic exchange, and set the ground for future research.

Not only economists have studied the problem of contract enforcement in Russia. Political scientist Timothy Frye and his co-author E. Zhuravskaya (2000) address the problem of racketeering that Russian small shop keepers face daily. On the basis of a survey of small shops in Russia they make a claim that it is an unreasonably high level of governmental regulation that pushes businesses into the unofficial economy, making it impossible for them to refer to state institutions for enforcement services. This study is important because in their view, proliferation of informal relations in the Russian economy does not result from the inefficiencies of state law enforcement institutions, but appears to be a by-product of the government’s regulatory activity.



## 1.2. Understanding Non-State Enforcement: Network Analysis of Economic Sociology

Both theoretical and empirical works of transaction cost institutionalists draw attention to the importance of contract enforcement for economic exchange. However, even though NIE helps us to acknowledge the variability of contract enforcement as a problem to study thus providing the point of departure for this project, it neither gives us an adequate toolkit to understand how non-state contract enforcement strategies operate, nor helps us decipher their origins and impact on the business environment in Russia<sup>3</sup>.

The scholarship that forms perhaps the core of economic sociology suggests a different outlook on economic action in general, and the problems of contractual relations in particular. Differently from the instrumental-reductionist vision of NIE, it offers a framework of analysis that emphasizes *relationships* rather than individuals, and multiple sources of action rather than pure self-interest (Granovetter 2001, 1994, 1985; Smelser and Swedberg 1994; Fligstein 1996a). The social embeddedness approach of economic sociology puts forward key insights into the role of social relations and networks in economic exchange, postulating that social relations and networks provide the structure in which economic transactions exist. Differently from NIE and transaction costs types of analysis, the embeddedness approach focuses on long-term cooperative ties between exchange partners as opposed to opportunism-based arm-length relations. In particular, Uzzi (1997) offers an important specification of the embeddedness approach, focusing on

---

<sup>3</sup> By 'business environment' I understand the equivalent to what N.Fligstein (1996a) calls governance structures, conceptions of control and rules of exchange.

structural embeddedness as opposed to cognitive, political or cultural types of embeddedness<sup>4</sup>. Structural embeddedness is defined as the influence that the quality and network architecture of exchange relationships have over economic activity.

The emphasis on the structure of social relations, rather than on formal institutional arrangements, seems to be particularly appropriate for the analysis of transitional economies where we see the failure of many formal institutions and the pervasive presence of informal arrangements. Scholars who study transformation processes stress that the existing patterns of inter-organizational networks in former Soviet economies not only make exchange possible but structure the pattern of subsequent exchange in powerful ways (Stark 1997; Stark and Bruszt 1998; Tatur 2000; Rona-Tas 1998).

This theoretical framework proves extremely useful for the analysis of the Russian case. On one hand, networks reflect continuity in institutional formation during transition. In his study of the role of networks in the Soviet Union and in post-Soviet Russia, Yevgeny Kuznetsov (1997) argues that both pervasive hierarchy failure (in the Soviet Union in the 1970s and 1980s) and market failure (post-socialist Russia) resulted in the formation of personal networks which constitute ‘intangible capital’, such as personal trust, reputation, and information that is tacit and difficult to transfer. Kuznetsov argues that while in stable environments, formal and informal institutions coexist peacefully, and often support and reinforce each other, in Russia a firm’s capital is embedded in personal networks. As a consequence of the shock of market reforms of 1991-92, new networks got carved from the old ones, realigning personal trust and reputation from previous periods.

---

<sup>4</sup> Distinction between these four types of embeddedness was offered by Zukin and DiMaggio (1990).

The particular blend of formal and informal institutions depends on the government's legal framework. If this framework provides low transaction costs for doing business, informal networks will have an incentive to register as legal entities and become subject to government supervision and regulation. ... If transaction costs are high, informal economic activity that takes place outside the government taxation and regulation systems will flourish. In this case, networks will perform functions the government is unable to perform. (Kuznetsov 1998, 160)

Enterprise learning includes the processes of acquiring competencies and accumulating social capital, as well as forming the social networks that will enable firms to put both capital and competencies to productive use. During the post-socialist transformation, the interaction among these various facets of enterprise learning has created an unusually rich and diverse set of transformation options.

Applied to the study of contract enforcement in post-Soviet Russia, the network/embeddedness approach is suitable on two levels. First of all, the concept of structural embeddedness helps us understand the relationships that are formed among firms in the milieu of unreliable and weak formal institutions, and how these relationships structure one particular aspect of exchange: contract enforcement. Second, entrepreneurs' participation in networks *outside* of the business community may be recognized as a factor that can determine their enforcement choices, in particular, ties that link entrepreneurs to criminals on one hand, and to state officials in certain state organizations, on the other. Such ties give entrepreneurs enforcement options that can be valuable at times.

### **1.3. Digging for the Roots: Neo-Institutionalism in Organizational Analysis**

For the analysis of the origins of non-state enforcement strategies I invoke a particular branch of neo-institutionalism in organizational analysis that comprises an eclectic variety of works that emphasize the impact of culture on the economic institutions and relations (Powell and DiMaggio 1991; DiMaggio 1994; March and Olsen 1989; Meyer and Rowan 1977; Fligstein 1996a, Dobbin 1994, Douglas 1986). This framework of analysis concentrates on the configuration of meanings, values and cultural definitions and treats institutions as not simply rules, procedures and norms, but as symbol systems, cognitive scripts, and moral templates that define actors' preferences and their range of culturally acceptable choices. Preexisting models, scripts and traditions define the rules of appropriateness and shape preferences which lead to certain actions, and not others. According to this account, the "logic of instrumentality" is embedded in the "logic of appropriateness", because the former is culturally determined (March and Olsen 1989). Thus even instrumental rationality is seen here as guided by culture-specific orientations.

In contrast to the rational-actor model of firms postulated by NIE scholars and rational choicers in sociology, this perspective sees organizations as "sites of situated social action" (Powell and DiMaggio 1991) that embody institutional logics that are "more than beliefs and normative pressures however: They find social and material expression in concrete practices and taken-for-granted organizational arrangements that both prompt and constrain economic actors at multiple levels, from individual actors to

the state as actor, and help to determine which social roles and strategies are conceivable, efficacious, and legitimate in a given setting” (Biggart and Guillén 1999, 725). The distinction between normative patterns and “institutional logics” (also called cognitive scripts and schemas, moral templates and models by other scholars) is fundamental since normative patterns presume the availability of a socially given choice when the actor can conceivably choose a deviant path away from a socially accepted norm. Institutional logics on the other hand do not presume such a choice; they comprise an overarching view of all available choices within a given culture. Institutional logics are much more resilient to changing circumstances than normative patterns.

This conceptual framework is uniquely suitable for the analysis of various aspects of economic and social life in countries that undergo post-Soviet transition. It draws attention to collective understandings of social order and rationality that are culture-specific and deeply embedded in any society. These collective understandings can account for the variations in the results of standard packages of free-market reforms that were implemented across the former Socialist block at the beginning of the 1990s. Thus, it is not the logic of the exogenous economic laws that guided reformation processes in each of the former Soviet countries, but the historically developed patterns of social organization (Dobbin 1994; Biggart and Guillén 1999).

For the purposes of analysis of the origins of non-state contract enforcement strategies devised by Russian entrepreneurs a conceptual framework developed by Ann Swidler (1986) is especially interesting. In her work, the culture is seen not as the meaningful end to which the action is directed, but instead as a supplier of a repertoire of habits, skills, styles and other cultural components from which “strategies of action” are

constructed. Strategies of action are “persistent ways of ordering action through time” (Swidler 1986, 273) that are not equivalent to a plan to attain a certain goal. Instead, they are understood as a general way to organize action:

People do not build lines of action from scratch, choosing actions one at a time as efficient means to given ends. Instead, they construct chains of action beginning with at least some pre-fabricated links. Culture influences action through the shape and organization of those links, not by determining the ends to which they are put. (Swidler 1986, 277)

Swidler pays particular attention to periods of social transformation (“unsettled lives”), when new strategies of action may get developed. During such periods, culture provides actors with a set of styles and skills that they can choose from in attempts to establish new dominant models of authority and cooperation, and ultimately form new strategies of action. The choice will be determined by concrete structural constraints and historical circumstances within which competing strategies struggle for domination.

The theoretical perspective offered by cultural institutionalists helps me identify culture-specific roots of non-state strategies of contract enforcement that were shaped in the past decade but in fact can be traced back much further into the past, to Soviet and pre-Soviet era “institutional logics” and “strategies of action”, and explain their durability as well as change (Campbell 1996; Ledeneva 1998; Nelson, Tilly and Walker 1998).

## **Chapter 2:**

### **RESEARCH PROCEDURES AND DATA DESCRIPTION**

This chapter has a number of tasks to fulfill. First, it outlines the general methodology that guided this research. It then presents research procedures that were used to collect data, and discusses the quality of the data. Then a separate section discusses subjects of the study – population of small and medium-sized firms in St.Petersburg, Russia. The next section is devoted to the data description, including general description of the surveyed firms, and socio-demographic characteristics of respondents. The overview of the five explanatory variables concludes this chapter.

#### **2.1. General methodology**

To test the hypotheses I develop detailed case studies of a range of small and medium sized firms through field research<sup>5</sup>, following the procedures of multiple case study research by Ch. Ragin (1994, 2000). I selected a multiple case study technique because I consider this approach to be the most adequate given how little we know about the processes of business exchange in nascent capitalist economies. Multiple case-based research helps avoid “homogenizing assumptions” (Ragin 2000, 5) that are inevitable in more formalized quantitative methodology without sacrificing the possibility for

---

<sup>5</sup> The field research was made possible by the generous support of the National Science Foundation (Dissertation Improvement Grant #0221100, July 2002); Cosmos Club Foundation Award (January 2002); Milton Dean Havron Social Sciences Award (October 2001); and a research grant from the Sociology Department, University of Maryland (May 2001).

documenting generalities. One can commence the investigation with little information about the nature of relationships on the ground and guided by theory, and through careful comparison of characteristics of a number of cases, arrive at a comprehensive picture.

It is common among social scientists to focus either on *complexity* of studied social phenomena through ethnographic, historical and macrolevel research, or on *generalities* – patterns that hold across many cases (Ragin 2000, 21). These two approaches are traditionally viewed as a variable-oriented versus case-oriented strategy, and their origins traced to the founding fathers of sociology – Durkheim and Weber (Ragin and Zaret 1983). A typical case study concentrates on the details of a small number of cases that are studied in-depth; cross-case analysis allows only for very limited generalizations that may not have wider relevance. Quantitative techniques are typically applied to large numbers of cases that are not studied in depth but instead a researcher focuses on a variation of specific factors to arrive at some broad patterns of causality.

The multiple case study technique developed by Ragin (1987, 2000) attempts to bridge the gap that exists between these two traditions. It suggests the in-depth study of relatively large sets of cases, thus preserving the focus on complexity of case-oriented research strategies and simultaneously attempting the possibility of some generalizations typical for variable-oriented strategies. Attention to the details of cases are supposed to help avoid homogenizing assumptions, while coding techniques make some degree of formalized quantitative analysis possible. In essence, the comparative case-based methodology formalizes and deepens the diversity-oriented techniques that are common in qualitative inquiries and applies them to relatively large datasets.



In my research I compiled a data set of forty-five cases, and apply some of the techniques of multiple case studies offered by Ragin. I use his idea of partial set membership: instead of having a case fully ‘in’ or fully ‘out’ of the dataset on some attribute, a case can be assigned a partial membership, depending on the degree of its participation. This feature helps me better capture the complexity of the real world because it helps avoid the homogenizing bipolarity of an exclusive ‘yes’ or ‘no’, instead inviting a range of in-between possibilities into the analysis. I apply this technique to the analysis of the frequencies of use of contract enforcement strategies by the studied firms. It allows me to follow the trends in strategies’ use, to distinguish between strategies that used to be popular in the past, those that are currently in common use and those that are gaining popularity among entrepreneurs, and also to estimate the intensity of their use.

For the purposes of presentation, I organize the analysis not around the cases – individual firms, but around the variables – contract enforcement strategies. Analytic description of each strategy in chapters 4 and 5 includes not only the discussion of its patterns of use by the studied firms, but also the examination of its origins and the implications for inter-firm and state/firm relationships.

## **2.2. Research procedures and data**

### *2.2.1. Research site, sampling, sample bias*

The field research took place in St.Petersburg, Russia. St.Petersburg is located in the north-west of Russia, on the banks of the river Neva and the shore of the Finnish Gulf, and close to the borders with Finland to the north and Estonia to the west. The city excluding suburbs has a population of approximately 4.62 million people, out of which nearly 2.7 million are considered to be of working age (16 to 55 for women, and 16 to 60 for men). In reality these figures are probably significantly larger due to a great influx of refugees and people from the provinces looking for jobs in recent years, which authorities have little, if any, way to account for.

St.Petersburg was chosen as the site for the research for two reasons: (1) this is the second largest city in Russia and has sufficient organizational diversity and complexity of economic life, and (2) because it is my native city, where I myself worked between 1990 and 1995, and have access to networks of organizations which may be closed to outsiders.

A snowball technique of sampling was used in data collection, and was chosen because differently from random sampling it ensures *trust*, which is a fundamental prerequisite for researching sensitive issues like double bookkeeping or the bribing of state officials. Snowball sampling is a special non-probability method that relies on referrals from initial subjects to generate additional subjects. While this technique can dramatically lower search costs, it comes at the expense of potentially introducing bias because the technique itself reduces the likelihood that the sample will represent a good

cross section from the population. Awareness of the possibility of this bias is the first step towards overcoming it.

A clear selection bias might have been present in the data collection toward more educated as well as toward younger people. My own background undoubtedly played an important role in starting the ‘snowball’ rolling. The selection bias may have limited the validity of my data, although the bias has hopefully been reduced by the relatively large number of cases.

What may present an even more important concern is that snowball samples are usually biased towards the inclusion of individuals with inter-relationships, and therefore over-emphasize the cohesiveness of social networks missing those who are isolated from such networks (Atkinson and Flint 2001). This potential difficulty is even more dangerous than selection bias because of the importance of networks among firms as stated in my hypotheses. The low number of maximum referral links<sup>6</sup> (detailed description is in the next section) is intended to reduce this bias.

Clearly, no generalized conclusions about the whole population of small firms in St.Petersburg can be made solely on the basis of the information obtained from this sample. Snowball sampling contradicts many of the assumptions fundamental to the conventional representative sampling, and the degree to which this sample deviates from the population remains unknown. However, for the exploratory purposes of the research, and in the combination with the secondary data this technique appears to be adequate.

---

<sup>6</sup> “Referral link” denotes the degree of separation of the researcher from the interviewee. One referral link means that the researcher knows the interviewee personally; two referral links mean that the interviewee was recommended by a personal acquaintance of the researcher, and so forth.

### *2.2.2. Data collection and data management*

The first set of data I collected in St.Petersburg, Russia, in the summer of 2001. I conducted interviews with owners and/or managers of eighteen<sup>7</sup> small private firms (seven of them engaged in trade, five offered services, and six were involved in product design and manufacturing). An open-ended questionnaire was used; interviews were tape-recorded, and transcribed verbatim. Field notes were also taken at the time of interviews. Interviews lasted from forty-five minutes to four hours, and took place in informal environment, either in the respondent's home, or in a quiet public place, like a café or restaurant. Snowball sampling was used to generate additional subjects. In the first wave of data collection six interviewees were personal acquaintances of mine, nine were recommended by them, and the remaining three had three referral links.

The information obtained during the first wave of data collection allowed the elaboration of the research hypotheses, further specification of explanatory factors, and the development of a more formalized questionnaire (see Appendix 1) for the second stage of data collection. This stage took place in St.Petersburg during the summer of 2002, when representatives of forty-one business firms were interviewed. The sample selection included thirteen<sup>8</sup> firms that were interviewed during the first phase of research in the summer of 2001. A second interview with them appeared to be necessary since the format of interview and questionnaire used were different. Four firms from the first stage

---

<sup>7</sup> One of the cases from the first stage of field research was later dropped from the analysis because it presented a deviation: the firm was bankrupt.

<sup>8</sup> Besides one case that was dropped (see footnote above), four other firms were not interviewed during the second stage of the field research. Owners of two of those firms (#44 and #45) were unavailable for a second interview, claiming a hectic summer schedule. Since the information they provided in the first stage of the research was very valuable, they were not omitted from further analysis. Respondents from two other firms (#29 and #32) changed jobs in the meantime and were included in the second stage as new cases (the general description of all studied firms is given later in this chapter).

of data collection that could not be interviewed for the second round were nonetheless also included in the final data set, thus bringing the total to forty-five firms.

The questionnaire was changed from an open-ended format in the first stage of data collection to a multiple-choice format in the second stage to facilitate subsequent analysis of the data. To gather as much information as possible from the respondents I was asking them questions from the questionnaire, and while tape-recording their full answers, coded their answers in the multiple choice questionnaire booklets. I encouraged respondents to give comments and examples from their personal experience, emphasizing the importance of their first-hand knowledge. The final result of interviews was therefore two-fold: a completed questionnaire on one hand that allowed later quantitative analysis, and tape-recorded comments and examples on the other hand. The latter part of interviews was to be treated as qualitative data, analyzed separately, and was meant to enhance research findings by giving them richness and detail.

Interviews for the second stage of data collection lasted from forty-five minutes to two and a half hours, averaging one hour, and took place mostly in an informal environment: in a respondent's office (twelve interviews), his or her home (twenty-four interviews), or in a public place of their choice (nine interviews). Snowball sampling was used to generate additional subjects. In this stage of data collection out of forty-five interviewees twelve were my personal acquaintances or friends, and the remaining thirty-three were recommended by them or by other acquaintances of mine: twenty-eight cases had two referral links, and five had three referral links<sup>9</sup>.

---

<sup>9</sup> It is likely that the number of referral links in the snowball sample is associated with a within-sample bias. In the following chapters I will be quoting participants of my study, and it certainly appears that interviewees with just one referral link get quoted more frequently. Out of a total of 94 direct quotations

The table below summarizes the differences between the first and the second stages of data collection and analysis:

	<b>First (pilot) stage (completed in summer 2001)</b>	<b>Second stage (completed in summer 2002)</b>
<b>General methodology</b>	Multiple case study	Multiple case study
<b>Method of data collection</b>	Qualitative interview, tape-recorded	Semi-structured interview with tape-recorded comments and examples
<b>Technique of sampling</b>	Snowball sampling	Snowball sampling
<b>Subjects of field research</b>	Owners/managers of small private Russian firms	Owners/managers of small and medium sized private Russian firms
<b>Number of subjects</b>	18 small firms	45 firms in total, including 13 repeat, 28 new firms and 4 firms from the first stage without new interviews
<b>Research site</b>	St.Petersburg, Russia	St.Petersburg, Russia
<b>Data analysis</b>	Qualitative analysis of interviews	Cross-case analysis of contract enforcement strategies used by studied firms, with relation to the explanatory factors
<b>Final outcome</b>	Specification of explanatory factors, further elaboration of hypotheses and creation of structured questionnaire for the second stage	PhD dissertation in Sociology

All data obtained from interviews and participant observation are preserved for the entire duration of the project and after<sup>10</sup>, and are available for re-examination. During the data collection all respondents were assured of complete confidentiality and anonymity of the process, and were asked to sign an Informed Consent Form. Questionnaires and

---

and references to interviews 34 belong to interviewees with just one referral link (average 2.83 quotations per firm with one referral link), 49 quotations are from respondents with two referral links (average 1.75 quotations per firm), and 11 quotations are from respondents with three referral links (average 2.2 quotations per firm). Thus there appears to be no strong relationship between the number of referral links and the average number of quotations per a firm, both firms with one referral link and with three referral links get quoted more than those with two referral links. The average number of quotations per firm across whole sample was 2.47. All but 7 interviewees got quoted; maximum number of quotations per firm is 8, a median is 2 quotations per firm.

<sup>10</sup> With the exception of the interview tapes that were destroyed after transcription, as indicated in the approved application to the University of Maryland Institutional Review Board with regard to treatment of human subjects.

consent forms have been approved by the University of Maryland Institutional Review Board<sup>11</sup> with respect to their treatment of human subjects prior to the field research stages.

### *2.2.3. The data: problems and virtues*

Virtually all interview-based data present certain problems. First, it cannot be ensured that the respondents always tell the truth, either for the innocuous reason of forgetfulness, or to intentionally distort reality. It is in human nature to try to project a positive image to one's interlocutor, thus respondents are typically quite likely to ignore or omit those past experiences that make them appear in a less than flattering light.

In the context of this research it is possible that the participants overemphasized the contractual disputes which for them had positive outcomes, and neglected to mention, or were reluctant to elaborate on, the disputes with negative outcomes, or those that involved illegal means of redress. This potential bias is particularly significant in this research because of the sensitivity of the issues in question, like hiring criminals to exert physical violence, or bribing a tax inspector to pressure another firm. Many entrepreneurs might have been reluctant to admit such doings. Hence it is possible that the scale of occurrences of such overtly illegal activities may in fact be larger than it appears from my data.

---

<sup>11</sup> IRB approval of the questionnaire and research procedures for the first stage of data collection: University of Maryland Institutional Review Board, IRB HSR Identification Number – 01 sociology006, April 18, 2001. IRB approval of the questionnaire and research procedures for the second stage of data collection: University of Maryland IRB HSR Identification Number – 02 socy010, April 5, 2002.

On the other hand, entrepreneurs might have been embarrassed to admit their lack of certain knowledge that could be instrumental in shaping their contract enforcement attitudes. For example, some respondents might have been reluctant to reveal their lack of knowledge regarding litigation in state courts that is in fact responsible for their failure to use this potentially valuable enforcement tool, and instead exaggerate their distrust of the state in general. It is both common and popular in Russia to blame the state for all problems, and for many entrepreneurs it could have seemed like an attractive avenue to take in a conversation about their business practices.

Second, interviews are hardly a precise instrument in measuring an objective reality. Few entrepreneurs are capable of, or even willing to try, to recall exactly how many contract violations they have experienced, or how much money they have lost as a result of these disputes. Instead, what they reveal are their *perceptions* of their business reality: how serious they feel the contract enforcement problem is for their business, how reliable they perceive their enforcement strategies are, or how strongly they feel about the state. While understanding of this difference between the objective and the perceived realities is important to keep in mind, it should neither discourage analysis, nor put off the reader. As it will be argued in subsequent chapters, perceptions are as important, and sometimes can be even more important, than the objective reality because the former have the power to influence and shape the latter. Small Russian entrepreneurs are not simply passive bystanders of the business environment that is bestowed on them; they actively form this very environment through business transactions they engage in every day, and the way they perceive this environment influences their choices.



Finally, entrepreneurs are reluctant to talk about money. While they might be willing to share anecdotes and little stories from their experience, when the questions concern actual amounts of turnover concealed from tax authorities, or amounts paid to criminals, or size of bribes to state officials, their enthusiasm suddenly wanes and brows get raised in suspicion as to why such information is requested. While I managed to obtain rough estimates of those figures that appeared to me to be of particular value for understanding the scale of the discussed issues, it should not surprise the reader that more detailed information is not provided, and that the accuracy of the given numbers is not always asserted. Secondary data was used for comparison when possible to give more credibility to those figures that were provided.

Methodological triangulation – developing cases in-depth and in breadth – was used to minimize the effect of all potential sources of problems with the data, with regard to both sampling and data collection method problems. Embeddedness of the research into the data and richness of the data allows avoiding mistakes that can be found in results of surveys, and are seen as more appropriate for the exploratory goals of the research. Breadth of the data, achieved through a substantial number of cases, allows me to move beyond a “thick” description of a handful of cases, and attempt to look across cases for broader patterns which can have wider relevance. Researchers of the processes of transformation in former Soviet block typically use either qualitative (Hendley 2001; Hass 1998) or quantitative-oriented strategy (Hendley, Murrell, and Ryterman 2001; Frye 2001). My research is an attempt to bridge the two types of inquiry, and address the problem of contract enforcement on the level of many firms studied in a “thick” fashion.

Thus even when firms are looked at in aggregate in certain parts of analysis to point out some general patterns, a rich, detailed qualitative description typically accompanies it.

The reason why the qualitative side of the data is emphasized in the analysis is so we can understand the logic that actors use to make decisions about their economic actions, the reasoning behind their choices, the way they perceive their business environment and other actors. The answers to these kinds of questions are pivotal for understanding the context in which contract enforcement in Russia occurs. Thus, given the kind of data I collected, the way the sample is compiled, and the character of the research questions, the only kind of quantitative analysis I have confidence in is non-parametric<sup>12</sup> correlations between causal factors and the reliance on a specific contract enforcement strategy on the level of an individual firm to help me to identify what kinds of firms use particular strategies. Other types of quantitative analysis, like regression models, do not seem suitable for the kind of data and exploratory goals of the study.

---

<sup>12</sup> The term “non-parametric” refers to non-normal distribution; typically a non-parametric type of analysis is used with distributions that are suspected to be not normal, often produced by small, non-probability samples.

### **2.3. Study subjects: Population of small and medium-sized firms in St.Petersburg**

The notion of small businesses was formally introduced in Russia at the end of the 1980s, in the midst of Gorbachev's perestroika. It started with the Law on Individual Labor Activity (1986), the Law on State Enterprises (1987), and the Law on Cooperatives (1988). A few other important laws regarding private property rights were introduced in 1989 and 1990. Finally, in 1990 the Law on Enterprises and Entrepreneurial Activity allowed individuals start their own small private business.

The official definition of small businesses has changed a few times over the course of the 1990s. Originally, by the law of 18<sup>th</sup> of July 1991, a firm was considered "small" for the purposes of tax collection if the number of employees did not exceed an officially established limit of 200 people (200 in heavy industry and construction, 100 in R&D, 50 in other areas of production, 15 in trade and services). On the 19<sup>th</sup> of June, 1995, a law was passed that currently regulates all activity of the small business sector in the territory of the Russian Federation. According to this law, the number of the employees in a small firm should not exceed 100 people in industrial production, transport and construction, 60 people in R&D and agriculture, 50 people in wholesale trade, 30 people in retail trade and consumer services, and 50 people in all other activities. The government's share in a firm's equity should not exceed twenty-five percent (National Research Institution 2003). A medium-sized business is defined as employing up to 250 people.

There are three ways in which small businesses were created in Russia during the transitional 1990s:

1. through the privatization of state-owned companies or their sub-units;
2. as spin-offs of the existing (often state-owned) large enterprises, tailored for the needs of the mother-company;
3. through establishing new businesses from scratch.

The last category – newly established firms – constitutes the majority of existing small businesses, and they are at the center of my interest. Each method of organization gave small businesses different access to resources and power, and different internal dynamics. Privatized firms and spin-offs inherited the old Soviet ways of doing business, while start-ups often lacked access to existing trade networks and had to build new ones from scratch, unless they had management with strong connections to pre-existing Soviet exchange networks. Stiff competition for financial and human resources accelerated the “natural selection” process as markets have developed.

Almost 900,000 small companies were established in Russia by 1995; this number has diminished slightly in subsequent years. In 1999, there were 890,000 small companies (32% of all enterprises) registered in Russia, 90% of them privately owned.

According to the most recent statistics (Resursnyi Tsentr 2003), by the end of 2002 there were 882 thousand small business firms registered in Russia, and 2,137 thousand medium-sized enterprises. Including farmers (264 thousand) and the self-employed (4,717 thousand), the number of all businesses that employed up to 250 people increases to eight million, which 93.4% of the total of 8,562 thousand of firms working in Russia in 2002 (figure 2.3.1). The overall share of small and medium-sized firms in the Russian

economy is 39%, and they employ 45.1% (29,547.2 thousand) of the working population of Russia<sup>13</sup>.

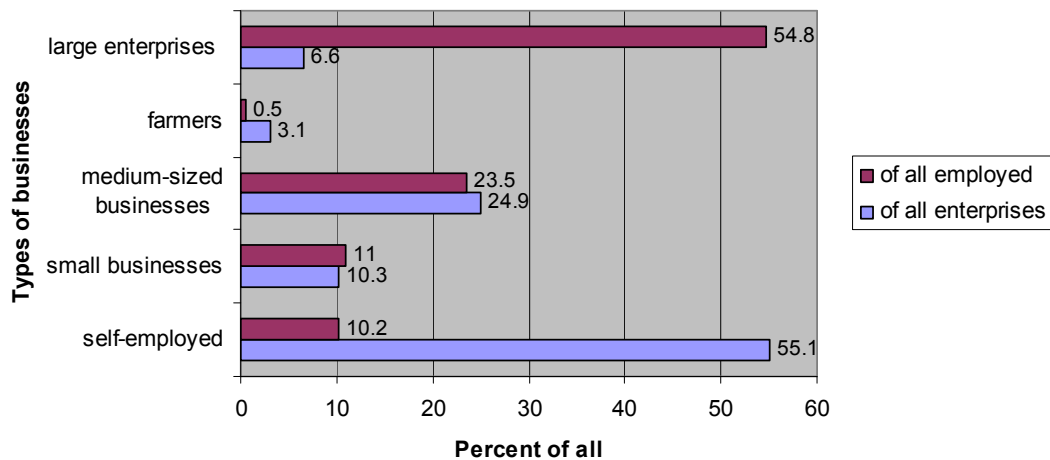


Figure 2.3.1. Types of businesses in Russia, by share of all enterprises, and by share of all the employed in 2002, in %. (Resursnyi Tsentri 2003)

In 2002, the Russian state received 7,278.5 billion rubles in taxes from small and medium-sized businesses, 39.3% of all its revenue (of this 20.8% came from small businesses and the rest from medium-sized businesses). The share of small businesses alone in the economy is quite significant: in 2001 they covered 51% of all wholesale trade, 26% of retail trade, 28% of subcontracting jobs and 4% of all industrial production. Their share of the Russian economy grew dramatically in the past three years: in 2000 small businesses made up only 6% of GDP, in 2002 they made up 11% of GDP, and in 2003 they made up 21% of GDP. In 2003 alone, small businesses created 260 thousand new jobs across Russia (National Institute 2003).

<sup>13</sup> In the US, small and medium-sized business is defined as employing up to 500 people. Calculated according to this standard, the share of economy for this category in Russian is 57%, and they employ 58% of the working population (Resursnyi Tsentri 2003, 5).

Small businesses emerged mainly in the sectors of economy which were most neglected in the Soviet past, such as trade in consumer goods, public catering (cafés, restaurants) and services. About half of all small businesses were engaged in trade and intermediary commercial services; by the end of the 1990s, they occupied half of the market in these sectors.

At this moment, St.Petersburg is a city with the second highest percentage of small firms in the territory of the Russian Federation, after Moscow. In 2002, there were 131,447 small firms<sup>14</sup> registered (Komitet 2004b): 36.8 small firms per 1,000 of working age population, three times the average for Russia. Small and medium-sized firms comprise 67.2% of all enterprises in St.Petersburg; they employ 40.5% of all residents of St.Petersburg of working age; and they produce 50.6% of the total economic output for St. Petersburg (Resursnyi Tsentr 2003).

Officials in St.Petersburg tend to combine needs and problems of small and medium-sized private firms in their speeches, but provision of any kind of information and support is given only for small business that qualify according to the number of their personnel. Such support, especially in a form of tax-breaks and low-interest loans, is often responsible for the nominal breaking of firms into a number of small ones that in fact function as one medium-sized firm, with a single administration and budget. In my research such cases were described according to their operational status, rather than paperwork that they submit to tax authorities.

---

<sup>14</sup> Experts' opinions vary on the issue of how many small firms really operate in St.Petersburg. The most common estimates are that in reality there are at least a third small firms fewer than the official statistics suggest (Komitet 2004a).

## 2.4. Data description

### 2.4.1. General description of the studied firms

The table 2.4.1 presents a summary of a few main characteristics of the forty-five privately owned small and medium-sized business firms and their representatives whom I interviewed during the summers of 2001 and 2002. The table contains information about the firms' main activity, the year in which they were founded, the number of personnel, position of respondents that they occupied in those firms at the time of interviews, and in the last column the month and year when the interview was conducted.

**Table 2.4.1. General description of the studied firms.**

#	FIRM'S ACTIVITY	FOUND- ED IN	# OF STAFF	POSITION OF A RESPONDENT	DATE OF INTERVIEW
1	manufacturing of tents	1992	105	co-owner, executive manager	June 2002
2	construction	1993	35	co-owner, executive manager	June 2002
3	media retailer	1991	3	owner, executive manager	July 2002
4	advertising	1996	13	executive manager	July 2002 June 2001;
5	advertising	1995	12	manager	July 2002
6	publishing	1999	6	owner, executive manager	July 2002
7	business consulting	1992	200	manager	July 2002
8	art gallery	1992	2	co-owner, executive manager	July 2002 June 2001;
9	geophysics equipment development	1997	8	engineer-constructor	July 2002
10	computer wholesale	1991	200	head of finance department	July 2002
11	packaged bread snacks production	1998	20	co-owner, executive manager	July 2002
12	construction	1997	35	co-owner	July 2002
13	beer, soft drinks wholesale	1996	35	executive manager	July 2002
14	restaurant	1987	12	co-owner, executive manager	July 2002
15	mobile phone retail	2000	7	co-owner, executive manager	July 2002
16	design and manufacturing of furniture	1994	28	co-owner, executive manager	July 2002
17	oil refinery parts manufacturer	1992	19	co-owner, executive manager	July 2002
18	labels, packaging manufacturing	1996	40	accountant	August 2001;

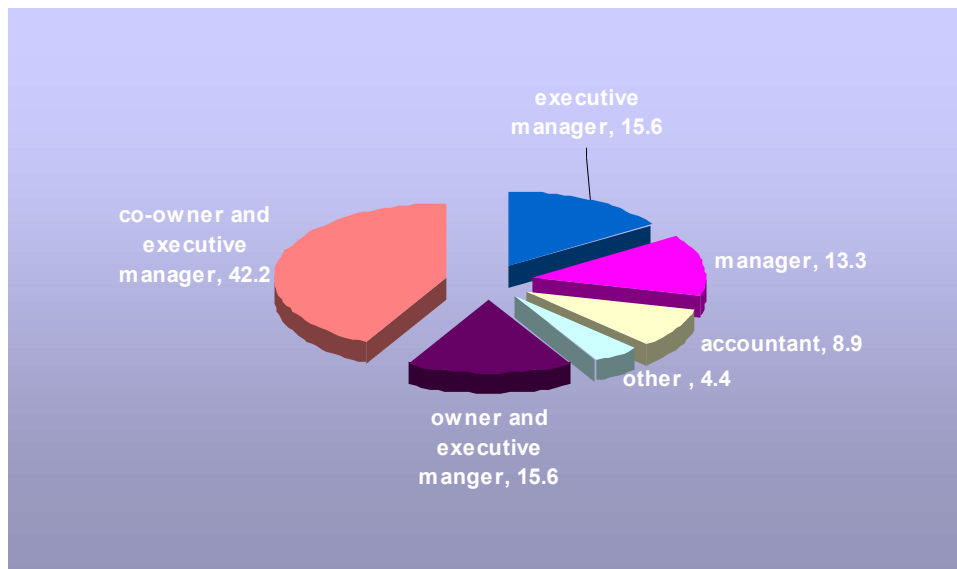
					July 2002
19	chemicals wholesale	1991	120	manager	August 2001; July 2002
20	engineering	1992	8	co-owner, executive manager	August 2001; July 2002
21	import and wholesale of lime	1995	2	executive manager	August 2001; July 2002
22	medicinal cosmetics wholesale	1997	10	owner, executive manager	July 2002
23	sales of consumer electronics	1995	54	executive manager	June 2001; July 2002
24	manufacturing of advertising banners	1992	40	co-owner, executive manager	July 2002
25	fur and leather clothing retail	1998	19	executive manager	August 2001; July 2002
26	publishing	1999	2	co-owner, executive manager	August 2002
27	manufacturing of beer packaging	1998	110	manager	July 2001; August 2002
28	lease of offices	1997	7	accountant	August 2002
29	musical instruments wholesale	1999	2	owner, executive manager	August 2001
30	sales of musical instruments	1992	30	manager	August 2002
31	advertising	1995	2	co-owner, executive manager	June 2001; August 2002
32	manufacturing of advertising banners	1998	200	accountant	August 2002
33	consumer electronics retail	1994	150	accountant	June 2001
34	telecommunications	1993	100	co-owner, executive manager	August 2002
35	ship electronics repair service	1987	20	co-owner, executive manager	August 2002
36	business consulting, market research	1991	25	co-owner, executive manager	August 2002
37	construction parts manufacturing	1995	4	executive manager	August 2002
38	consulting, market research	1995	15	co-owner, executive manager	August 2002
39	sales of construction goods	1996	10	owner, executive manager	August 2001; August 2002
40	convenience store and cafeteria	1995	14	owner, executive manager	August 2002
41	sales of video/audio equipment	1993	100	financial director	August 2002
42	radiology equipment design, manufacturing	1989	150	co-owner, engineer	August 2001; August 2002
43	real estate agency	1999	180	owner, executive manager	August 2001; August 2002
44	café	2000	6	co-owner, executive manager	August 2001
45	hiking equipment retail/wholesale	1992	20	co-owner, executive manager	August 2001



## 2.4.2. Socio-demographic characteristics of the respondents

### Position

Firms in the sample were selected by means of snowball sampling, where some respondents were my personal acquaintances, and others were referred to me by them or other personal acquaintances of mine. Although the goal was to interview firms' primary decision-makers, in a few cases it was not possible and instead less significant decision-makers were interviewed. Figure 2.4.1 shows the distribution of the respondents' position in their firms:



**Figure 2.4.1.** Position of respondents within firms (n=45), in %.

Most respondents share ownership and active managerial participation in their firm's activity: single owners who are also executive managers of their firms, and co-owners who are executive managers combined compose 57.8% of all respondents. Executive managers and managers without ownership in the firm compose a total of 28.9%. Accountants (8.9%) are a well-informed category of respondents but without much

decision-making capability. Finally, the category “other” includes one chief engineer-  
constructor and one engineer who is also a share-holder. Out of all six categories three  
comprise primary decision-makers in the firm: single owners who are also executive  
managers, co-owners who are also executive managers, and executive managers without  
ownership, combined constituting 73.4% of all respondents. The other 26.6% of  
respondents participate in local decision-making and/or have an exclusive access to  
information regarding firm’s finances and activity, but do not have final authority over  
the firm’s major strategic decisions.

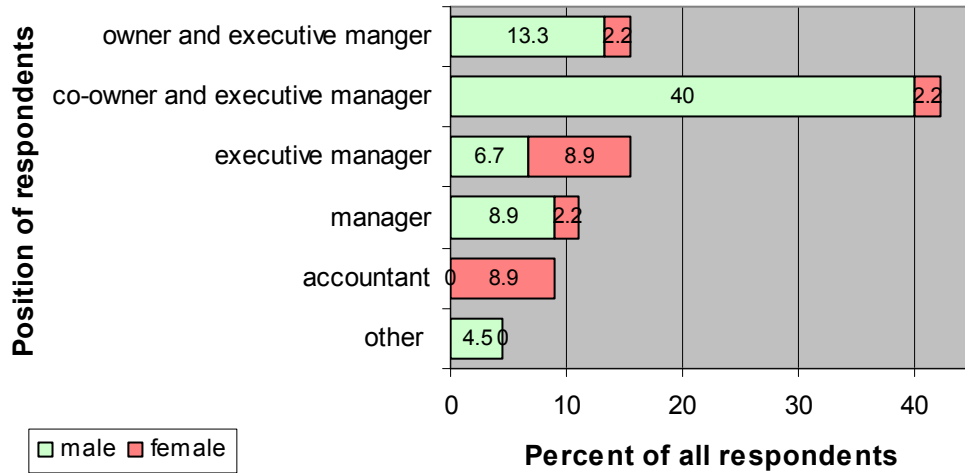
### Gender

The majority of respondents (73%) were men<sup>15</sup>; business ownership and  
management in Russia still remains predominantly a male affair. Most women in the  
sample occupy less significant positions, like accountant or manager. In fact, all  
accountants among respondents were women, accounting being traditionally a woman’s  
job in Russia (figure 2.4.2). Overall, the more significant the position of a respondent in a  
firm, the more likely it is to be occupied by a male<sup>16</sup>.

---

<sup>15</sup> Consistent with official statistics: according to the administration of St.Petersburg, in 1999 “over 70%”  
of owners of small firms were men (Resursnyi Tsentr 2000).

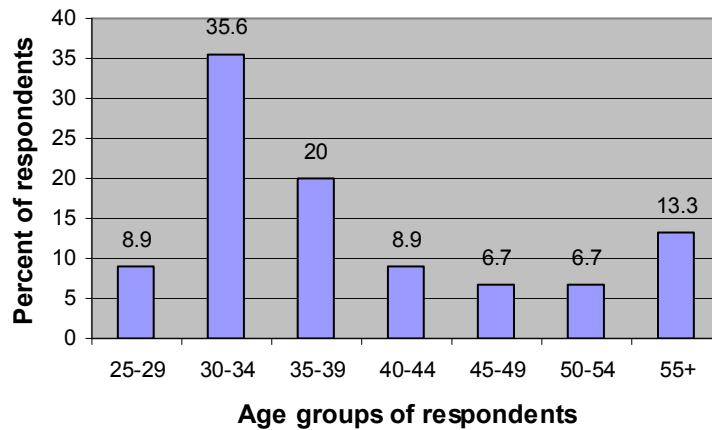
<sup>16</sup> Correlation between a respondent’s position in a firm (ranked from 1 to 6 in order of decreasing  
significance, where 1 = “single owner who is also an executive manager” and 6 = “other”) and sex of a  
respondent (1 = male and 2 = female) has a coefficient = .380 (Kendall’s tau\_b, significant at the .01 level,  
1-tailed), and .421 (Spearman’s rho, significant at the .01 level, 1-tailed). It shows that the more significant  
the position of a respondent in a firm, the more likely it is to be occupied by a male, within given sample.



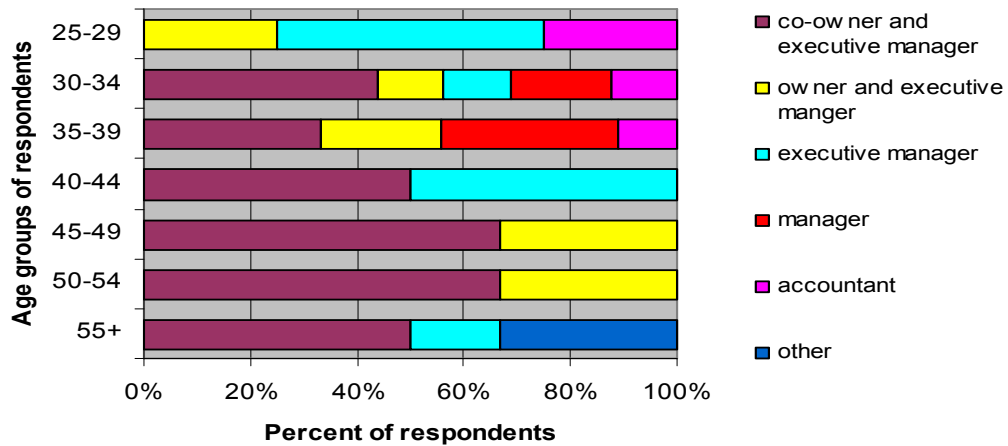
**Figure 2.4.2.** Respondents' position in a firm by gender (n=45), in %.

### Age

Respondents' ages varied from 26 to 65 years, with the mean age of 39.2 (fig. 2.4.3). Most respondents were in their 30s, and older respondents tend to have more significant positions in firms than younger ones (fig.2.4.4).



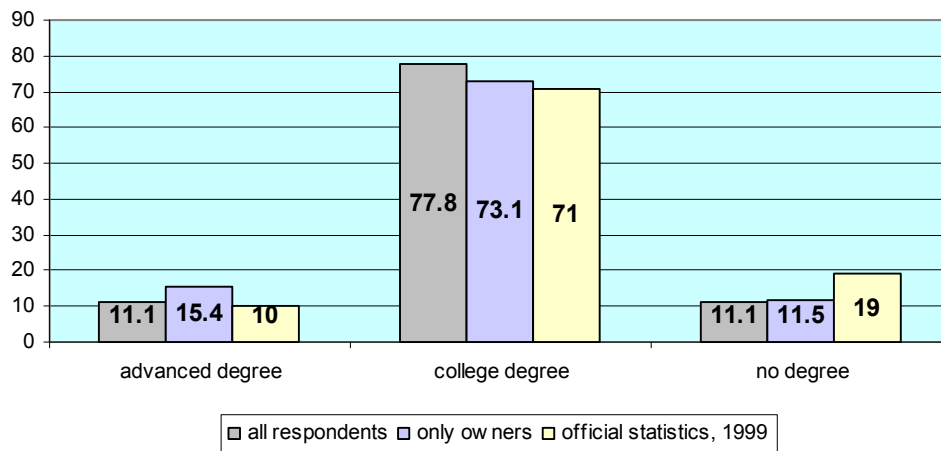
**Figure 2.4.3.** Distribution of respondents by age groups (n=45), in %.



**Figure 2.4.4.** Age groups by position of respondents (n=45), in %.

### Education

Finally, almost all respondents had a college degree or college degree with advanced degree<sup>17</sup> (figure 2.4.5).



**Figure 2.4.5.** Comparison of education of all respondents, owners only, and official statistics for 1999 (n=45), in %.

<sup>17</sup> Consistent with official statistics: according to the administration of St.Petersburg, in 1999 71% of all owners of small firms had a college degree, and 10% had an additional advanced degree (Resursnyi Tsentr 2000).

Lack of education did not seem to prevent respondents from achieving a significant position in firms: out of those who did not have college degree only one person was employed as a manager, all the rest were either owners with managerial participation, or executive managers.

## 2.5. Explanatory factors

### 2.5.1. Overview of the explanatory factors

Three explanatory factors were selected on the basis of secondary evidence prior to the first stage of data collection as having a significant impact on strategies of contract enforcement used by a firm: the sector of economy (three sectors are considered: “service”, “trade”, “product design and manufacturing”), time of founding (three periods are specified: 1991-1994, 1995- August 1998, and August 1998-2001), and previous experience of management in the Soviet era.

Two more explanatory factors were added after the first wave data was analyzed: the size of a firm (small or medium sized), and criminal involvement. Size was added as a factor because in the first set of interviews many informants indicated that the size of their firms determined the contract enforcement strategy they used. Regarding criminal involvement, three out of eighteen studied firms in the first set of interviews indicated that they had some kind of criminal involvement, either on the level of investment, or on the level of personal connections, and the pattern of their contract enforcement strategies was remarkably different from firms that did not have any criminal involvement. Therefore, I included involvement of criminal capital as a fifth explanatory factor.

All five explanatory factors can be seen as manifestations of one of two things that seem to have the greatest effect on the contract enforcement choices that a firm’s management makes. The first and perhaps the most essential cause is the firm’s *need*, persistent contract enforcement problems that require some kind of solution or solutions. The need in contract enforcement solutions is most strongly determined by the business

area in which a firm operates. For example, some firms in service – like a café or a restaurant – many not have experienced any contractual violations because of the way their business operates: they would typically take food and beverages as a commodity credit, sell for cash to their customers, and then repay the debt to their suppliers. On the other hand, firms in such areas as wholesale trade, realty or certain kinds of manufacturing can suffer substantial and persistent losses due to contractual violations, and they may feel pressured to develop some kind of response to contract violations.

The other feature that may shape the enforcement response of a firm (once contract violations are determined to be a threat to a firm's well-being) is a firm's available *resources*, both financial and social. The social capital of a firm's key figures – like a firm's owner or an executive manager – dictates the set of available choices among the firm-based contract enforcement strategies. For example, without access to bribable state officials the “Threat of punitive action by state officials” strategy obviously cannot be used. Likewise, the larger the information network is, the more successful it becomes for its members. Availability of financial resources, on the other hand, determines both a firm's capability to pay for those services that can only be accessed through personal connections, and its ability to resort to extra-firm contract enforcement strategies, like becoming a member of a professional association or initiating a litigation process against a contract violator.

Out of five offered explanatory factors, three are intended to help find out how different types of available resources play out in picking various contract enforcement strategies. Soviet experience of a firm's upper management is hypothesized to provide a firm with connections to state officials that can potentially be used for enforcement

services. Criminal involvement can give a firm an access to the underworld and the possibility of using the “Threat of violence by criminals” strategy. The year in which a firm was established can be particularly relevant for two contract enforcement strategies: “Information and closed exchange networks”, because they grow and acquire influence with the time in business; and the “Private protection firms” strategy, because protection firms were very widespread and connected to small business particularly in the first half of the 1990s.

The size of a firm can determine both the need for contract enforcement (larger firms may suffer bigger losses), and resources (they would have larger financial resources to invest into solving of enforcement problem, and may have wider social connections due to larger upper management personnel).

The explanatory factors were made measurable in the following way:

1. Sector of the economy. Question 1.1 of the Questionnaire<sup>18</sup> asked: “What is the main business activity of a firm?” Three sectors are specified: “service”, “trade”, or “manufacturing” when the description of the main activity of the firm was recorded.

2. Time of founding. Question 1.2 asked: “When was the firm founded?” Three periods are specified: 1991-1994; 1995-1998; 1998-2001 and the actual date was recorded.

3. Previous experience of management in the Soviet era. Question 1.3 asked “Was the firm previously a part of a state enterprise?” (yes/no answer), and question 1.10 asked:

---

<sup>18</sup> See Appendix 1.



“Have you ever held a managerial position in a Soviet enterprise?” Number of years is specified if the answer is “yes”.

4. Size of a firm. Question 1.4 asked: “What is the number of full time personnel employed by your firm?” A firm is classified as small or medium depending on the number of employees and the sector when the actual number of employees is recorded<sup>19</sup>.

5. Criminal involvement. Questions 9.1.1 and 9.1.2 asked: “To the best of your knowledge, has there been any connection between the owner(s) of the firm and criminal business (please remember that the interview is anonymous and will be analyzed only in aggregate with dozens of other questionnaires): a) connections on the level of personal relations; b) connection on the level of capital investments in the firm”. Three possible answers are specified: “yes”, “no” and “don’t know”.

### **2.5.2. Sector**

The first explanatory factor – sector of the economy – was selected as a most important factor for two reasons. First, identified sectors (product design and manufacturing, service and trade) differ remarkably in their entry requirements, and returns on the investments. Product design and manufacturing tends to be very labor intensive, requires quite a lot of time for any return on invested capital, and the profit margin tends to be quite small. Service tends to be less labor intensive, but requires more

---

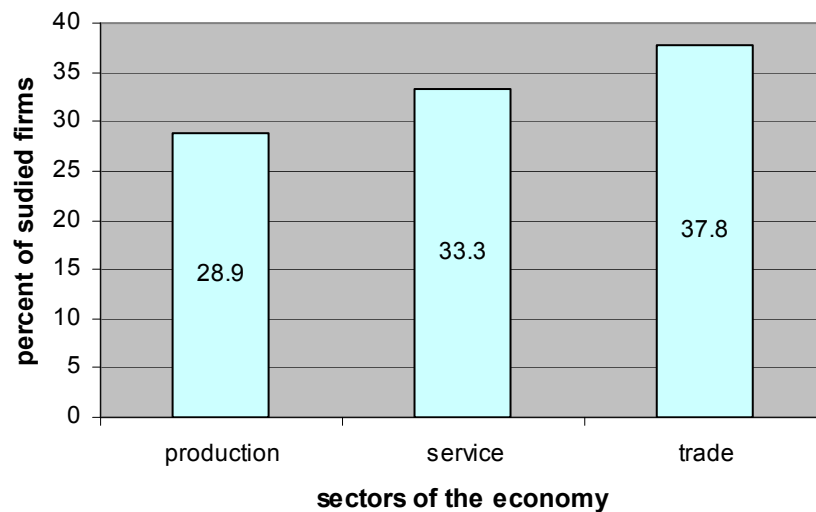
<sup>19</sup> The dividing point between small and medium sized firms was chosen according to official guidelines for the definition of small firm: maximum of 100 employees in industrial production, transport and construction, 60 employees in R&D and agriculture, 50 employees in wholesale trade, 30 employees in retail trade and consumer services, and 50 employees in all other activities. Firms with more employees than that but fewer than 250 were considered as medium-sized. Firms larger than those having 250 employees were not included in the sample.

starting capital; speed and rate of return on invested capital is on average higher than in product design and manufacturing. Finally, trade commonly offers the fastest and the highest rate of return on invested capital, and it requires the least labor and specialized knowledge.

Consequently, the nature of transactions within each of three specified sector is very different, too. In the production sector (= product design and manufacturing) contracts are commonly concluded for extended time periods (normally a year) and imply a number of transactions to occur within this time period; service contracts typically are concluded for each particular transaction (excluding food service providers); and in trade the two patterns are mixed: usually trade firms make time period contracts with suppliers, and transaction contracts with clients. These differences affect types of contract enforcement problems experienced by firms in each sector.

Another important reason why sector of economy is an important explanatory factor is the legacy left over from the Soviet era. Under the Soviet regime, the biggest share of the economy was production, while both service and trade were rather underdeveloped. Thus, newly organized private firms that engaged in production may have enjoyed certain advantages in comparison with firms in both trade and service because the former were more likely to have access to old exchange chains, were more familiar with the business routine (ie, know-how to do things), and might have experienced fewer obstacles from the state bureaucracy. Not surprisingly, the only two firms out of forty-five that were created on the basis of a state-owned firm (firm #20 through the privatization of a state-owned sub-unit, and firm #27 as a spin-off of the existing [former] state-owned large enterprise) are both engaged in production.

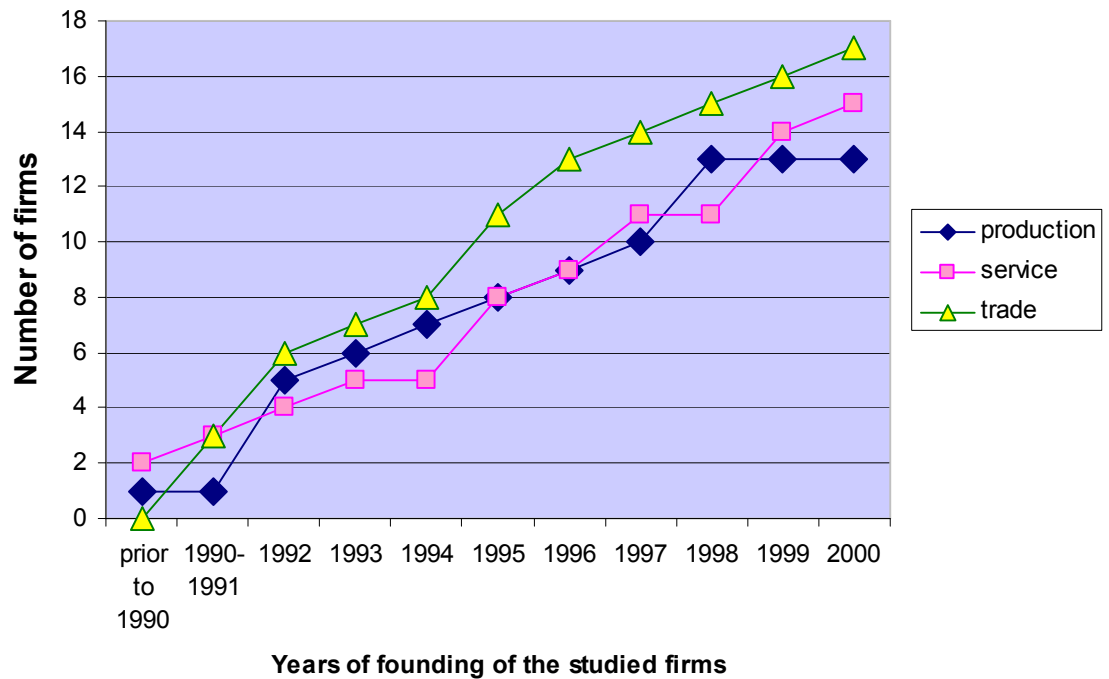
Despite snowball sampling, data distribution along the first explanatory factor is rather consistent with the official statistics<sup>20</sup>. Out of forty-five surveyed firms, thirteen firms (28.9%) are involved in production; fifteen firms (33.3%) offer services, and seventeen firms (37.8%) are engaged in trade. Figures 2.5.1 and 2.5.2 show the sector distribution of the surveyed firms, and number of firms in each sector by the date of their founding, taken cumulatively:



**Figure 2.5.1.** Sector distribution of the studied firms (n=45), in %.

---

<sup>20</sup> According to the official statistics, approximately half of all small firms in St.Petersburg in the end of 1990s were engaged in trade and public catering, 30% were engaged in different types of services, and 20% in production (Podderzhka 2001). Since ‘public catering’ can be classified as service, the number for service can be brought a little up from 30%, and for trade a little down from 50%.



**Figure 2.5.2.** Cumulative growth of the studied firms (n=45).

These figures show that trade is the most wide-spread type of activity among small firms, followed by service. This is consistent with the notion that small firms were organized mainly in the sectors of economy which were least developed in the Soviet economy.

### 2.5.3. Size

During the first stage of data collection in the summer of 2001 many respondents from small firms indicated that size of their firm (and consequently, the size of their assets) heavily influenced the choice of the contract enforcement strategy that they used. First and foremost, small firms would rarely consider using the state judicial system because of their limited financial resources. For the same reason they seldom can buy unofficial protection from state officials. Second, because the average number of

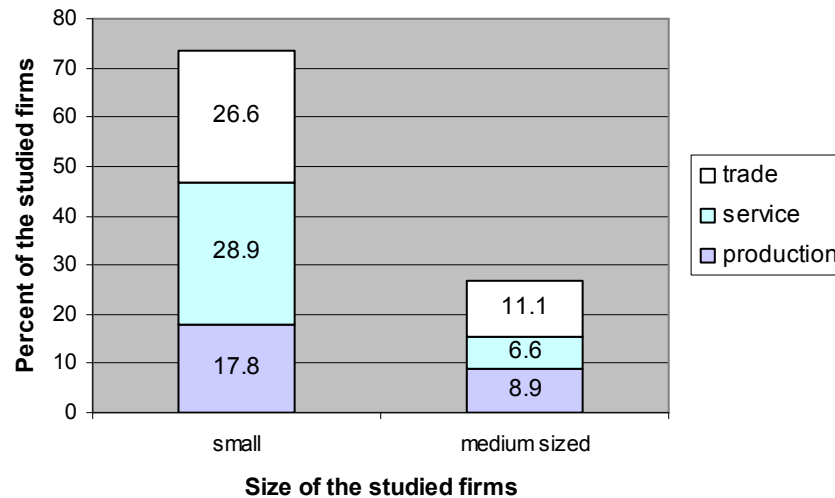
transactions is relatively small, smaller firms less often become victims of fraud schemes and marauding criminals when compared with larger firms.

Sociologists have long recognized size of organizations (number of personnel) as one of the most important variables in studying organizational behavior. Size is considered a central property of a firm because of its influence on level of managerial control and formalization, inter-organizational communication, structural differentiation. Size directly affects organizational resources, the mobility of employees (Kalleberg and Mastekaasa 1998), and ability of organizations to survive and to adapt to changes in the environment (Aldrich 1979; Haveman 1993). The size of the firm is directly linked to the amount of resources available for solving any problems that should arise, including contract violation.

To be able to assess the influence of these differences on the contract enforcement strategies used by firms, size of a firm was introduced as a separate explanatory factor in the second wave of the data collection in summer 2002. The dividing point between small and medium sized firms was chosen according to official guidelines for the definition of small firm: 100 employees in industrial production, transport and construction, 60 employees in R&D and agriculture, 50 employees in wholesale trade, 30 employees in retail trade and consumer services, and 50 employees in all other activities. Firms with more employees than that were considered as medium-sized. Firms larger than those having 250 employees were not included in the sample. Firms were identified as “small” or “medium-sized” according to their factual operational status, rather than paperwork that they submit to tax authorities.

It is reasonable to suggest that having larger available resources to put in resolving contract enforcement problem, medium-sized firms will be more likely to make use of the court system, and to use such expensive contract enforcement strategies as Private protection firms and Threat of punitive action by state officials.

A majority of the studied firms (thirty-three firms, constituting 73.3% of total) are small firms; the remaining twelve firms (26.7%) are medium-sized firms with a number of employees up to 200. Figure 2.5.3 below demonstrates the distribution of firms in a sample by size, with the breakdown by different sectors:



**Figure 2.5.3.** Distribution of studied firms by size (n=45), in %.

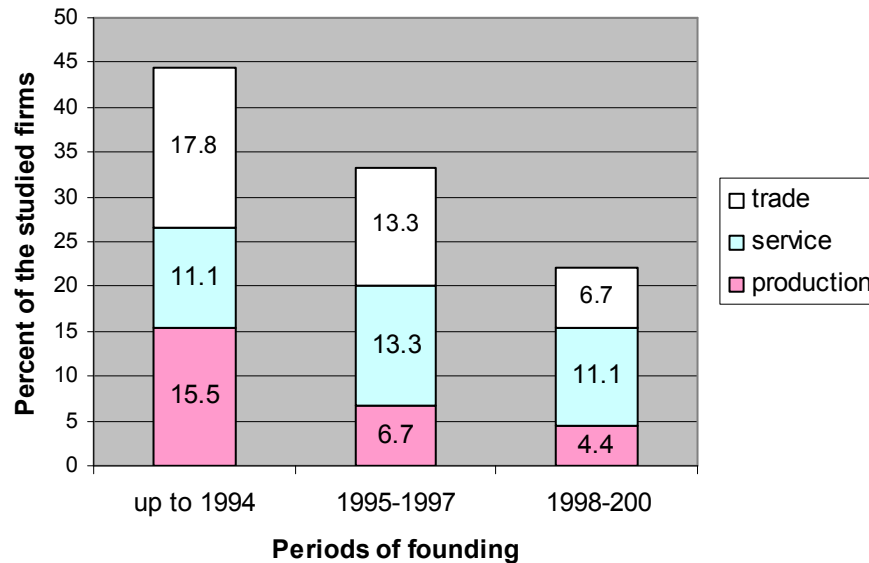
#### 2.5.4. Time of founding

The third explanatory factor is the time of founding. This factor assesses the impact of change in the general economic and political environment over the 1990s that might have affected the choice of contract enforcement strategies used by firms. I differentiate three distinctive periods in Russian economic development. The first period is

characterized by implementation of large-scale reforms intended to transform the economy from the socialist mode of organization to the capitalist one. It started in the end of the 1980s, when the first laws permitting private property and free economic exchange were passed, and continued throughout the major reformation process until 1994. The second period lasted from 1995 to the crisis of August 1998 and is characterized by rapidly deteriorating economic and political conditions and further criminalization of the economy. The third period started after the crisis and continues to the present, and is characterized by a general stabilization of the economic and political environment. Each period presented business firms with unique challenges that they had to respond to by developing resources necessary to use particular strategies available at that time, in order to survive. I suggest that the founding time may thus influence the contract enforcement orientation that firms adhere to. Firms that were unable to adapt to the challenges of each particular period were less likely to survive. For example, enforcement by private protection agencies was very widespread in the first half of the 1990s, and those firms that did not connect to one, or at least learn how to deal with them, quickly found themselves disadvantaged.

Twenty-one firm out of forty-five surveyed firms (46.7%) were organized during the first period, between 1990 and 1994 (in fact three of them were organized even earlier, when Gorbachev's reforms allowed non-state enterprises to come into existence, and had to re-register to change their status to fully private firms when the appropriate law was passed). Fourteen firms (31.1%) were organized in the second period, between 1995 and 1997, and ten firms (22.2%) were organized in the third period, between 1998 and 2001.

Below is the chart of the distribution of the forty-five surveyed firms by periods of their founding and sector of the economy in which they are involved:



**Figure 2.5.4.** Studied firms by three periods (n=45), in %.

### First period

The first law regarding small firms was passed in the fall of 1990, specifying that individuals can organize into small for-profit firms. A precursor of this law was a decree issued by Gorbachev’s administration in 1988 that allowed groups of individuals to create so-called “cooperatives”, which were a somewhat intermediary entity between a socialist enterprise and a capitalist private firm. Cooperatives could bring profit to their founders, but legally and structurally they still bore a lot of resemblance to their state-owned predecessors. Founders of the first cooperatives were glad to re-register their firms in 1991 and become legal private owners of their firms.

Meanwhile, the general economic and political environment was in turmoil. During the early 1990s revolutionary changes were happening in the former Soviet empire. To



start with, the empire ceased to exist, ironically right after the majority of the population voted in the referendum for the preservation of the Soviet Union. The Communist Party hardliners attempted to get their power back in August 1991, and failed. Finally, the first ever democratic presidential elections took place in Russia, and Yeltsin, committed to capitalist reform, came to power. The great experiment had begun.

Russia has a bizarre history of grand experiments. In the beginning of the 18<sup>th</sup> century, Peter the Great attempted to ‘modernize’ a huge and backward Russia in just a decade, inevitably failing to achieve his dreams, although changing Russia forever. Two centuries later a couple of young ministers tried to do the same, with quite similar result: Stolypin’s agricultural reform and Witte’s economic reform were both curtailed before they could produce any positive outcome. Finally, the 1920s witnessed the impressive experiment by Lenin and his followers, who were committed to creating the first ever man-made progressive alternative to capitalistic order.

It seems that no Russian ruler of significance and ambition can resist the temptation of astonishing the world with yet another undertaking of unheard-of scale. Yeltsin proved to be no exception. Having initiated shock therapy in 1991-1992, his government together with American advisors managed to effectively destroy the Soviet economy, and irreversibly change Russian society and the political landscape. Those who were in Russia in 1991-1994 remember the feeling of living in a giant casino: even if you win today, you may still lose everything tomorrow, and in the end of the day only those who made up the rules are the true winners.

Structural adjustment reforms initiated by Yeltsin’s government in accordance with World Bank and IMF advice, brought about among other things redistribution of power

in Russian society. Having given up much of its ownership in the economy, the state had lost its most significant lever of control. The severe financial difficulties of the Russian state put state employees, including enforcement officers, in the lowest income group. Police officers and judges experienced long delays of payment of their tiny salaries. Consequently, many of them either quit their government jobs and went on providing the same services for cash in new private enterprises, or found ways to make their position within a state institutions more lucrative through rent-seeking behavior. At the same time, disintegration of police forces brought about an unprecedented increase in the rate of crime, both petty street crime, and large scale organized groups that engaged in all kinds of money extortion from new private businesses<sup>21</sup>.

For private businesses 1991 - 1994 were the years of hope and the years of loss. There was little continuity between laws that the government was issuing daily, and the reality of chaos and opportunism. Rapid changes in legal code and disintegration of state enforcement institutions caused normlessness in the business environment and emergence of many competing business practices. New-born business firms had to learn quickly how to respond to hyperinflation, bandits on the streets and in the offices, and new rules of the game every day. It is likely that small firms organized at that time would choose “close exchange networks”, “private protection firms” and “organized criminals for pay” as their dominant contract enforcement strategies.

---

<sup>21</sup> See, for example, Sergeev (1998) and Volkov (2002).

### Second period

Year 1995 marked the official ‘end of reforms’, but neither the political arena, nor the economic landscape became more stable. Contradictions between the new laws of the 90s, and institutional legacies from the Soviet era became more pronounced than ever before. The state apparatus was in deepening crisis, its political authority was crumbling; hyperinflation and unemployment left the majority of the population impoverished and desperate; and the society was a no man’s land. Soon the government found itself on the brink of bankruptcy and began defaulting on its obligations to its own workforce. As the wage arrears to state employees kept growing, more and more of them used their positions for rent seeking, some out of desperation, some because legal system no longer posed a threat.

Lack of cash in the economy forced businesses to shift to primitive forms of barter exchange. Numerous *tovarnyie birzhi* (commodities markets) were set up in urban centers to facilitate the exchange (Frye 2000). Proliferation of barter exchange further exacerbated the financial crisis of the state: it is very difficult to tax barter exchange, and tax inflow into the budget thinned to a critical minimum.

The role of extortion forces that dominated the business landscape in 1991-1994 had changed, too. If in the beginning of the reforms extortion forces were more concerned with one-time profits, and often would ‘milk’ a private firm until its untimely death, now with increased certainty of irreversibility of free-market reforms there came an aspiration to participate in the business itself. Criminal fortunes accumulated in the first years of reform were looking to be invested. Consequently, many private firms that were

organized between 1995 and 1998 had significant criminal involvement on the level of ownership and capital.

Thus, lack of cash in the Russian economy of 1995-1998 caused both predominance of barter exchange in economic transactions among firms, and a tremendously increased level of corruption among state employees. For small firms bribing of all sorts (“Threat of punitive action by state officials”) may have become the most dominant contract enforcement strategy during this period. The other new feature of the environment was that many former foes from the criminal world now presented themselves as business partners.

### *Third period*

The crisis of August 1998<sup>22</sup> had a devastating effect on small Russian business. With most commercial banks gone bankrupt, firms’ deposits were wiped out. One-third of small firms suspended their activity, or went bankrupt altogether (Bonnell 2001). At the same time, it must be noticed, the post-crisis turmoil opened opportunities for new firms to enter the market. In a way, the crisis turned out to be a positive event for small firms: the government stopped wasting resources trying to artificially maintain the ruble against devaluation, and the purchasing power of the ruble was brought to reality creating a healthier economic environment. The economy finally got the cash it needed, bringing about an end to the reign of barter exchange, and the country entered a period of relative

---

<sup>22</sup> The crisis had a number of causes, some of which were internal, and some were external. Most important internal causes were persistent budget deficits, low tax collection, corruption and poor management of exports of raw materials, government’s reliance on short-term domestic and foreign financing, and underdevelopment of fundamental financial institutions. External causes included raised premiums on foreign loans as a consequence of the Asian crisis of 1997, and lowering of world market oil prices by 30% from November 1997 to summer 1998.

stability<sup>23</sup>. While businesses that dealt with imports suffered most damage, domestic production received sudden and very much needed boost. The ruble kept falling, but gradually and predictably, giving firms time to adjust. New president Putin's agenda included strengthening of state institutions and ending the crime wave, which he successfully started with paying off salary arrears and increasing wages to police officers, judges and other law enforcement officials. Both these trends had positive effect on private businesses.

In general, the economic and political environment after August 1998 appears to be more favorable for small firms. I suggest that overall fewer firms that were organized after August 1998 had to resort to non-state contract enforcement strategies, and of the used strategies financial tools would be most commonly used. It is also likely that more firms refer to state enforcement institutions to solve their disputes now than in the preceding years.

#### *2.5.5. Soviet-era managerial experience*

The social embeddedness approach in economic sociology emphasizes the importance of inter-organizational networks for the definition of the patterns of exchange. The Soviet economy before the 1990s was permeated by strong networks running both vertically, from various ministries that dispatched ordered and distributed resources down to local factories and shops, and horizontally, connecting managers of Soviet enterprises

---

<sup>23</sup> Numerous factors played role: growing oil prices helped the budget; political stabilization with appointment of Putin as prime minister, and his consequent election to presidency; determination of the new government to improve tax collection and bring lawlessness in the economic relationships to an end.

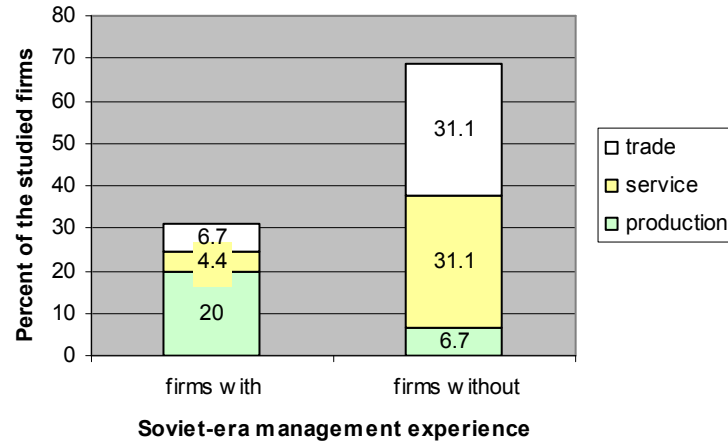
that were linked by chains of commodity and service exchange. Important members of networks were representatives of governance structures.

Being a member of, or having an access to a managerial/Party network was an important asset during Soviet era. It remained important in the 1990s, when many jobs changed titles but did not change people who occupied them. It is possible that former Soviet managers with substantial ties to people in a position of power use these ties to their advantage, including for creating leverage in disputes with their trade partners. Thus “Threat of punitive action by state officials” is the possible dominant strategy of contract enforcement among new firms’ owners/managers who had access to a managerial/Party network during Soviet era.

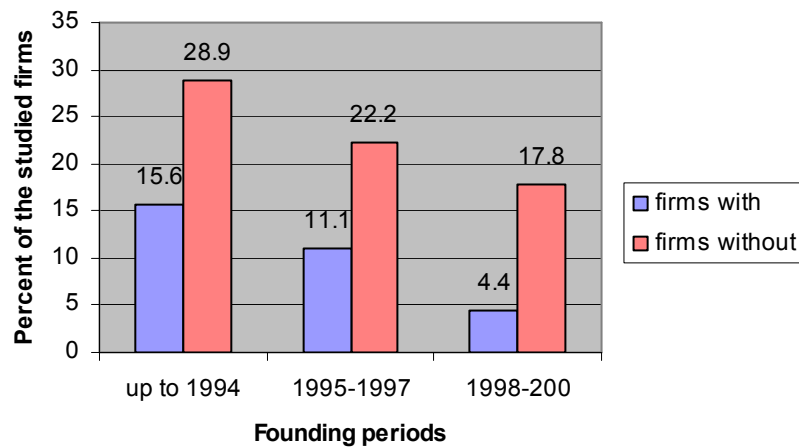
Lower-ranking managerial experience on Soviet enterprises is also important to look at. People who learned how to manage divisions of an enterprise in the Soviet economy may have picked up strategies that they still could find applicable and useful in today’s economy. On the other hand, today’s application of the Soviet-type strategies may not always be consciously realized: some strategies can become generalized and start existing outside of the individual actors. When it happens, we can expect all actors to have access to such strategies and use them circumstantially. Examples of such old style Soviet practices would be both *blat* and bribing, translated into the “Threat of punitive action by state officials” contract enforcement strategy.

Out of forty-five surveyed firms thirteen (28.9%) had a respondent who had had a Soviet-era managerial experience varying in length from three to thirty years (with mean of 9.7 years), and thirty-two (71.1%) did not have such experience. Figures 2.5.5 and

2.5.6 show distributions of the surveyed firms in relation to Soviet-era managerial experience, sector they are in and their founding period:



**Figure 2.5.5.** Soviet-era experience of the management and the sector of the economy the firm is in (n=45), in %



**Figure 2.5.6.** Soviet experience of the management by the founding period (n=45), in %

Since most enterprises during Soviet period were engaged in production, it is quite natural that the majority of small private firms that have owners or managers with the

Soviet management experience are engaged in production, too<sup>24</sup>. It is also logical that the number of newly organized firms with owners or managers with Soviet management experience would decline over the years, as they would age and retire<sup>25</sup>.

### *2.5.6. Criminal involvement*

Just like Soviet era managerial experience, criminal involvement in a firm constitutes an important resource that a firm can use to facilitate its contract disputes. Such criminal involvement can be acquired through the presence of criminal investment in the firm's assets, by personal connections to the criminal world, or both. Such criminal involvement can enable a firm to respond to a contract violation in ways that favor force over other means of dispute resolution. Such ways mainly involve exerting pressure on the disputing party, making it to comply under the threat of physical violence, but can also include gathering of information about the other party.

As it was described in Periodization section of this chapter, by the middle of 90s many criminals realized that real profits lie not in simple extortion and racketeering, but rather in ownership, and many of them began investing their capitals in legitimate businesses. Sometimes these would be businesses that they formerly 'protected', and sometimes the business would be started from scratch. Together with investments,

---

<sup>24</sup> Correlation between Soviet-era management experience and sector "production" has coefficient = .459, significant at the .01 level, 1-tailed (due to small sample size, non-parametric correlations were used: Kendall's tau\_b and Spearman's rho). Correlation coefficient shows that firms engaged in production are significantly more likely to have management with Soviet-era experience than firms engaged in either trade or service, within given sample.

<sup>25</sup> Correlation between Soviet-era management experience and founding period is not statistically significant, in this sample.

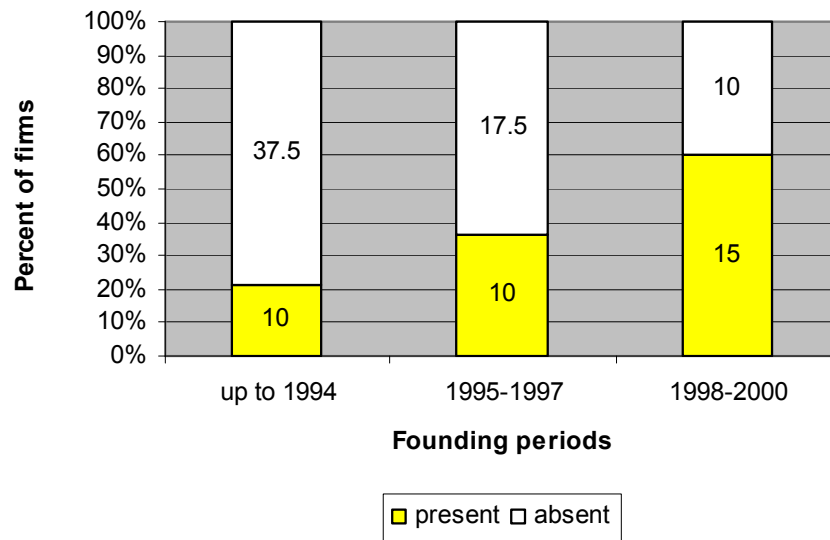


criminals brought with them their ways of solving problems that for the most part involved threats of physical violence.

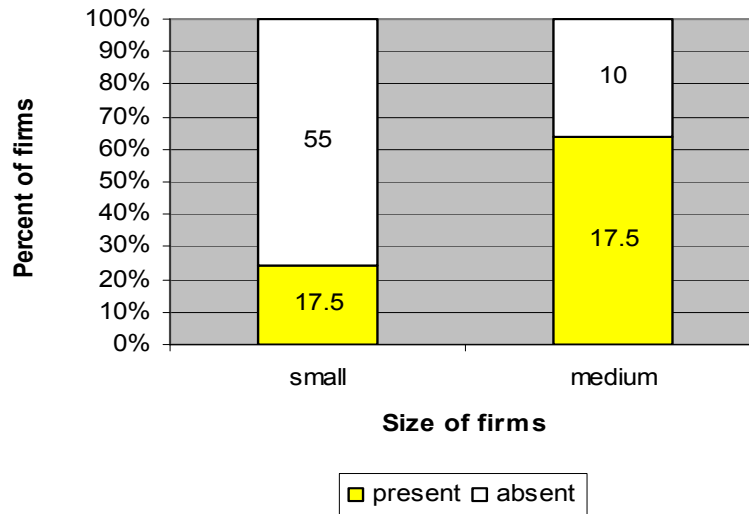
Criminal involvement could also be found on the level of participation in criminal networks of the ownership or management of a firm. Such participation can have similar consequence as criminal investment insofar as it will provide a firm with comparable resources.

It is possible that firms that possess such additional resource as access to criminal groups that can generate a credible threat of physical violence will choose to rely on this resource more frequently than firms without such resource, and thus will use “Threat of violence by criminals” strategy to help enforce their contracts.

Out of forty-five participants in the study fourteen (31.1%) indicated some criminal involvement, either on the level of connections, or on the level of investment. Twenty-six firms (57.8%) indicated absence of such involvement, and five respondents (11.1%) answered that they did not know. Figures 2.5.7 and 2.5.8 below demonstrate the distribution of the studied firms in respect to the criminal involvement on the level of investment, connections to criminal networks, or both:



**Figure 2.5.7.** Criminal involvement of the management and the time of founding of a firm (n=40), in %.



**Figure 2.5.8.** Criminal involvement of management and the size of firms (n=40), in %.

Figure 2.5.7 demonstrates that the proportion of the studied firms with criminal involvement of some kind has been steadily increasing over 1990s, which is consistent with assumptions made in the description of both Periodization and Criminal

Involvement factors<sup>26</sup>. Figure 2.5.8 shows that more medium-sized firms have some criminal involvement than small firms<sup>27</sup>, and it intuitively makes sense that firms with larger financial and enforcement resources would have more potential to grow to medium size than firms that don't have such resources.

---

<sup>26</sup> Correlation between period of founding and criminal involvement on the level of connections has a coefficient = .307 (Kendall's tau\_b, significant at the .05 level, 1-tailed), and .324 (Spearman's rho, significant at the .05 level, 1-tailed). This correlation coefficient shows that the more recently the firm was organized, the more likely it is to have criminal involvement on the level of connections, in this sample.

<sup>27</sup> Four (out of twelve) medium sized firms that were organized in the second and third periods all have criminal involvement, which is consistent hypotheses put forward in Periodization section of this chapter. Correlation between size of a firm and criminal involvement on the level of investment has a coefficient = .429, significant at the .01 level, 1-tailed (both Kendall's tau\_b and Spearman's rho), showing that the larger the firm is, the more likely it is to have some criminal involvement on the level of investment, in this sample.

## **Chapter 3: WORKING AROUND THE STATE: CONTRACTS AND THEIR ENFORCEMENT IN THE RUSSIAN CONTEX**

### **Introduction**

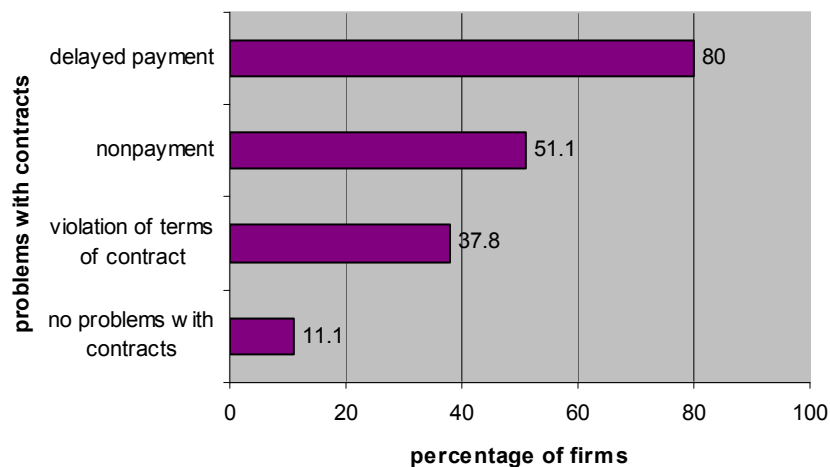
From the very first days of economic reforms initiated by Gorbachev in the end of the 1980s new privately owned firms faced a great deal of problems, including that of enforcing contracts (Frye 1997, 2000; Greif and Kandel 1995; Murrell 2001; Radaev 2000; Volkov 2000). Many entrepreneurs suffered from dishonest scheming by various opportunists who seemed to dominate the marketplace, from unresolved disputes with their business partners due to poorly written contracts, lack of legal advice on confusing and ever changing laws, or even more frequently due to the failure to understand the basics of business exchange on the part of entrepreneurs themselves. Firms' struggle to survive in the conditions of lawlessness, pervasive opportunism, and social and political upheaval shaped economic landscape for the decade of the 1990s.

I will start this chapter by showing types of problems with contracts experienced by the participants of my study who describe how contracting among small firms works in contemporary Russia, and how it often fails. While in developed western countries impartial legal services are available for contract dispute resolution and redress, in Russia the state is perceived by entrepreneurs as unable to guarantee such services. In the second and third sections of this chapter I will discuss historical and institutional roots of this incapacity of state institutions, and will outline various strategic responses developed by

firms. Detailed analytic description of the contract enforcement strategies developed by firms will be a subject of the following two chapters.

### 3.1. Contracting among small firms

Nearly all participants in my study – forty out of forty-five (89%) - said that they experienced some kinds of contract violation on a regular basis. Out of the remaining five one businessman (firm #40) handles his business (a roadside café) in “for cash only” manner, thus avoiding contracts altogether, and four participants explained their lack of problems with contracts by either having been in business for a short time (firms #15 and #26), operating exclusively with 100% prepayment as a safe-guard strategy (firm #8), or having dealings with only a small network of well-known suppliers (firm #14). Figure 3.1 shows the distribution of the problems with contracts that the participants experienced while they have been working for the firm that they worked for at the time of interviews.



**Figure 3.1.** Problems with contracts experienced by respondents (n=45), in %. The total is over 100% since multiple choices were possible.

Non-payment is clearly the gravest problem noted by Russian business owners and managers, while delayed payment is the most common. Breach of conditions of contracts

– like terms of delivery – is probably the least damaging to business owners, but annoying nonetheless. Let us see now how some participants from my study describe their experiences concerning problems with contracts. The executive manager from a firm engaged in manufacturing of small construction parts says that her firm has had all kinds of problems with contractual agreements since they started their business in 1995, despite all the precautions taken:

We always sign all the contracts before the deal, but in reality these contracts do not mean a thing because we depend on our clients – construction stores – and they do with us whatever they want. There are plenty of dishonest people out there who only want to make a quick fortune. They open a store, take goods from the gullible like us, and disappear without paying anybody. It has become rarer now, but still happens. Prepayment is not customary in this area of business; all stores take goods for sale [to pay us back after the goods are sold]. Even if they don't disappear altogether, they will always delay payment for as long as possible. There is a store that owes us money for more than a year already; I think that the owner is saving money for a new branch. It is much more profitable you understand than to take a loan in a bank. Well, maybe they will pay us eventually. We suffer quite big losses due to non-payment and delayed payment. (Firm #37, Personal interview, August 2002)

A participant on the receiving end of the complaint expressed in the above quotation – the owner of a chain of construction goods stores (firm #39) – does not deny that he always delays payments for as long as possible. He says that he sees no reason why not, since it is profitable for his firm and has no repercussions. Sometimes he receives a phone call from a supplier asking to speed up the payment, and in such cases he says he would pay sooner rather than later.

An accountant from a firm that leases offices is the person who makes such calls, asking firms to fulfill their contractual obligations. She says that without such reminding delays are much longer:

The average delay of payment is about a month. Delays depend a lot on our attitude. If we call and remind them to pay, then the delays are shorter, if not

– longer. 30% to 35% of all payments come with significant delay. There have been many instances of firms disappearing without paying altogether, and we usually do not do anything about it, because chances are we are never going to find them and get the money. (Firm #28, Personal interview, August 2002)

Most participants concur that the worst days regarding losses due to fraudulent bankruptcies are gone with the 1990s, and that now the market is becoming more civilized, especially concerning non-payment. Most problems happen now simply because people do not know how to conduct business properly, how to plan, and are generally sloppy. It is rare now that people actually mean to make money on breaching business agreements, participants say. “Intentional non-payment used to be a much bigger problem a few years ago”, says the manager from an advertising firm. “They even had words for that back in the 1990s: ‘grabber’ and ‘duper’, about someone who grabs, or dupes, and then disappears” (Firm #5, Personal interview, July 2002). A few participants associate the improvement with Putin’s coming to power, others say that people simply learned that cheating does not pay off in the long run, yet others maintain that honest people learned how to conduct business with the minimal risks, having developed effective mechanisms of contract enforcement.

To understand what the problems described above mean we must look at the concept and institution of the contract in the Russian context a little closer. Under the Soviet regime all means of production formally belonged to the state, and contracting among enterprises was largely regulated by the appropriate ministries. The procedures of exchange and redress in case of failure were drastically different from those in capitalist economies. So those Russians who began to engage in private business in the beginning of 1990s had to figure out how to build up contractual relations with their business



partners from scratch. In the chaos of the changing political and economic landscape people learned to rely on their own experience, very often negative. I will discuss negative experiences of small business owners with state institutions in depth in chapter 6, and focus here on the experiences and practices concerning use (or non-use, as it is often the case) of contracts. The co-owner and executive manager of a firm that manufactures and sells tents denies the usefulness of formal contracting in the Russian context altogether:

What can I say about contracts... Anyone can breach them, break them, violate them.

What are contracts for? In general, they are supposed to discuss real stipulations of the deal. But in our conditions contracts are made for accounting purposes exclusively. It is a formality that no one pays attention to, because anyone can breach them. Because in reality there is no system of accountability. There is no working judicial system that could guarantee redress, and mobsters also stopped doing it. So if someone owes you, no one can make them pay.

I personally always try to carry out my contracts, not because I am afraid not to, but simply because I like it better this way, it gives me self respect, even if it would be more profitable for me to breach a contract.

There are many firms with whom I work without contract altogether, we talk our deals over and work, no papers signed. What for? (Firm #1, Personal interview, June 2002)

Indeed, most small businesses in St.Petersburg often work without signing contracts, or sign the contracts after the deal has already taken place. Almost a quarter of participants (23%) say that they routinely sign contracts after the deal, and another 21% say that it happens quite often. The quotation above explains well the reasoning: why bother if a contract is just a meaningless piece of paper? The executive manager of a firm that sells consumer electronics puts it plainly:

The contract is a fiction. I can fix any problem, even if I know that I am wrong. I know all the gaps in law that allow me to avoid penalty payments. For example, I can close one firm and open another, and I don't even have to

move my office. Any lawyer will be able to prove in a court of law that this new firm does not have anything to do with the old one. This is exactly what I did when I was sued because I sold faulty equipment. And there were no problems.

And about contracts... It is the state that wants contracts [for tax purposes], not us. We usually sign them *post-factum*. (Firm #23, Personal interview, June 2001)

This quotation provides an example of the general sentiment about the futility of contracts as binding documents, expressed in the previous quotation. Some degree of familiarity between parties is highly desirable, though, in order to allow such kind of arrangement. The participant quoted above says that the first few transactions with new wholesale buyers he conducts strictly within the boundaries of the law because “I know all suppliers on the local market, but buyers can be... for example, they can come from the tax police, in attempt to understand how you evade. So during the first few transactions I have to figure out if the buyer is the real thing or fake, and behave accordingly. If he is real, we drop the pretense and start working with him for real” (Firm #23, Personal interview, June 2001).

Most participants agree that they sign contracts because they are legally required to do so in order to provide an account of transactions for taxation purposes. These contracts rarely reveal the full truth about a transaction. To avoid paying taxes, many firms distort actual volumes and prices of the purchased goods or services. Managers call this practice “double contracting”, meaning that there is one “official” contract with fictitious prices and/or volumes of supplied or purchased goods or services, and there is another document, kept for internal records, that reflects the real money and goods/services exchanged. The following quotation describes how an owner of a café handles supplies of alcoholic beverages:

Question: Do you indicate the volume of the supplied drinks in contracts, and how much you pay for it?

Answer: No, we do not. Reality differs greatly from what we specify in a contract. For example, the difference between real delivery of alcoholic beverages (in boxes of bottles), and volumes specified in a contract is ten to one. It means that for each bottle that we indicate in a contract that we purchase and is delivered to us, ten bottles are delivered.

Question: Is double contracting widespread in restaurant industry?

Answer: Of course, very much so. This is the only way one can make any money at all. I would say that 95% of firms work like that. (Firm #44, Personal interview, August 2001)

The system of double contracting is more widespread in some areas of business than others. Areas of business that require transfers of large sums of money, or that involve large, especially state-owned enterprises as transacting parties rarely use it. That would include mostly firms in production. For example, interviewees from firms #9, #17, #20, #34 and #42 (all in production) say that it is inconceivable for them to practice double contracting, for the two reasons cited above.

On the other hand, some areas of business seem to be particularly conducive to double contracting. Most firms that practice double contracting are engaged in small scale services, like advertising or middle-man services, with lots of small transaction, and often with a stable network of partners. For example, the owner and executive manager of a firm that is engaged in realty explains that all of their contracts are double contracts, because both sides want it. If they put the real sums of money exchanged, he says, both sides will have undesirable consequences: one side (the realtor) will have to pay taxes on the commission made on the transaction, and the other side (the property buyer) will have

to explain to the tax authorities where such a large sum of money<sup>28</sup> came from (because it is common to declare tiny salaries, to avoid wage taxes<sup>29</sup>). So when for example an apartment is being sold for \$20,000, a realtor signs a contract with a buyer for a significantly lower price: between \$2,000 and \$5,000, with the realtor's commission at around 300 rubles [≈\$10]. Like this the buyer does not have to explain to the tax authorities where \$20,000 came from if the buyer does not have the visible means, and the realtor doesn't have to pay taxes on the full commission. The participant describes what double contracts look like in his firm:

Question: What do you write in the second contract?

Answer: The second one is the real one, with the real \$20,000 and real commission money, and it looks simply like a receipt. A customer treasures this one because this is the only proof that he has that he gave us his money. But he would not be able to go to court with it, because it is unofficial.

Question: So you give a customer a 'receipt' type of the second contract, and keep a copy for yourself?

Answer: Yes. See, my TV set stands on a pile of boxes? [*Interview takes place at his home.*] These boxes are filled with these second contracts.

Question: You are not afraid that tax police will pay you a visit at home?

Answer: They don't know where I live. (Firm #43, Personal interview, August 2001)

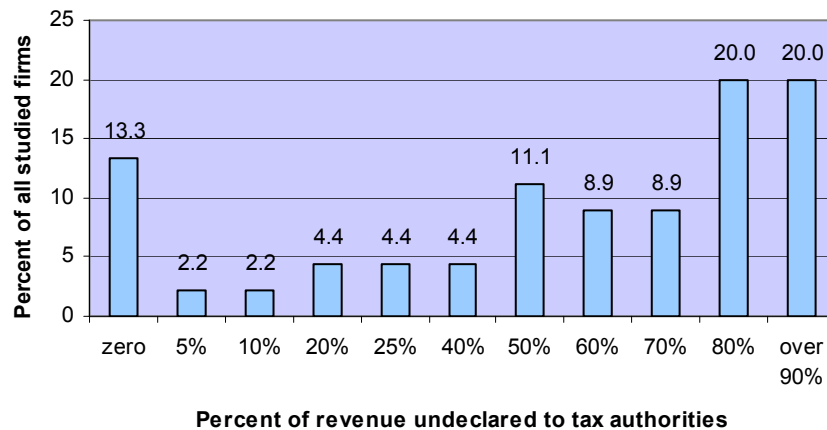
As it becomes apparent from the above quotation, for some firms the benefits of double contracting – tax concealment – outweigh the potential risks of not having a proper contract that can be used in a court of law. In the discussion of double contracting

---

<sup>28</sup> Since the consumer credit is non-existent in Russia, people buy everything, including apartments and houses, for cash. See Guseva and Rona-Tas (2001) on credit industry in Russia.

<sup>29</sup> It is very common in Russia to have salaries declared significantly lower than the reality. The main reason for this is a "social security tax" which is around 30% of the salary. The employers prefer to save this money by declaring small salaries to tax authorities, and paying the real salary to their employees in cash. 63% of all respondents said that their firms hide from tax authorities between 75 and 97% of the real salaries. This practice results not only in major underpayment of taxes, but also leads to a host of other problems. For example, financial penalties imposed by a court are skewed due to the underreporting of income, and are difficult to enforce.

during interviews I asked participants to estimate the percentage of the firm's revenue that goes undeclared to tax authorities through double contracting or other means. Figure 3.2 illustrates the responses that I received. They are unlikely to reflect exact figures of how much revenue is hidden, but they portray a general picture:



**Figure 3.2.** Firms' revenue undeclared to tax authorities (n=45), in % from all studied firms.

The mean of hidden revenues at 55.9% of the total revenues of firms in my study is somewhat consistent with the data from other sources. The Goskomstat estimates the overall figure to be between 50 and 70% (*Vestnik* 2003), and the National Institute of Systematic Research of Problems of Entrepreneurship conservatively estimates the total hidden revenues in the small business sector of the economy as 42% (Shestoperov 2003).

Some participants of my study lament the preponderance of double contracting among small firms. The owner and executive manager of a small chain of construction goods stores says in the interview that he personally would rather work honestly and sign truthful contracts, but he can find few suppliers willing to do so. The St.Petersburg

economy has two types of payment, he explains, cash versus bank transfer, and by law a buyer for cash has to pay an additional 5% “in cash purchasing” tax<sup>30</sup>. Most of his suppliers offer him delivery for cash, without papers, thus saving him 5% of the “cash” tax. For him the problem with cash transaction is that they reduce his firm’s turnover through the bank. Since the amount of credit he can request from the bank depends on his turnover, he prefers paying through bank transfers, whenever possible. He explains:

My bank sees that I have a decent turnover each month, and so they think that I am a reliable business owner. A majority of store owners that I know in my area of business buy everything for cash. I don’t know how they deal with tax authorities though, because in my cash registry it is recorded that my average daily income is \$300, totaling about \$10,000 a month. This money should go somewhere, right? If you have debit, you have to have credit, too. That’s why I would prefer to work honestly, in full accordance with law. But not all suppliers want that. One of my main suppliers insists on working only for cash, I suspect that he sells me goods (very cheaply, I must say) that are stolen from a factory. I think I even know from which. Another supplier is ready to give me a commodity credit with very good terms, only to maintain our ‘cash-only’ relations. But I am still planning to try to convince them to switch to legal way of doing business. (Firm #39, Personal interview, August 2001)

Many firms sign general contracts for a certain time period, customarily a year, and then skip the paperwork for each particular transaction. These general contracts reflect the fact of collaboration between two firms, but provide no specifics as to the terms of exchange. Many transactions between small firms are paid in cash. A manager of an advertising firm describes her work in the following way:

Our work is almost always paid for in cash. And we do not declare it [for tax purposes]. Everything is done by informal receipts: such and such paid to such and such a certain amount of dollars<sup>31</sup>. It happens often with long-term

---

<sup>30</sup> This tax was introduced to give an incentive to firms to pay by bank transfers that are easier to monitor and tax.

<sup>31</sup> Just as most Russian citizens keep their savings at home in dollars (as well as euros, but dollars remain the most popular currency), most cash transactions in business are made in dollars.

partners that I say: ‘I am giving you \$50, are you writing it down?’ He may answer: ‘No, you write it’. Then I will write it down, that I paid him \$50. Later he can even call me and ask how much I paid to him because he would forget. Very often we record the exchange simply not to forget [because we trust each other]. (Firm #5, Personal interview, June 2001)

Imagining millions of dollars changing hands like that in Russia, no records, no taxes, no traces, it is not modern capitalist exchange in a developed country that comes to mind, but rather some sort of village bazaar. Many features of business exchange in Russia are similar to those found in a typical bazaar economy described at length by anthropologists: scarcity and high value of information, stable ties between buyers and sellers, clientalization<sup>32</sup> and intensive bargaining (Geertz 1978). Information about trustworthiness of economic actors and quality of goods becomes an expensive commodity that participants have to invest enormous resources into. “The search for information one lacks and the protection of information one has is the name of the game” (Geertz 1978, 227).

To summarize, participants described the following practices regarding contractual relations with their business partners:

- a) contracts are signed after the fact of the deal (for tax purposes only);
- b) contracts contain false information (double contracting);
- c) contracts are not signed at all (cash transactions with no records);
- d) contracts are signed before the deal and contain truthful information.

---

<sup>32</sup> Clientalization is the tendency for repeat purchasers to establish continuing relationships with sellers, rather than searching through the market for a better bargain each time (Geertz 1978, 228).

The first two categories overlap, since contracts can both contain false information and be signed after the fact. The first three categories reflect the nature of transactions for most small firms in St.Petersburg.



### 3.2. Why is it a problem?

Why has contracting among privately owned firms been so problematic in the newly capitalist Russia? There are reasons aplenty, of course, and here I suggest looking for an explanation in one of them: the changing role of the state in the economy. As proposed in the general theory in chapter one, in a capitalist economy the state serves the role of a third-party enforcer of lawful contractual relations. In this capacity, the state should demonstrate a credible commitment not simply to creating a legal framework adequate for the needs of development of private business, but also – more importantly – to unwaveringly enforcing such a legal framework by ensuring suitable punishment for violators. In the context of contract enforcement, economist Partha Dasgupta explains why such commitment on the part of the state is required:

- In the absence of punishment for breaking contracts, there are no *incentives* to fulfill them. Threat of punishment must be *credible*: enforcement agency must be *trustworthy*. Trust is interconnected: not trusting the enforcement agency leads to not trusting the other contracting party.
- Transacting parties' trust in each other is not implicit; it is based on the calculation that given the other party's disposition, abilities, available options and their consequences, the party will *choose* to fulfill his obligations (Dasgupta 1988, 50-51; italics in the original).

As it appears from the words of the participants of my study, so far, the Russian state is perceived as failing to create positive precedents for effective contract enforcement. The state institutions have not yet managed, or have not been willing, to create a credible

threat of punishment for contract violators, and instead antagonized entrepreneurs by the predatory behavior of its agents.

In part, it is the historic legacy from Soviet times that can be blamed for ineffective contract enforcement on the part of the state. For seventy years there could be no disputes relating to contract enforcement, since there was only one lawful owner of the means of production: the state. All contractual issues among enterprises were resolved on the basis of the Plan, by or through the mediation of the officials from a corresponding ministry. But these practices became unfeasible with the beginning of the process of privatization and ownership diversification that were launched in the beginning of 1992, after the failed communist coup-d'état of August, 1991, and the de-facto collapse of the Soviet Union. The newly elected first president of the Russian Federation Boris Yeltsin publicly declared the commitment of his administration to market reforms in the economy and political liberalization and democratization. Privatization of a large share of state enterprises and price liberalization were important parts of a packet of economic reforms devised with the help of American advisors. But as the state continued withdrawing from the economy throughout the 1990s, its ability to exercise control over enterprises decreased accordingly.

The “withering away” of the state (Burawoy and Krotov 1992) was initially viewed as a means to achieve liberalization of the market, and was perceived as a positive phenomenon by both Russian economic actors and Western aid agencies, until it became clear that the state was not able to provide the necessary conditions for fair capitalist exchange. The neo-liberal paradigm, introduced by Western-minded reformers to Russia in the beginning of the 1990s, particularly emphasizes the importance of free

development of market relationships without interference from the state, but it also stands on principles of the sanctity of property rights and contractual agreements, and presumes their enforcement (Blanchard, Froot, and Sachs 1994). Observers viewed the collapse of the Socialist state as a positive event for the development of a free market economy, but as the state's share in the economy was shrinking, so was its ability to enforce the law by old socialist means. At the same time, the Russian state was undergoing deep structural changes that weakened it and diminished its authority in society; it became riven by corruption, fiscal crisis and inability to competently implement reforms it committed to.

The legal reform designed to support private property and new relations among enterprises could not catch up with rapidly developing new market relationships. The state contract enforcement system in Soviet Russia was underdeveloped, rarely used and generally tailored for different needs than those of private enterprise. When free market reforms were initiated in Russia in 1991, and fully private enterprises appeared after an absence of almost 70 years, they found the state system of law enforcement in disarray, corrupt and ill-equipped to deal with new kinds of claims and disputes (Solomon and Foglesong 2000; Waller 1997; Levin and Satarov 2000). The state courts system available to enterprises (the state arbitration tribunals - '*gosarbitrazh*') was changed in 1991 into *arbitrazh*, a system of commercial courts for use by state enterprises and private firms.

The problems with the *arbitrazh* system were many. Judges found it difficult to keep up with laws and procedural rules that changed daily. Numbers of courthouses and judges left after the collapse of the Soviet regime were insufficient to satisfy the needs of the rapidly growing private sector. But worst of all was the problem of implementation of the

courts' decisions. The old mechanisms that worked to assure implementation of court decisions were no longer possible. The power of the Soviet state was based on its ownership of the means of production and on its expansionist bureaucracy that monopolized the allocation of resources (Verdery 1991, 1996), and now with ownership diversification it crumbled completely. Under communism, state arbitration bodies used to deal mainly with cases of assigning blame for failure to achieve the Plan. Compliance with court decisions at that time was nearly universal. Enterprises were allowed to have only one bank account at a state-owned bank, so it was easy for the court officials to monitor the transfer of penalty funds in accordance with court decisions. Any dissent could be kept in check through a corresponding ministry. It also did not make much sense for Soviet managers to avoid paying penalties since ultimately it was not their own property at stake. Thus no special court enforcement services were needed for disputes among state-owned enterprises.

From 1991 the situation changed radically. Now the burden of ensuring implementation of court decisions fell on judicial enforcers (*sudebnyie ispolniteli*) who were mainly middle-aged women with poor pay and low status, and who in the Soviet period were engaged in the implementation of civil court decisions, like alimony payments. They could easily be bribed or intimidated by those not willing to comply with *arbitrazh* decisions. In 1997 a new system of so-called bailiff-enforcers was introduced in an attempt to improve the rate of implementation of *arbitrazh* decisions. Bailiffs formed a vertical hierarchy independent of courts and subordinated to a Chief Bailiff in Moscow. Most of the old judicial enforcers retained their jobs and continued working as bailiff-enforcers. A shortage of federal funding has not allowed the new system of bailiffs to

develop according to design, despite the importance that the government officials attach to the problem of implementation (Solomon and Foglesong 2000).

It has been estimated that during the 1990s fewer than 40% of all decisions handed down by *arbitrazh* courts in disputes among private firms were implemented (Solomon and Foglesong 2000). Although the situation seems to be improving in recent years (Hendley 2004), the level of implementation of court ruling still remains low. There are a number of reasons for why it is the case: the ability of entrepreneurs to hide their assets and the predominance of cash transactions are probably the most significant. Another problem is a reportedly high level of corruption among judges and judicial enforcers that is compounded by low salaries and a lack of oversight. Levin and Satarov (2000) also note how a ‘habitual bias’ by law enforcement bodies and their representatives to protect state interests vis-à-vis everyone else contributes to spread of corruption: “Protection of the legal rights and interests of citizens, including private owners, has not become the main perceived task of law enforcement bodies. Not having found formal legal protection, entrepreneurs are obliged to seek special arrangements by buying unlawful services from state officials” (Levin and Satarov 2000, 120).

One of the major goals of Yeltsin’s economic reforms of 1991-1992 was to liberate economic relationships from the interfering power of the state. The law was now supposed to fulfill regulatory functions that were once performed by state officials. In words of an American expert,

In a sense, law has to cease being simply a tool of the regime and has to be transformed into an instrument available to all economic actors. What is needed is flexibility without malleability. In other words, law has to be sufficiently supple so it can be used by economic actors in a wide variety of settings to help them achieve legitimate ends. At the same time, however, there has to be an inner core of reliability, sufficient to allow law to be used

as a shield to protect individuals and entities from arbitrary actions by the state and others (Hendley 1994, 29-30).

Two conclusions are evident. First, a major legal reform was needed, one that would comprehensively regulate relationships between private firms, state enterprises and individuals. During Soviet times the law was a Communist Party instrument of control, could be easily changed and manipulated and was upheld by a judiciary that was appointed and controlled by the Party. Legal reform was supposed to improve procedural regularity: ensure independence of the judiciary, the accountability of officialdom and the stability, feasibility, availability and clarity of law (Hendley 1994, 31). Instead, in the messed-up political landscape of the 1990s too many interests were seeking influence through the legislature, stalling legal reformation and further compromising the legitimacy of the law in the eyes of entrepreneurs and the general populace.

Second, once in place, new laws needed to be enforced. The problem of law enforcement emerged in post-Soviet Russia not simply as a problem of inadequate juries and judicial enforcers, but as a question of the state's capacity, its ability to execute its decisions, its apparatus and infrastructure. The Soviet state had a system of implementation and control that operated along Communist Party lines. At the heart of this system was the Committee of State Security (*KGB* in Russian abbreviation), the main coercive power of the Soviet regime. During the Soviet period the KGB performed the functions of both the CIA and FBI, and employed an armed bureaucracy of over 500,000 officers, 240,000 troops, tens of thousands of support staff, and millions of agents all over the world (Weller 2000, 96). The offices of public prosecutor and police forces (*MVD*) served as KGB subordinates and accomplices. From the very beginning of its existence the KGB secured unprecedented power over both the Soviet government and general

populace, forming what observers and its own commanders called “a state within a state” (Weller 2000, 97).

In his richly documented essay on the KGB and its role in post-Soviet Russia, Weller claims that at the dawn of new capitalism the old communist party apparatus used KGB networks to secure “the best piece of the pie”, when the national treasures and the most profitable enterprises were “privatized”. The Party used KGB officers in early joint ventures with Western companies to control all the profits from business with foreigners. When the first private banks and holding companies appeared they were also a creation of either Party or KGB officials. Weller also shows how the KGB operated as a “racket”: for example, privately founded in 1989 the Russian Commodities and Raw Materials Exchange all of a sudden started experiencing difficulties and problems on all levels of operation, when its founder received a KGB proposal to help to solve all the problems in exchange for representation on the board. According to the Weller’s sources, the KGB functioned as an organized crime syndicate that used its own agents as well as regular criminals for the purposes of personal enrichment of its top leadership.

Understanding of the KGB’s post-Soviet activity is important for making sense of failures in law enforcement in contemporary Russia. As noted above, the KGB used to be the central enforcement agency of Soviet Russia, and this legacy shapes the landscape of law enforcement today. In the words of Weller, “the issue of KGB collaboration remains a major obstacle to effective, objective law enforcement and development of true civil society” (Weller 2000, 108). As long as chief state enforcement agencies stay outside and beyond the law, no hope for a truly lawful society can remain.

In this chapter, I argued that there are two sets of reasons why state enforcement institutions are perceived as failing by Russian entrepreneurs. First, it was suggested that it is the changing role of the state in the economy that is considered responsible for the problems with contractual relations experienced by most small firms in contemporary Russia. The following factors were discussed as the most important components of the problem: diminished administrative power and diminished coercive power. Second, there is a historical and institutional legacy: lack of both norms and formal institutions designed to deal with contractual problems. I outlined three factors as essential for understanding the reasons for the failure of state contract enforcement institutions:

a. Underdeveloped and inadequate legal infrastructure: the judicial system left over from the Soviet era was not prepared to handle new economic relationships. The number of courthouses and judges was insufficient; judges did not understand how a market economy functioned and were corrupt.

b. Slow and partial legal reform: old laws were not appropriate, new laws were poorly written.

c. Compromised law enforcement: the state's coercive power was undermined during the reform years, and it affected state enforcement institutions on all levels, from the top enforcement authority – the KGB – to regular courts and police officers.

All three components are important for understanding why the state enforcement institutions are perceived as untrustworthy by Russian entrepreneurs. The problems of legal infrastructure and legal reform are outside the scope of this work. The next part of this chapter will discuss what solutions were devised by firms to respond to the



challenges posed by an unsatisfactory legal framework and the absence of reliable contract enforcement by the state.

### **3.3. In search for solutions**

In the absence of the state as a reliable third-party enforcer firms have to find new ways to make their partners fulfill their contractual obligations. This process is costly and time-consuming. It commences with informal personal connections and is a hallmark of markets lacking institutions processing and distributing information about its participants. Many potentially beneficial relationships are not initiated because no incentives for fulfillment of obligations are seen.

The use of informal personal connections became the first natural response of Russian small firms to the insecurities of the new capitalist market and to the inefficiencies of the state enforcement system. Based on reputation and trust, informal networks served as channels of information and enforcement, and helped minimize losses and keep enforcement costs under control (Polishchuk 2001). Old Soviet networks became a basis on which new networks were often built. These networks functioned as ‘intangible capital’ of enterprises, defining their ability to adapt and prosper (Kuznetsov 1997). The informal networks were the most common alternative to state enforcement.

Many of the other contract enforcement strategies that firms developed related directly to the kind of state failure to guarantee impartial contract enforcement that firms experienced. For example, corruption among state officials, widely perceived as the most grievous problem faced by Russian entrepreneurs, could be used by some less scrupulous business managers to their advantage. Unreliability of state enforcement agencies meant that entrepreneurs could make deals with criminals as more effective enforcement partners.

New enforcement strategies had a profound effect on the structure of firms and business practices. In personnel decisions personal loyalty came to be prioritized over competence; stringent financial enforcement measures were adopted to deal with new business partners; firms created and maintained safety nets to protect themselves.

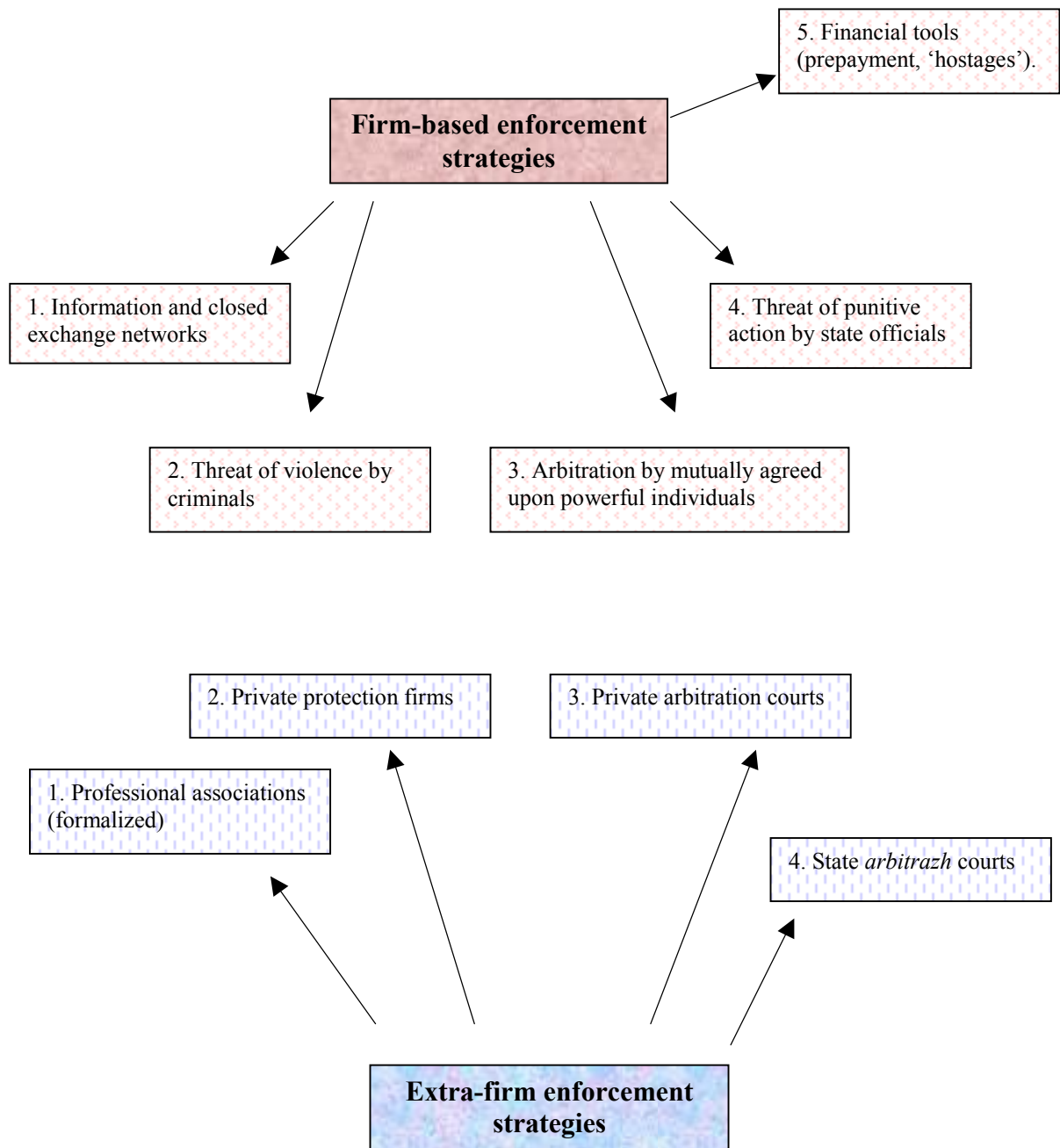
At the same time, private alternatives to state enforcement institutions began appearing on the market. Private protection firms were the most commonly used means of private enforcement of contractual agreements and property rights. They became widespread in the beginning of the 90s and competed with each other (explicitly) and with the state (implicitly) for the opportunity of collecting fees from firms in exchange for their enforcement services.

On the basis of information obtained from the interviews with owners and/or managers of forty-five small privately owned firms, and secondary data analysis, I developed a typology of enforcement mechanisms currently used by Russian firms. In this typology, I draw a distinction between two basic types of contract enforcement: enforcement based on the internal resources of the firm, and enforcement commercially available in the marketplace, including state *arbitrazh* courts. Firm-based enforcement rests on networks, on values and norms, on continuity between present and future economic transactions. This type of contract enforcement exists in all economies to various extents, and is based on the social capital of a firm's key figures. It has been observed in capitalist economies by many scholars since Macaulay described non-contractual relationships among Wisconsin businessmen (Macaulay 1963). In Russia, however, firm-based enforcement acquired a meaning quite different from developed

countries: it is not considered a suitable and convenient complement to a functioning law, but rather as the only means to make a transaction possible.

Extra-firm enforcement, on the contrary, is based on the coercive power of either the state, or other third parties – private enforcers. This type of enforcement is peculiar because since the modern state is defined in terms of a monopoly on coercive power and the means of violence, it is unusual for a state to transfer voluntarily some of its key function to private agencies. In Russia private enforcement agencies appeared in the beginning of the 1990s and took over a large part of the state's enforcement functions.

Figure 3.3 presents the graphical representation of the most widespread forms of contract enforcement available to businesspeople in St.Petersburg in 2002. Both types of non-state contract enforcement evolved rapidly during the 1990s. Their development was marked by gradual transition from primitive and crude forms of obtaining enforcement, to more civilized and lawful means of redress. The state enforcement institutions – courts – gradually acquired a more substantial place among contract enforcement strategies used by market participants.



**Figure 3.3.** Contract enforcement strategies available to small Russian firms.

Below is a brief description of these contract enforcement strategies.

Firm-based enforcement strategies:

1. **Information and closed exchange networks.** This strategy is based on business-to-business relations, and evolved as a means to reduce uncertainty typical to the initial stage of market institutions building (Frye 2000). Small businesses lack resources to form monopolies and powerful conglomerates as larger enterprises can do, but they can limit their transactions to a number of well-known partners and work predominantly or exclusively with them. This enforcement strategy works by the threat of exclusion of a violator from the network, and consequently from all future transactions with members of the network, by ruining its reputation (Greif 1993). Reputation and reciprocated help are the basic levers of this strategy. Information networks facilitate information search and protection.

2. **Threat of violence by criminals.** Ties to criminals allow firm managers to display a credible threat of violence against contract violators (Radaev 2000; Volkov 1999, 2002). This strategy appeared when the state institutions began their disintegration in the beginning of the 1990s, due to economic crisis and political uncertainty (Greif and Kandel 1995). Two factors contributed the most: a) a weakening of the police forces that brought about the b) upsurge of criminal activity on all levels, from petty theft by teenagers to large-scale organized crime. The penetration of criminal influence into business dealings was the consequence of both factors. This most primitive and repulsive form of enforcement was unfortunately very popular in Russia in the first half of the

1990s. Criminals were paid to use force to obtain redress for breach of contract, or deter contract violation by credible threat of violence.

3. **Arbitration by mutually agreed upon powerful individuals.** Parties that request unofficial arbitration agree to be bound by the arbitrator's decision because of the respect they feel for his personality and/or his position. The position of an arbitrator often carries not only social prestige, but also real power to interfere with someone's business. Various individuals can play a role of arbitrators: a prominent official in a local administration, a powerful mobster, a well-connected and respected banker, or other influential persons. The choice of an arbitrator depends on the social connections of the parties in dispute, since they have to have access to a potential arbitrator in the first place.

4. **Threat of punitive action by state officials.** Ties to state officials allow firm managers to mobilize state enforcement institutions in their firm's interests through a credible threat of punitive action. This strategy is based on the connections between businesses and governing institutions, and works by creating a credible threat of punitive actions for breaching contracts, as well as disseminating information about firms and their reliability as business partners. Many of them being underpaid, state officials are often ready to sell or exchange their information and enforcement favors to their friends in the business world (Ledeneva 1998). Government officials "for sale" are available through friendship networks, and used by some business owners and managers to deal with problems of non-payment.

5. **Financial tools.** These include prepayment or property held 'hostage' which guarantees the transaction. This mechanism is applied to new business partners and clients and is used to ensure that there is no default. The size of the prepayment is often directly

correlated with the numbers of previous transactions (Hendley, Murrell, and Ryterman 2000). This mechanism can be viewed as the opposite of closed networks with its inherent lack of trust.

Extra-firm enforcement strategies:

1. **Professional associations.** These formal networks often take on duties of keeping the behavior of their members in check. Members of associations are supposed to follow a certain code of conduct with regard to other members, and if reported to have violated this code, the swift punishment will be exclusion from the association (Greif, Milgrom, and Weingast 1994). This measure can often equate with forcing a violator out of business, since for example a distributor of certain goods cannot function if all regional producers of these goods refuse to sell their products to him. Professional associations are a powerful enforcement strategy provided that a sufficient number of firms in the industry are incorporated into the network.

2. **Private protection firms (agencies).** Many small businesses are connected to, and pay monthly fees to, a private protection agency (Radaev 2000). These firms can combine coercive power (used illegally) with more ‘civilized’ means like bribery and blackmail. The law allowing such private agencies to exist was passed in 1993, and in six years their number in Russia grew from zero to over eleven thousand, most of which are concentrated in large urban centers. While some of these firms started their activity with the racketeering of the first Russian entrepreneurs in the end of the 1980s, a majority of the protection agencies were headed by, or even entirely composed of former KGB officers, other state law enforcement agents or military personnel (Volkov 2000).



3. **Private arbitration courts.** Government licensed private arbitration courts - *treteiskyi sud* – first appeared in Moscow in the beginning of the 1990s as a response by business groups to the inefficiency of state enforcement which was expensive, slow, and could not guarantee the security of business information (Greif and Kandel 1995). This enforcement mechanism became a legal alternative to state courts. These courts are organized by various types of business groups and associations, and licensed by the state. Up to the summer of 2002 *treteiskyi* courts were regulated by a provisional article in the Russian legislation<sup>33</sup>. In July of 2002 a full-scale law (№102-Ф3) was finally passed that detailed their operation on Russian territory.

4. **State *arbitrazh* courts.** Currently, there are two types of state courts where a firm can go to solve a dispute: a regular state court, and a state court of economic affairs (*arbitrazh*). The first of the two bears a close resemblance organizationally to its predecessor from Soviet times, and mainly serves to resolve disputes between ordinary citizens. The second type was transformed from the old *Gosarbitrazh* at the dawn of capitalist reforms in Russia, and was supposed to answer the demand for arbitration among new private firms. This type of courts deals only with disputes regarding economic affairs and managerial issues, where the sides are either registered firms or self-employed businesspeople. The hearings in this type of court are faster than in regular state courts, and significantly more expensive.

---

<sup>33</sup> Vremennoye polozhenie o treteiskom sude dlia razresheniya ekonomicheskikh sporov, postanovlenie Verhovnogo Soveta Rossijskoi Federatsii ot 24 iunia 1992 g. (Provisionary regulation of *treteiskyi* courts for economic disputes, adopted on June 24, 1992).

Although there are nine strategies described above, in fact, they each follow one of three basic logics of operation. Informal networks and formal associations work by threat of exclusion from future transactions; we can call them the strategies of positive incentive. Courts, security firms, private arbitration, use of criminals and/or connections work by threat of physical and financial punishment of the violator; we can call them the strategies of coercion. The remaining financial tools strategy works by prevention, making it impossible for the violation to happen. In essence, all nine strategies are distributed along the axes of the two specified types in relation to these three logics of operation in the following way:

ENFORCEMENT TYPES	PREVENTIVE	POSITIVE INCENTIVE	COERCIVE
Firm-based strategies	* Financial tools.	* Information and closed exchange networks.	* Threat of violence by criminals; * Arbitration by mutually agreed upon powerful individuals; * Threat of punitive action by state officials.
Extra-firm strategies	-	* Professional associations.	* Private protection firms; * Private arbitration courts; * State <i>arbitrazh</i> courts.

The firm-based and extra-firm types of enforcement strategies are actually complementary; only commercially available strategies are in competition. This difference between firm-based enforcement and private enforcement is often neglected in the literature, although it is significant. Both self-enforcement and private enforcement have positive as well as negative consequences for inter-firm and state/firm relationships, and for capitalism building, and will be discussed at length in the following chapters.

## **Conclusion**

While problems with contract enforcement can occur in any economy, in the transitional Russian economy they have reached epidemic proportions. When state institutions cannot guarantee enforcement of contracts and property rights, firms increasingly rely on alternative (non-state) strategies of enforcement. In this chapter I presented the results of a series of in-depth interviews with owners and/or managers of small private firms in St.Petersburg, Russia, regarding the kind of problems with contract enforcement encountered by Russian entrepreneurs. I then discussed the historical and institutional roots of the problem of contract enforcement, and proposed a typology of available contract enforcement strategies that emerged from the field research and secondary data analysis. Next chapters will look at these contract enforcement strategies in more detail.

## Chapter 4: FIRM-BASED ENFORCEMENT STRATEGIES

### Introduction

This chapter presents an analytical description of firm-based contract enforcement strategies developed by small Russian firms in the 1990s, discusses origins of the particular institutional forms that they took, and outlines the patterns of their use by small Russian entrepreneurs, on the basis of my empirical data. Five strategies are discussed: Information and closed exchange networks, Threat of violence by criminals, Arbitration by mutually agreed upon powerful individuals, Threat of punitive actions by state officials, and Financial tools.

Contract enforcement strategies are described in the following way. First, the strategy's *modus operandi* is explained in the words of the respondents, and the origins of the strategy are described. Concrete examples of the strategy will help understand how it works. In the analysis of the origins of each strategy (apart from the last one, Financial tools) I adopt the logic of reasoning from a particular branch of neo-institutionalism in organizational analysis that emphasizes the impact of culture on the economic institutions and relations (Powell and DiMaggio 1991; DiMaggio 1994; March and Olsen 1989; Meyer and Rowan 1977; Fligstein 1996a, Dobbin 1994, Douglas 1986). I trace the roots of the contract enforcement strategies described in this chapter in both Soviet era norms and rules, and pre-Soviet values and traditions. These practices are not necessarily transmitted on the level of individual response; instead, they permeate the Russian society on the level of symbol systems, cognitive scripts, and moral templates that define

actors' preferences and their range of culturally acceptable choices. In the post-Soviet landscape, they become incorporated into the repertoires of contract enforcement strategies. Having become institutionalized, these repertoires can be seen as existing outside of individual actors who select strategies on the basis of a firm's needs and availability of strategies, and also suitability for specific conditions. Different actors may perceive a strategy as more or less legitimate, more or less appropriate, or more or less effective for a particular context. These differences may be as much the result of individual predisposition and moral choice as previous exposure to similar practices. More often than not actors simply do not believe that they have alternatives: they are faced with a problem, and the solution arises from available resources.

All firm-based contract enforcement strategies are based on the resources that are internally available to a firm. Four out of five presented strategies are network-based: information and closed exchange networks work by mutual commitment on the part of trading partners; organized criminals and state officials who can create respectively a threat of violence and a threat of punitive action are predominantly available through social relations, and arbitrators are likely to be found both through social and through trading connection. The structure of social relations of firm's key figures plays an instrumental role in their preferences of contract enforcement strategies; it defines the very nature of firm's economic exchange (Stark 1997; Stark and Bruszt 1998; Kuznetsov 1997; Tatur 2000; Rona-Tas 1998). The degree of embeddedness of firm's decision makers in these social relations will define the choice between network-based strategies and financial tools strategy, or will determine the degree to which the two are combined.

I will describe complementarities between strategies at the end of the next chapter, after having discussed in detail all contract enforcement strategies available to small firms.

Each section of this chapter is devoted to one strategy; strategies vary a lot in frequency of their use by entrepreneurs. Consequently, sections of the chapter differ greatly in their length. In each section of this chapter after having described a strategy's method of operation and its origins, I present data on frequency of its usage among the studied firms. An assessment of the frequency of usage of the strategy was made on the basis of the information from interviews. Four-point qualitative scale was used:

0 = Strategy has never been used.

1 = Strategy was used in the past once or a few times, but is not used anymore. For example, market research firm (#38) used to use a network strategy but abandoned it in favor of a financial strategy that they find more effective in preventing losses due to contract violations.

2 = Strategy is used occasionally but not as the main strategy. For example, an advertising firm (#4) uses the network strategy to supplement the financial strategy.

3 = Strategy is used as the main strategy. Not all firms would have one main strategy, however. Some firm use more than one strategy on a regular basis, depending on the nature of a transaction and partner.

All contract enforcement strategies were evaluated in relation to the level of their usage among forty-five studied firms. The results of evaluation were used in determining what kinds of firms employ each strategy of contract enforcement.

## **4.1. Information and closed exchange networks**

### *4.1.1. Networks in action*

In his book on market institutions in Russia, Timothy Frye tells a story how in 1993 he asked a broker on a commodity market exchange in Moscow how he knew when someone was planning to cheat him. The following answer was given: “Well, before we sign the contract, I look him straight in the eye, and if he blinks, then I know he is going to cheat me.” Understandably surprised, Frye asked whether this method ever worked. “Not usually,” broker responded, “but I don’t have anything else to go on” (Frye 2000:1).

It is all about the classic problem of social order, Frye says, when “in the absence of reliable third-party enforcement, individual incentives to cheat on agreements are too tempting to ignore and lead to perverse results for society” (Frye 2000:1). According to his research, contract violation did become rarer as time went by and as brokers developed a system of self-enforcement – “by word of mouth”, he points out. Brokers learned rather quickly that good reputation brings more income than cheating.

Small firms in St.Petersburg had the same ‘learning curve’ as brokers in Moscow. Entrepreneurs of the 1990s realized quickly that redress can be hard to obtain, and that a good name goes a long way. They became very cautious in choosing their business partners, and careful to maintain good relationships with those who they preferred to work with. Many chose to work only with a few reliable partners; others formed more

loose information networks<sup>34</sup>. This strategy of ‘networking’ in the environment of uncertainty and unreliable third-party enforcers is certainly neither new nor unique to Russia, it can be found in many different times and places<sup>35</sup>. In Russia networking became the easiest way for small firms to protect themselves from potential fraud. A manager of an advertising firm from my sample gives the following description to show how their informational network functions:

Question: When you commence business relationships with a firm, how do you protect your firm against potential fraud? For example, you mentioned earlier that you started recently working with a new small publishing company. How do you know that having given them today your order along with 50% prepayment they won’t disappear together with your money tomorrow?

Answer: Before the first transaction is made with a new firm I always check their clients. St.Petersburg is a small city, and it frequently turns out that we know someone who already works with a firm in question. I call them and ask them how they like working with that firm. They always gladly give me their opinion, because they know that tomorrow they will call me with similar question and I will share with them my experience. On a job market they even have a name for such type of networking relations that a manager can have. They call it “manager with connections in such and such area of business”. I have worked with quite a few firms in advertising, and know personally their management, and it makes me a very valuable manager.

Question: So tell me about this small publishing company, with whom you started working relatively recently (last year). You mentioned that they were new on the market. How did you check their ‘credentials’?

Answer: Well, at first when their manager showed up on our doorsteps and offered their services, we checked the quality of their work and liked it. Then we attempted to gather information about them, and could not find any. Nobody knew anything about them. So despite their good prices (15% cheaper than the publishing firm we worked with at the time) and good quality, we refused to work with them. For half a year their manager visited us regularly, seeking to convince us to give them a try. Finally, we took pity

---

<sup>34</sup> A social network can be defined as a specific set of linkages among a set of actors (where the actors can be individuals as well as firms), with the additional property that the characteristics of these linkages as a whole may be used to interpret the social behavior of the actors involved (Seufert, von Krogh, Bach 1999).

<sup>35</sup> See, for example, an analysis of the medieval Maghribi traders’ coalition by Greif (1993), the study of Wisconsin businessmen’s networks by Macaulay (1963), and the study of the New York apparel industry by Uzzi (1997).



on him – he is such a nice young man – and decided to give them a small order. They coped fine. So we started working with them. Now we work with them on standard conditions: 50% prepayment and 50% after the fact of having completed the order. (Firm #5, Personal interview, July 2002)

This quotation from the interview with the manager of firm #5 attracts attention to some important points regarding the usage of networks for contract enforcement. First, it highlights the role of personal relations among managers that form the core of information networks. The above-quoted manager characterizes her relations with her business partners as ‘trustful’. Many other respondents referred to their relations with business partners the same way, but also as, ‘informal’, and ‘unofficial’. In Russia one often goes with another, and once having formed trustful relationships, people often cross the threshold of formality, and develop personal friendships with their business partners. For example, the owner of a firm that sells medicinal cosmetics says that friendships and trustful relationships with business partners are central for conducting business in Russia. They are the foundation of any business, she says, and essential for the survival of small firms. Many business decisions are made as personal favors, like lowering prices for a good partner, or even warning about upcoming bankruptcies (Firm #22, Personal interview, July 2002).

Trust is thus seen as an important variable in Russian business relations, and especially for small firms. Despite the fact that nearly all respondents (89%) declared that they have had difficulties with contract enforcement, and almost a third (29.5%) have been a victim of nonpayment, most of them (61.4%) do trust their business partners, however, not necessarily subscribing to having formed personal friendships with them, like the owner of the firm #22 quoted above did. Fourteen respondents (31%) maintain exclusively formal relations with their partners, while the remaining 69% claim that they

tend to establish friendships of various depth with some of their business partners. Eighteen respondents (40.9%) say that they occasionally or frequently have informal social gatherings with their long-term business partners, and 62.5% of respondents believe that informal relationships help avoid such potential problems as nonpayment or delayed payment.

Another interesting insight that we can gather from the above quotation with the manager from firm #5 is that the importance of such personal relations – “social capital” of managers – is openly recognized and accepted as a part of one’s job description. Information about a firm’s past behavior thus becomes a commodity for which firms are willing to pay. Firms with limited access to information networks find themselves disadvantaged. On one hand, their risk of being cheated is significantly higher. On the other, many firms will not have any dealings with firms that do not have an established reputation on the market. The story about the publishing firm from this quotation illustrates the difficulties a newcomer encounters in attempts to enter the market. Even offering competitive quality of work and lower prices, it was very hard for them to get clients. Twelve respondents (29% of studied firms) said that have in the past refused to work with a firm only because their information network did not have any past experience of dealing with the firm in question. Six participants (13%) said that they would not work with a firm unless it came recommended by someone whom they know well.

Managers with numerous connections to other firms have access to the information about reliability of various market participants that proves crucial to their firm’s prosperity. An information network supplies its participants with the timely knowledge

about past conduct of its members. Thus participants reduce their potential risks of losses due to dishonest behavior, or even due to bankruptcy, as a respondent from firm #22 noted above.

Participation in an information network, of course, works also to discourage its members from cheating by the promise of widely broadcasting the disreputable behavior of the offender. Negative information about a firm's behavior transmitted via information networks can jeopardize firm's financial well-being and even survival. For example, one business owner recalls how in 2001 she signed a contract with a store to sell some medicinal cosmetics that she supplied, for the total value of over \$1,000, and the store's administration refused to pay claiming theft. The respondent doubted the fact of the theft, but did not sue (I will discuss why in the chapter 6). Instead she notified her network of business partners. The store apparently went out of business quite soon after the event, because many of its suppliers terminated their contracts with it (Firm #22, Personal interview, July 2002). We do not know, of course, the definitive causes of the store's bankruptcy, but it is probable that the respondent's network sanctions played some role in it.

If we imagine loose information networks on one side of the continuum of the network enforcement strategy, the other side would be closed exchange networks. This is a very conservative strategy deployed mainly by those small firms whose management feels comfortable working only with a small number of well-known business partners. These firms are not willing to take any risks in admitting new participants to their network, or do not see it as necessary for the success of their business. A co-owner and

executive manager of an engineering firm describes their work within a closed exchange network, and why they limit their exchange to it, in the following way:

Question: Do you have any problems with contract enforcement?

Answer: We used to. We used to take orders from anybody, then sometimes we would fulfill the order, and receive no payment, the client would just disappear. Of course we then suffered losses. So we stopped taking orders from just anybody. Now we work only with a few reliable partners who we can trust. Some of them are those whom we know for long time [*ie, from Soviet times*], and some came to us recommended by long term partners. (Firm #20, Personal Interview, July 2002)

For firms that evolved from state-owned enterprises of the Soviet period, old production networks are very important. The two firms in my sample that grew out of the remains of Soviet-era enterprises are both involved in production, and both use networks as their predominant contract enforcement strategy.

If trustful relationships between business partners are valuable in information networks, they are absolutely imperative in closed exchange networks, as the above-quoted respondent points out. Any enterprise that wants to have dealings with a firm that uses closed exchange network as its contract enforcement strategy would have to be highly recommended by someone trusted. The interviewee who manages a store that sells leather and fur clothing says that she accepts new suppliers only when they come recommended by someone she knows and trusts. She gives the following reasons:

Question: Why are recommendations so important for you?

Answer: Because I need to know the quality of a product, the quality of raw materials from which the clothes [*leather and fur clothing*] are made. If the raw materials are of low quality, then the clothes will be defective, even if they look nice, then we will have returns, problems with dissatisfied customers. And the supplier may turn out to be an opportunist, take money and disappear, so we will suffer losses. That is why we will work with a new supplier only when they come recommended by someone who we know well. (Firm #25, Personal interview, July 2002)

Participants in my study, however, do not agree on the definition of trust. While most respondents agree that trust is a significant variable in their relationships with their business partners, they disagree as to where exactly trust is bestowed. The respondent from a firm that sells consumer electronics says that it is his personal reputation that matters, not the firm's, and that he feels personally responsible to fulfill his obligations under a contract that his firm enters. "If I am given a commodity credit by some other firm, they give it to me personally, not to a firm which I happen to run", he says. "If I cannot live up to my promises, I cannot just say 'sorry, the firm had difficulties...' I run the firm, and they gave merchandises to me and not to the firm" (Firm #23, Personal interview, June 2001).

Other respondents disagree. The respondent who co-owns and runs an engineering firm says: "We work not with people, but with organizations. If they changed their director – so what? We still have a connection on the organizational level, on the level of the chain of production" (Firm #20, Personal interview, August 2001). One quarter of respondents agree with this point of view, saying that when they build relationships with another firm, they work with them as with organizations, regardless of changing personnel. Significantly more respondents (42%) agree with the opinion of the respondent from firm #23, maintaining that they build trustful relationships with specific people and not with firms that these people work for. For example, the advertising manager from firm #5 has been providing advertising services for firm #23 for the past four years, although she changed three jobs in this time period, working for different advertising firms. Such practice is quite common.

Despite the fact that St.Petersburg is not a small town<sup>36</sup>, many business owners and managers who worked longer than a couple of years claim that they know everyone who works in their area of business, thus maintaining that they have a *de facto* closed exchange network. It is difficult for outsiders to penetrate such networks:

*If nobody [ie, managers of firms that operate in this area of business and are known to the respondent] knows anything about a firm, then it means that it is most probably phony. It would be unjustifiably risky to work with them, so we would never take an order from such a firm. Although if we did not have any other order at the time, and were really in a bad need, maybe we would take a risk, but so far we have never found ourselves in such situation. (Firm #35, Personal interview, August 2002)*

The fears expressed in this quotation that if nobody knows about a firm it must be phony are not groundless. Especially during first half of 1990s there were lots of shell companies, and if one was not careful, or lucky, one could easily fall victim to fraudulent schemes. The opinion expressed by the manager from firm #25 was the result of experience of working in trade – an area of business particularly vulnerable to fraud. An executive manager from a firm that sells consumer electronics explains why personal connections are crucial, and why it is risky to transact with outsiders:

Say, one day you come to my office and offer for sale a consignment of consumer electronics that stores that I run can sell, and I am interested. First thing, I will be looking for people who know you, had dealings with you, and can confirm that you are an honest person. Everyone in this area of business knows everyone in St.Petersburg. If I can't find anyone who could vouch for you, I won't take the deal because it is very likely that this consignment that you are trying to sell me has been obtained by criminal means. And then I might have problems with the police, and hassle, and I don't want that. I am not afraid of the police, but of a possibility that someone who I know who also deals with this type of goods will come to

---

<sup>36</sup> Its population is over four million people (for details, see chapter 2).

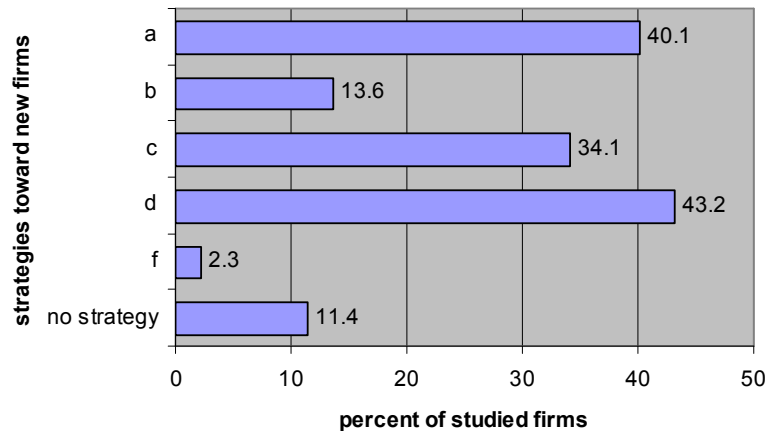
me and say “you know, this consignment was stolen from me a week ago”. And I don’t want that to happen.

For example, two months ago a consumer electronics store got robbed; they stole goods for over \$50,000. So what can one do with such a big consignment of consumer electronics? You cannot sell it at a flea market, you know. So they will try to sell it to people like me, and I am not interested. (Firm #23, Personal interview, June 2001)

While worries about quality and origins of goods are very legitimate and common, they are not exclusive. Sometimes managers are wary of working with firms that they have not worked with before for other reasons. They are concerned whether or not a new firm will fulfill orders on time, whether they will provide adequate quality, whether they will pay accurately and in timely fashion. Many managers complain about sloppy and irresponsible partners that caused them problems in the past:

I am afraid to work with people about whom I don’t know anything. There are so many careless managers around. Once there was a case when we had to carry out a big order, and we risked subcontracting one firm with whom we had not worked before. That firm specialized in such orders. And despite being quite big and well-known, that firm violated the terms of our contract pretty badly: they did not complete the order on time, and the quality of the final product was appalling. As a result, we lost a very good client, and they lost us as a potential business partner. (Firm #5, Personal interview, July 2002)

Because of the concerns of this sort, almost all surveyed firms (91%) have established routines of dealing with new firms, and information gathering prior to a first transaction is only one of them (figure 4.1.1):



Where:

a = “Always try to gather information about a new firm before the first transaction.”

b = “Will never work with a firm unless it is recommended by someone we know well.”

c = “Everything depends on the impression that representatives of a new firm make.”

d = “For the first few transactions 100% prepayment will be required.”

f = “Other”: one respondent put “declaration from tax inspection about firm’s income”.

**Figure 4.1.1.** Strategies used by studied firms toward a new supplier or a new customer (n=45), in %.

About a third of all firms combine more than one approach. Eighteen respondents (42%) say their firms rely heavily on preventive measures – they would not work with a new firm without first receiving a payment in full. We will discuss this as a separate financial strategy further in this chapter. An even more harsh approach is used by 13% of firms, whose management refuses to even consider dealing with a firm about which they don’t have any information. 40% of all managers say that they routinely collect information about other firms from their information networks. But a third of respondents (33%) say that they predominantly trust their own opinion, and make a decision about collaboration with a firm on the basis of personal impressions from its representatives.

Information networks are not always confined to a firm’s business partners. Occasionally other parties may get involved, especially when a firm’s well-being is at stake. The manager from an advertising firm explains that her firm’s management would



often look for necessary information from sources other than business acquaintances. For example, if their debtor has an account in the same bank as theirs, management could request information about the debtor's state of affairs from the management of the bank:

Being good clients, we know our bank's management personally. We can go and explain the problem. The bank can then either call the debtor themselves, or suggest other ways of influencing the debtor. Sometimes what we need is just reassurance. Maybe, the debtor delays repaying for some legitimate reasons, but their finances are in order and they will pay. Or maybe not. The thing is, the debtors always say "I will pay", but will they really? Any information about the debtor is essential because it helps determine our firm's course of action with regard to the debt. (Firm #5, Personal interview, July 2002)

Like in the case with business partner networks, referring to a bank manager serves as a means to reduce the unknown to manageable proportions. Such relationships are built on chains of personal dependencies and trust, are highly informal, and carefully maintained.

Networks described in this chapter do not exist entirely outside of the state legal system, like in case of networks in the informal economy (Portes 1994; 2003). They interact with the state institutions as much as it is necessary, and parties do not depend on their networks for survival as much as it is the case in the informal economy. However, they are quite similar to informal economy networks in their reliance on trust, reputation and mutual help. The similarity becomes more pronounced if we take into account the frequency of cash transactions, unaccounted for by the tax authorities: a whopping 40% of respondents said that they declare only 20% or less of their firm's income. Even more is concealed from tax authorities in terms of personnel's salary: 53% of studied firms declare less than 20% of salaries. I will discuss this phenomenon in Chapter 6.

#### *4.1.2. Origins*

The particular character of the network enforcement strategy which has evolved in Russia in the past decade is deeply rooted in the nature of the Soviet system. The Soviet state's ideology condemned individualism and promoted collectivism as a distinct feature of socialist society. Seventy years of propaganda pictured true Soviet citizens as subsuming their personal interests to the interests of their peer group, be it in the work place, at home, in the Party, or simply with a group of friends. The ultimate role of this propaganda was to ensure loyalty to the Party and the socialist system, but in the end of the day the same collectivism helped brew dissidents, a culture of silent non-compliance and shirking, and corruption.

Communist emphasis on community as the foundation of social order and the shunning of everything individualistic and utilitarian was however neither original nor unpopular among Russians. As a number of authors poignantly show in their works (McDaniel 1996; Berdjaev 1990; Fedotov 1992; Kljuchevskii 1990), it was a part of the so-called "Russian idea" that existed for centuries among different strata of Russian society. "The rejection of egotistic utilitarianism; the desire for community; the suspicion of private property; the hatred of formalism in social relations, especially as concerns law; the desire for a state that will protect the subject against social elites; ..." (McDaniel 1996, 24) were the arguments of Russian intellectuals both under tsarism and under communism.

Community in Russia, McDaniel (1996) argues, has always been experienced in local contexts and defined in oppositional terms to exogenous groups, be they ethnic, religious, or class-based. This binary logic delineates the world as "right" versus

“wrong”, “us” versus “them”, “community” versus “state”, and “truth” versus “law”. Cold and impersonal law is grouped by this logic with state, in opposition to the righteousness of truth that a community possesses. Traditionally the law has been weak in Russia, legal institutions inspiring more suspicion and intrigue than trust. To the contrary, friends and relations were the ones to be relied on and referred to at times of crises as well as in everyday affairs. Familial group identity among Russians traditionally served as a foundation for personal identity, and loyalty to the collective superseded one’s egotistic self-interest.

This cultural emphasis on the collective was probably one of the reasons why Marxism won hearts and minds of many a Russian intellectual, and eventually gave rise to bolshevism. Bolsheviks used networks of supporters to advance the revolutionary cause; lacking formal organizational resources after the revolution and the civil war they relied heavily on informal networks in attempts to consolidate disintegrated pieces of the former empire (Easter 1996).

Kuznetsov, along with other sociologists (Berliner 1988; Ledeneva 1998; Randall 2001) claims that the Soviet economy was operating, from the very beginning, on the basis of informal networks, based on personal trust. Participation by Soviet managers in informal networks of influential people in the region was a key to success, or at least to keeping a job. As Burawoy and Krotov note, “In contrast to the capitalist enterprise, the secret of the successful Soviet enterprise lies in its bargaining relations with external organizations” (Burawoy and Krotov 1992, 28). This arrangement was embedded in the system of a centralized planned economy. It was formed under Stalin’s regime, when failure to achieve planned quotas could easily send a manager to the *GULAG*, and

matured during the decades of Brezhnev's sleepy rule. The main reason for the "survival networking" was of course the incongruities of the system, which led to frequent disruptions of supply schedules, and then it was up to a manager to ensure that the production quotas were met:

A manager who had the right contacts in other economic enterprises within the Soviet Union could unofficially swap or barter for needed materials. Therefore, Soviet managers developed networks of people within their enterprise, local party officials, and managers from other enterprises in order to facilitate the acquisition of these necessities. ... If the director of the enterprise or one of its top managers had these connections or acquaintances, then both enterprises would receive secret shipments, many times at night, so that production quotas could be met. The use of personal influence, or *blat*, saved many managers. This system required the unofficial support of a number of people in the enterprise, in the local party, and sometimes even in the government. (Randall 2001, 56)

Thus the success for Soviet managers was often defined by their skills in networking, and not in optimizing production or stimulating innovation, like in a capitalist enterprise. I will discuss Soviet-style networks in more detail later in this chapter, in the section devoted to the Treat of punitive action by state officials strategy.

At the time of economic and political upheaval in the beginning of the 1990s the social value of trust increased dramatically. People referred to their friendship networks as one of the last things to believe in, and count on. Information and closed exchange networks were frequently formed by people who knew each other from before they entered the business worlds, and who relied on their feelings of friendship as an ultimate enforcement guarantee. These people might often have displayed opportunistic behavior toward outsiders, but they tended to maintain loyalty to their group.

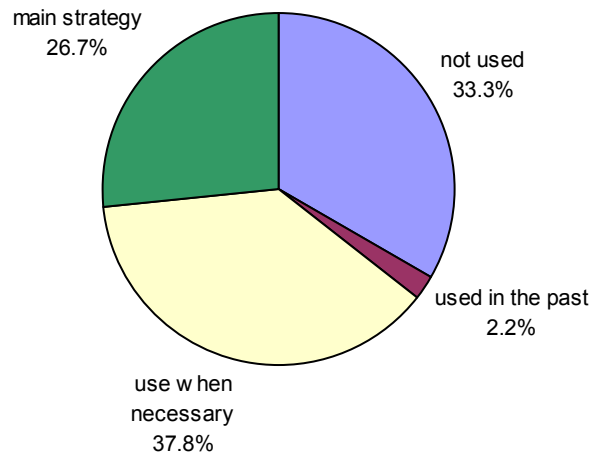
### *4.1.3. Usage of networks enforcement strategy among studied firms*

To determine how frequently participants of my study relied on the network strategy I first asked those entrepreneurs who do not experience problems with contract enforcement to assess the significance of networks in their enforcement arsenal. Second, all respondents were asked to evaluate the ratio of long-term business relations to short-term/rotating ones, thus uncovering existing *de facto* networks, regardless of their use in contract enforcement by those firms. Third, a wide range of questions were asked throughout the interviews that were meant to indirectly indicate reliance on networks for contract enforcement. For example, question #3.5 asked whether long-term or new business partners are given priority in a tight financial situation (which happens often to nearly all respondents); question #4.13 asked about speed and reliability of the dissemination of information about contract breaches. Finally, section #7 of the questionnaire is fully devoted to relationships between firms and asks questions about the level of trust that exists between respondents and their business partners and clients, level of formality in communication, and sources of information about business partners.

The inference about degree of usage of networks as a contract enforcement strategy was made on the basis of all of these questions (2.1; 2.2; 3.2; 3.5; 4.13; 4.14; 7.1 – 7.14).

Four types of strategy usage are identified (Figure 4.1.2):

- a) strategy has never been used;
- b) used once or several times in the past but unlikely to be used it again;
- c) currently used to some extent, when necessary or possible;
- d) currently used as a main strategy.



**Figure 4.1.2.** Usage of Information and closed exchange networks contract enforcement strategy among studied firms (n=44), in %.

Who are these firms that use networks as their contract enforcement strategy? Statistical analysis of intensity of usage of networks as a contract enforcement strategy and five explanatory variables produced the following results. Sector of economy appears to matter to a certain extent: firms in service tend to choose this strategy a little more frequently than firms in trade or production. Firms organized earlier tend to use networks as a contract enforcement strategy more frequently than firms organized later. This can be due to two reasons: either because they organized at such time when you only could survive through networks, or because they had enough time to create networks. It is likely that both reasons are in play. Neither of these two correlations is statistically significant.

Correlation between the size of the firm and likelihood of choosing this contract enforcement strategy is statistically significant: smaller firms are more likely to use

networks to enforcement their contracts<sup>37</sup>. Small firms have fewer resources, losses are more costly to them, and they more rarely can afford the costs of debt recovery via the courts or other third parties. Consequently, they prefer to rely on strategies that do not require financial investment, even though this can potentially limit new business opportunities.

Criminal involvement of firm's management correlates negatively with using this strategy<sup>38</sup>, which means that firms whose upper management has connections to criminal world on the level of investment or personal ties are less likely to enter information and closed exchange networks for the purposes of contract enforcement than firms without such connections.

In essence, we can say that the Information and closed exchange networks enforcement strategy is based on business-to-business relations, and evolved as a means to reduce uncertainty in the 1990s. This strategy is widely used by small businesses that lack the resources to form monopolies and powerful conglomerates as larger enterprises can, but can limit their transactions to a number of well-known partners, and those firms that were organized in the first half of 1990s.

This enforcement strategy encompasses a whole range of behaviors, from relying on networks for information about a (potential) business partner to limiting a firm's

---

<sup>37</sup> Correlation between the size of the firm and usage of exchange and information networks for contract enforcement purposes has a coefficient =  $-.319$  (Kendall's tau\_b) and  $-.340$  (Spearman's rho), significant at the .05 level, 1-tailed (due to small sample size, non-parametric correlations were used). Correlation coefficient shows that larger firms are significantly less likely to use exchange and information networks for contract enforcement purposes than smaller firms, within the given sample.

<sup>38</sup> Correlation between criminal involvement and usage of networks for contract enforcement purposes has a coefficient =  $-.288$  (Kendall's tau-b) and  $-.307$  (Spearman's rho) significant at the .05 level, 1-tailed. Correlation coefficient shows that firms that have criminal involvement on the level of investment or personal connections of upper management are significantly less likely to use networks for contract enforcement purposes than firms without criminal involvement, within the given sample.

transactions to a few well-known partners. It works by relying on trust and reputation as well as by threat of exclusion of the violator from the network, and consequently from all future transactions with members of the network, by ruining its reputation.



## **4.2. Threat of violence by criminals**

### *4.2.1. Criminal groups in post-Soviet Russia*

Ever since perestroika opened up new possibilities for private entrepreneurship, violence and criminality became both an integral part of private business, and arguably its biggest problem. Even today it is common to see advice in the media, especially in the business press, on how to deal with people and groups from the other side of law. Most businesspeople in St.Petersburg either have some kind of connections to the criminal world, or at least are aware of its existence in their close vicinity.

There is little information about the scope, sources and functions of criminal groups in the business world of post-Communist Russia, without doubt largely due to the difficulties of studying such a subject. Much of the existing body of theoretical research on the role and place of crime in modern Russia (Sachs and Pistor 1997; Leitzel 1997; Åslund 1997) is based on the seminal work of Diego Gambetta (1993) who explored the economics of private protection by the Mafia in Southern Italy. However, with the lack of hard evidence, theoretical speculations seem to be based more on “anecdotal or impressionistic evidence” (Frye and Zhuravskaya 2000, 478) spurred by “‘excitation’ on the part of mass media” (Radaev 2000, 42) than on the realities of present day Russia.

A number of empirical studies have been done in the recent years attempting to fill in this void. Fry and Zhuravskaya (2000) collected substantial empirical evidence on a particular aspect of criminal involvement in Russian business: the role of rackets in the retail trade. They discovered that small Russian shops tend to rely heavily on private protection rackets, especially when compared with shopkeepers in Poland and Romania.

In particular, they found a strong positive link between the level of official regulatory demands, and the level of reliance on protection rackets.

Another important empirical study of Russian private enterprises was conducted by Russian sociologists in 1997-1998<sup>39</sup>. This survey tackled the issue of violence in Russian business, including rackets, protection services by both criminal groups and registered protection agencies, evolution of criminal involvement in business relations, and changes in state power structures. Overall, the survey found that the media reports about the prevalence of criminal means of problem-solving in business conflicts are exaggerated. The researchers list a number of factors responsible for a general decline in application of forcible methods in Russian business. First, while most business people, according to survey results, pay for protection services “just in case”, they prefer not to use them. Second, protection agencies themselves changed: more of them now are respectable registered enterprises and not criminal groups who are after quick money. And finally, state power structures are perceived as becoming somewhat more forceful and effective than a decade ago (Radaev 2000).

Research by Russian sociologist Vadim Volkov (1999, 2000, and 2002) provides a very valuable insight into the nature of the relationships between the criminal and business worlds in Russia, and also is extremely helpful in conceptualizing these relationships which he calls “enforcement partnership”. Enforcement partnership refers to strategic alliances formed by agencies capable of violence, and (sometimes unwilling) entrepreneurs, in which the former is hired to perform debt recovery, contract

---

<sup>39</sup> The study was conducted by the Center for Political Technologies (managed by I. Bunin), on order from the Center for International Private Enterprise of the United States (CIPE), reported by V. Radaev (2000).

enforcement, dispute settlement, and negotiations of various kinds, including those with state officials. Enforcement partnership frequently results in violent entrepreneurship which Volkov defines as “a set of organizational decisions and action strategies enabling the conversion of organized force (or organized violence) into money or other market resources on a permanent basis” (Volkov 1999, 741). In his own work, Volkov distinguishes between three types of the ‘violent entrepreneurial agency’: state agencies illegally acting as private enterprises, non-state private protection companies, and organized criminal or bandit groups. In this part, I am focusing on the role of the last in the enforcement services in St.Petersburg.

For the purposes of analytical clarity, I also would like to point out the distinction between extortion/racketeering and enforcement services by criminal elements. Here I am including in the analysis *only* those contacts between business managers and the criminal world which result in enforcement of the firm’s contracts. This enforcement strategy presents a particular challenge for analytic exploration not simply because it is often virtually impossible to distinguish between racketeering and enforcement services, but also because of its convergence with private protection companies. The organized groups that offer enforcement services along with extortion can be seen as moving in and out of the legal framework as they acquire or lose a state’s license to offer security and protection services; offer services that are allowed by law, or not; and properly document the nature of their relationships with their clients for the regulatory authorities, or not. These variables make it extremely hard to differentiate between enforcement by threat of force offered illegally, and the same type of enforcement that comes from licensed private protection agencies.

Although the dividing line is thin, I draw the distinction between the two on the basis of *availability* of the services. Private protection agencies offer, or are supposed to offer, their services to an entire business community. This type of commercially available enforcement will be discussed in depth in the next chapter. Enforcement by threat of force from criminals that is *not* available to the business sector and can be obtained only through immediate connections to them is in the focus of this part.

#### *4.2.2. Origins of the strategy*

Criminal groups started offering services of enforcement by threat of violence in the beginning of the 1990s, when for those of them engaged in lucrative racketeering of co-operatives of the late 1980s it became clear that it pays to support the business you milk. Gone were the days of random and violent extortion; competition on the “market” of extortion and racketeering made them seek more regularized relationships with their “clients”, and look after their clients’ well-being:

As extortion became regular, it turned into a protection racket – an institutionalized practice whereby tribute is collected on behalf of a criminal group that, in exchange, claims to offer physical protection from other such groups. But as the private sector expanded and the intensity of business transactions grew, criminal groups got engaged in more sophisticated activities such as debt recovery, contract enforcement, dispute settlement, and negotiations with the state authorities concerning registration, export licenses, tax exemptions, and the like. (V.Volkov 2000:491)

At that time, perhaps the biggest concerns faced by most businesspeople were premeditated non-payment on the part of dishonest business partners, and the threat of violence on the part of numerous rival criminal and semi-criminal groups. Most

St.Petersburg business owners in the beginning of 1990s ended up entering into some kind of relationships with at least one such group.

What did those criminal groups look like? Frequently, they would initially be formed on the basis of either some region or place (like students in St.Petersburg who came there to study from a town nearby could form a group named after that town), on the basis of ethnicity (Chechens are probably the most notorious), or athletes on the basis of some sport club (boxers, wrestlers and the like). Later they inevitably blended together, adding to the mix quite a few professionals from the KGB, military and police forces (Konstantinov 1997; Volkov 1999, 2000). Many young street thugs start out in this particular “career” by offering protection services to local business owners for cash. Private protection and enforcement services became one of the major engagements and a source of regular revenue for criminal groups in the beginning of the 1990s.

The general transition to more legal and less violent means of settling the conflicts during the 1990s meant that more and more such groups were becoming legalized private protection firms, or started their own businesses altogether. But of course, far from all took this road. And to those business owners who did not shy away from drastic measures to recover their debts or cope with a competitor, criminal groups offered certain advantages. They were less picky in their means than their legalized competitors, and as was maybe the case with some prominent criminal organizations, their reputation frequently worked for them:

The name of the group has a specific function in the practice of violent entrepreneurship: it guarantees the ‘quality’ of protection and enforcement services and refers to the particular kind of reputation that is built from the known precedents of successful application of violence and ‘question solving’. Because the functional necessity of the institution of enforcement partners derives from high entrepreneurial risks, the media stories about

‘horrible’ and ‘omnipowerful’ bandit groups only help to sustain the functional necessity of this institution and support the reputation of such groups. (Volkov 1999, 746)

There is very little evidence on how widespread enforcement by threat of violence by criminals is. Numerous figures have been cited in both Russian and Western sources, all being crude estimates. For example, in 1998 the MVD<sup>40</sup> published the following information concerning involvement of the criminal world into the business world in Russia: criminal gangs were said to control or own 40,000 economic subjects, including 1,500 state enterprises, over 500 joint enterprises, and over 500 banks<sup>41</sup>. According to the results of an all-Russia survey conducted in 1997, about a half of 227 studied firms made regular payments for protection services to various organizations (Radaev 1998). It however remains unclear whether such payments are made voluntarily or they represent old-fashioned extortion in a new “protection services” guise, and how many of these protection services are provided illegally by criminal groups. A survey in 1997-1998 conducted by the Center for Political Technologies found that 11% of entrepreneurs are inclined to use force in conflict situations, like deception on the part of a partner. Overall, sociologists who conducted the study estimate that around 15% of Russian private firms “gravitate toward criminal segments of the market”. That is in spite of the fact that 42% of those surveyed said that they have experienced threats and forcible extortion, and 53% said that they pay to some organization for protection services (Radaev 2000).

---

<sup>40</sup> MVD stands in Russian for the Ministry of Internal Affairs, a mother organization of police forces.

<sup>41</sup> *Zaschita i bezopasnost'* 1998(2):4-5, cited in V. Volkov (1999, 748).

### *4.2.3. The patterns of the strategy operation*

The results of my study are somewhat consistent with the results of prior surveys. Eighteen respondents out of forty-five (40%) indicated that their firm makes regular payments to a private protection agency. How many of those are illegal bandit gangs is not clear, and even the most frank interviewees were reluctant to disclose any details that could shed some light on this matter. During some interviews, when answers to certain questions led me to believe that the respondent's firm may be affiliated with a criminal group (regardless if it happened of their own accord, or was forced on them) and I tried to dig a bit deeper, I typically heard "It is better for you not to know"<sup>42</sup>. Some respondents did admit that they employ criminals, and a few made an explicit distinction between using criminals for contract enforcement, debt recovery and various negotiations, and a protection agency for office security. I will discuss the usage of protection agencies and how they differ from criminal enforcement in the next chapter.

Realizing that inferences from indirect question will always be inferior to exact information, I still attempted an "informed guess" to estimate the level of active presence of criminals in a firm's enforcement repertoire. This guess is based on a number of questions from the questionnaire: question #4.1.5 asked if a firm ever hired somebody to use unlawful violence or a threat of violence against a dishonest business partner; question #4.1.3 asked if a firm's management requested help from friends or relatives to use unlawful violence or a threat of violence against a dishonest business partner. Those

---

<sup>42</sup> There was one respondent whose amazingly candid account of her encounters with criminals made me want to include it in full. It can be found in the Appendix 2: "Luba's story".

respondents who answered yes to either of these two questions were asked to explain the circumstances, and the frequency of occurrence.

Four respondents said that their firms had paid criminals to use the threat of violence against dishonest business partners in the past, and four more admitted having long-term relationship with a criminal group. Two out of these eight respondents said they have close, informal relationships with those criminals that they hired. There are also a substantial number of respondents – eleven out of forty-five (24.4%) – who said that they were not in the position to know whether or not criminals have ever been hired to address contract enforcement problems.

These numbers are quite likely to underestimate how frequently enforcement by threat of violence by criminals is actually employed. As indicated in chapter two, a third of all respondents admitted having some criminal involvement in their business, either on the level of connections, or on the level of financial investment. Having such an important resource available means that these firms are much more likely to use it at times of trouble than firms without such connections. It is also reasonable to suggest that just like the reputation of a criminal group works to discourage any violations against those under its protection, so does the reputation of criminals if they start their own business. For example, an advertisement manager from firm #5 who has also four-year long personal and business relationships with firm #23 reports the details of firm #23's operations that their executive manager was reluctant to share:

Question: Tell me about this firm you have been working for [in addition to your main job]. How do they solve their problems with contract enforcement?

Answer: Their owner is a real, well-known bandit, he owns a few firms in St.Petersburg. My friend V. (*the executive manager*) manages one of his firms very well, and they are quite happy with each other. My friend once



told me that if I ever have any problems with bandits, that if ever someone threatens me, I should just let him know, and his boss will fix it immediately.

Question: You say he is such a good manager. Why does not he open his own business?

Answer: With his own business he would be completely unprotected. The way things are now, all his problems are solved before he even knows about them. Nobody dares to cause his boss's business any harm [because of the boss's reputation in town as a tough criminal], even state authorities. For example, he placed an ad banner on Nevski (the *main thoroughfare in St. Petersburg*) a while ago, and in theory he was supposed to make a substantial payment to the City Center of Advertisement Placement for this ad, but he did not. And guess what? Nobody did anything against him. If my friend was the owner, being unprotected and small, they would make him pay in full, plus fine. (Firm #5, Personal interview, June 2001)

Unfortunately, but understandably, the executive manager from firm #23 refused to provide more details on the role of his boss's reputation in town in the business relations of his firm. However, he did not deny that all the above-said were true. This example demonstrates that such unseen factors as a business owner's past and present connections can play a considerable role in preventing contract violation from happening.

But how does the strategy of contract enforcement by threat of violence by criminals operate when it is actually used by managers? Respondents reveal two major patterns of usage. In the first one, the upper management hires criminals to use force against dishonest business partner as a last resort, does so reluctantly, and prefers to dissociate themselves from the criminals they hired as soon as the job is done. A good example of such pattern was described by the owner of a firm that develops geophysics equipment:

It happened once, when our client refused to pay what they owed us, they said they went bankrupt. Unfortunately, we owed money to our supplier for the materials we used to make that order that the client could not buy out. The supplier started demanding repayment quite aggressively. I explained to them that I did not have the money because my client went bankrupt. They said they did not care and threatened me. I had to do something, so I found people who could credibly threaten my debtors. Criminals, of course. It all worked out well in the end, my debtors paid the debt to my supplier, and they

[=*the supplier*] left me alone. Unfortunately, things like this happen these days. (Firm #9, Personal interview, June 2001)

This firm is engaged in the development of highly specialized geophysics equipment, their profit margin is very low, they deal with a small number of large enterprises, and all the transactions are done through banks. They also do not advertise their services. Because of these reasons they rarely experience problems with contracts that may require such drastic and expensive measures as the one described above.

For firms that use cash transactions more than bank transfers, have large number of clients and suppliers, and are highly visible through their offices and advertising, the risk of coming in contact with the criminal world is much higher<sup>43</sup>. The second pattern of usage of this contract enforcement strategy is more typically found to be employed by this kind of firms. In this pattern, firms tend to form strategic alliances with a criminal group, involving stable financial and personal connections. Criminal groups in this pattern of relationships receive monthly payments, separate bonuses for “solved problems”, and their leaders frequently socialize with leaders of the firms. The monthly payments can vary, depending on the firm’s turnover, from a hundred to several hundred dollars a month. For example, an accountant from a firm that manufactures labels says that her firm pays \$800 to a criminal gang whose services they occasionally use, a sum equivalent to a monthly salary of an upper manager in a small or medium-sized firm (Firm #18, Personal interview, August 2001). Any actual work is paid for separately,

---

<sup>43</sup> The idea that the nature of one’s business is an important determinant of the likelihood of criminal involvement is supported by the findings of an all-Russian survey of entrepreneurs conducted in 1997-1998 by the Center for Political Technologies. Results of this survey show that enterprises in the retail trade, public catering, domestic services and other areas of business that are highly visible and depend on advertising are much more susceptible to criminal interference, be it welcome or not (Radaev 2000, 41,43).

depending on the level of difficulty, the respondent says. Retrieving debts from non-payers is paid the highest, up to 50% of the sum in question<sup>44</sup>. This criminal gang that they use does not consist of any highly-trained professionals, she says, they are just “boys from the street”, friends of the executive manager (Firm #18, Personal interview, August 2001).

Another respondent, an accountant from the firm that manufactures advertisement banners, says her firm hires both, an official protection agency, and criminals:

Question: What happens when your partners do not fulfill their contractual obligations? Do you use your protection agency?

Answer: No, no. A protection agency is hired to guard the office, they don't deal with our problems. For that we have a “roof”. I see this guy every month, he comes for his salary. If our firm has any problem with business partners, he solves these problems.

Question: How does he do it?

Answer: I don't know the details, but he has his methods. I know that often it is sufficient for him to show up in the office of the offender, the way he is, with all his props that identify him as a criminal, like gold chain on his neck, leather jacket, very short haircut and an obligatory Mercedes car. And the problem will be solved immediately; no one wants to inflict violence upon themselves... (Firm #32, Personal interview, June 2001)

In the case of this firm, according to the respondent, it was the criminals who showed up one day on the doorstep of the firm and offered their services. Few firms ever dared to refuse an offer of such kind, largely due to the massive amount of scare stories about “what happens to those who...” in mass media. Most of those who pay however do not use their services; they just pay to avoid violence against their family members and damage that can be done to their property. The owner of a chain of construction goods stores describes his experience with bandits:

---

<sup>44</sup> Other empirical studies give similar figures: see Volkov (1999), Radaev (2000), Bliahker (2000).

It happened a few years ago. I think it was one competitor of mine who gave information about my firm to a Chechen gang, and they paid me a visit. It was quite scary, to be honest, they threatened violence against my wife and daughter if I didn't agree to pay them monthly. I took the threat seriously and made my family go to the USA for a while, to visit my wife's relatives. What happened after is that some local gang stopped by, and offered their protection services. At first I thought the two were connected, but it turned out that they were not. The locals contacted the Chechens, they both sent representatives to me and offered me a choice, who do I want to "work with". I chose the locals, and paid them the first monthly installment, something around \$90, I remember. And then they never showed up again. I later learned that their chief got jailed, and the rest scattered. I never initiated contact myself, not wanting to have anything to do with them. (Firm #39, Personal interview, August 2001)

Differently from this businessman, some other business owners actively seek out contacts with bandits. Criminal groups with whom a firm forms a partnership are commonly called a "roof" (*krysha*). The term originated in the professional vocabulary of the intelligence service where it meant an official cover-story for a spy (Volkov 2000, 493). Although it can be used to refer to any persons or groups of people that actively protect the interests of a firm<sup>45</sup>, but who are not actual employees of the firm, it most commonly refers to criminal gangs.

The owner of a real estate agency says he started looking for a "roof" of a criminal kind when he decided to open his own firm, because "in our business, you need one". He found one through a friend of a former colleague. He says he is very happy with their collaboration, his "roof" proved itself very useful. "There are lots of problems in our business," - he says. - "Like a person signs a contract to sell an apartment, takes money,

---

<sup>45</sup> Since the term is entirely unofficial, its usage is hardly precise. State officials like a police official, a city hall bureaucrat, or a tax inspector, are as likely to be called a "roof" as a protection agency or a criminal gang that are hired to protect firm's interests. The main criterion is the ability to help entrepreneurs in one way or another, be it a credible threat of violence, or an unexpected tax revision against a debtor or a competitor. Observers have noted that the latter is becoming more and more common (Radaev 2000, Morozov 2002).

and then refuses to vacate the premises. If you try to sue him or her, that will take years, and no one has this kind of time. So we need speedy solutions, a team that can get to that person and ‘explain’ that it is time to go. In 90% of cases my ‘roof’ uses psychological pressure, and only maybe in 10% physical violence” (Firm #43, Personal interview, August 2001).

He still tries to avoid using them too much, he says. Although the times when bandits used to routinely take over firms that they initially “protected” are gone, there is still a danger that it can happen. This danger makes him very sensitive to the amount of information he is willing to disclose to his ‘associates’:

If I can cope myself, I do not request their help. A few years ago, it was typical that a ‘roof’ would appoint their own accountant to a ‘protected’ firm, and then it was only a matter of time before they would fully take over. But I realize that even without an accountant my ‘roof’ can show up one day and ask me ‘Who are you here?’.

Question: How frequently do you need their help in solving problems?

Answer: Lately not that often. Mostly people have problems when they just open, when no one knows you, and people ‘probe’ you. When you are in business for a few years, it tends to diminish. When I just opened my firm, I had problems all the time. Even a year ago I had to use my ‘roof’ once a month at least. Now it is much more rarely, I think last time I used their help was half a year ago.

Question: But do you still meet these guys regularly?

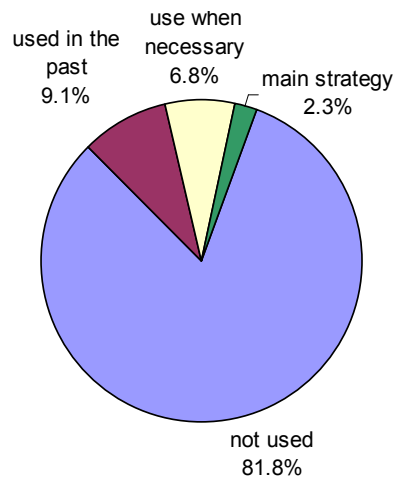
Answer: Of course, we socialize. I like them, they are not as thick as most people in their business. I play pool with them. (Firm #43, Personal interview, August 2001)

The above-quoted owner of a business firm is a young man with a good education who did not used to have anything to do with the criminal world. His decision to recruit a criminal group was a calculated choice based on the information he possessed about how things work in his chosen area of business. Before opening his own real estate firm, he worked in the real estate business for a number of years, and knew about potential

problems that a business owner can encounter in this field. He would be very happy to terminate his relationships with the criminal gang, he says, but so far the advantages of using it outweigh the risks. He does not see any possibility of things changing in the near future either, he says, the judicial system is in too big a mess for it to become useful to businessmen like him any time soon.

#### ***4.2.4. Usage of the strategy among studied firms***

A number of questions were used to determine the frequency of usage of this strategy by participants of my study. First and foremost, the questions #4.1.5.3 (“*[Have you ever] hired someone who can physically threaten the violator, [to use violence against a dishonest business partner, to obtain redress, or force them to comply with the terms of a contract]?*”) and #4.1.3.3 (“*[Have you ever] asked friends or relatives who can physically threaten the violator [to use violence against a dishonest business partner, to obtain redress, or force them to comply with the terms of a contract]?*”) were used to determine if this strategy was ever used by a firm; and if yes additional questions were asked to clarify the circumstances. Figure 4.2.1 shows that the majority of studied firms have never used this strategy, and only a few firms currently use this strategy to address their enforcement problems:



**Figure 4.2.1.** Usage of Threat of violence by criminals as a strategy of contract enforcement, among studied firms (n=44).

The eight firms that admitted having used this strategy are evenly spread across different sectors of the economy, they were all organized in different time periods, they are of different sizes, and some of them have management with Soviet experience. Out of all explanatory variables only criminal involvement seems to have an effect on the probability of using enforcement by threat of violence by criminals<sup>46</sup>.

Whether it is indeed the nature of the business that is the decisive factor here, like the owner of firm #43 maintains, or the personalities of the firms' leaders, those firms that use the threat of violence for contract enforcement purposes, also become the victims of such threats. Question 4.8 of the questionnaire was designed to reveal if there is reciprocity in dealings with the criminal world, and the analysis of the interviews suggests that indeed there is. Out of eleven firms (25.6%) that have been threatened

---

<sup>46</sup> Correlation between criminal involvement and usage of criminals for contract enforcement purposes has a coefficient = .277 (Kendall's tau\_b), and .284 (Spearman's rho), significant at the .05 level, 1-tailed (due to small sample size, non-parametric correlations were used). Correlation coefficient shows that firms that have criminal involvement on the level of investment or personal connections of upper management are significantly more likely to use criminals for contract enforcement purposes than firms without criminal involvement, within the given sample.

because of contractual obligation not being fulfilled, six resorted to threats of violence themselves; the correlation is statistically significant at the 0.01 level<sup>47</sup>.

In conclusion, it has to be said that while enforcement by threat of violence by criminals is undoubtedly the most primitive and repulsive form of enforcement in the contract enforcement repertoire available to business people in Russia at the moment, many business people still choose to use it despite the risks involved. Two patterns of its use were discussed: one is very occasional, as a last resort when no other means seem to work; and the other is a long-term partnership that a firm in a particularly high-risk business area forms with a criminal group to receive contract enforcement services on a regular basis for a monthly fee and additional payments for debt recovery and dispute resolution. In both patterns entrepreneurs are aware of the risks involved in dealing with criminals, and often are reluctant to use their services, but deem the alternatives to be catastrophic for the survival of their businesses.

---

<sup>47</sup> Correlation between usage of criminals for contract enforcement purposes and having been threatened at least once has a coefficient = .378 (Kendall's tau\_b), and .389 (Spearman's rho), significant at the .01 level, 1-tailed.



### **4.3. Arbitration by mutually agreed upon powerful individuals**

Arbitration by mutually agreed upon powerful individuals emerged as a contract enforcement strategy during the field stage of data collection. Consequently, there is no sufficient evidence to suggest how widespread it might be without substantial additional research; therefore, the analysis offered here has a tentative and heuristic character. There were only two instances where this strategy came up in conversations with managers whose firms had used it in the past, although it was mentioned by a number of other managers as a strategy they heard of but did not have any first-hand experience with. It would have been logistically difficult to incorporate this new information into the existing questionnaire. However, as a separate contract enforcement strategy, arbitration by powerful individuals appears to be both too analytically interesting and strikingly different from other strategies to ignore it as an odd case.

Arbitration is a private dispute resolution process in which the parties agree to take their dispute to a neutral third party for a decision, and to abide by this decision, rather than litigating the dispute through the formal courts. It is a common strategy of dispute resolution in non-capitalist and early capitalist societies, and it functions on the premise that impartial observers could decide issues that the disputing parties could not resolve themselves. There is a vast literature on how arbitration was developed by medieval merchants who preferred to refer to other merchants to help resolve contractual disputes rather than rely on expensive, complicated and often partial formal legal system (Jaffe 2000; Argenti 1958; Greif and Kandel 1995).

In Soviet Russia, private arbitration was widespread in the criminal world. Disputes among criminals or criminal groups were often brought to criminal authorities for so-called *treteiskii sud*, or trial by a third-party<sup>48</sup>. With the beginning of perestroika and the collapse of the Soviet institutional and normative structure the boundary between the criminal world and new business world became thin. Criminals, old and new, brought into business not only their money, but also their methods of dealing with problems, including *treteiskii sud* by criminal authorities. With former criminals resurfacing from the underground *en masse* in the end of 1980s, both the business world and that of public service found themselves infiltrated by people with questionable pasts and suspicious affiliations (McDaniel 1996; Konstantinov 1997; Klebnikov 2000).

There is no way of knowing exactly how frequently business disputes were resolved via unofficial arbitration by powerful personalities. We can however infer from the known and well-documented examples of usage of private arbitration in pre-capitalist and early capitalist societies that its effectiveness depends on a number of factors. Parties that request unofficial arbitration agree to be bound by the arbitrator's decision because of the respect they feel for his personality and/or his position. The position of an arbitrator would often carry not only social prestige, but also real power to interfere with someone's business. In the modern Russian context, such a figure could be a prominent official in a local administration, a chairman of a trade association, a powerful mobster or a well-connected banker. Consequently, the non-compliance with the arbitrator's decision could be very damaging, if not lethal, to the reneging party's business.

---

<sup>48</sup> Not to be confused with the government licensed private courts that are also called *treteiskii*, but that operate legally since the beginning of 1990s. See section 3 of the next chapter.

In my research only two respondents indicated that the firms they worked for had resorted to this strategy. The executive manager who runs an advertising firm says that they occasionally use this contract enforcement strategy when they have disputes with their clients:

There is a professional association of advertising makers in St.Petersburg, and they do dispute resolution on demand. We contacted them a number of times when we had disputes with our clients. The association sends a competent and well-respected person to serve as a *treteiskii* judge in our dispute. Both sides voluntarily agree to abide by this person's decision. (Firm #4, Personal interview, July 2002)

Another respondent who reported the strategy in use - a manager from a business consulting firm - had not been working for the firm long enough to know the details: who the arbitrators were, under what circumstances their services were requested and what the remuneration was. The respondent was only able to report that one of the arbitrators that the firm periodically used was the governor of St.Petersburg (Firm #7, Personal interview, July 2002).

A number of other respondents said that they "have heard" of private arbitration as a way of resolving disputes between firms, but could not report any knowledge as to how the strategy operated. Most of these respondents associated the strategy with criminal involvement of either the disputing parties, or arbitrators, although without any real life examples to support it. Consequently, it is reasonable to suggest that such an opinion among Russian business people can be based on stories in the media of questionable accuracy rather than on concrete evidence.

#### 4.4. Threat of punitive actions by state officials

Grassroots corruption (*blat*<sup>49</sup>) was ubiquitous in socialist societies. The economy of short supply and great demand provided an excellent breeding ground for it. In everyday life people routinely exchanged favors to obtain everything – from food to good grades in college to family vacation packages (Ledeneva 1998). Connections also played a crucial role in economic exchange among enterprises. The success of an enterprise and its management with reaching output targets set by a five-year Plan depended on timely supply of the necessary raw materials, something that was far from certain in the economy of shortages (Berliner 1957; Randall 1997). Soviet managers had to be skilled in establishing the right kinds of connections at the level of fellow management from other enterprises, but mainly at all levels of communist party administration, if they wanted to keep their jobs:

Plans could not normally be fulfilled by formal means. As remarked by Mikhail Yarikov, famous for his sarcastic observations: ‘in the fourth year of a five-year plan, *blat* is decisive in fulfilling the plan.’ Enterprises either negotiated the planned targets or had to engage in informal efforts to obtain extra resources. The system of relationships with suppliers, mutual trust and support between partners were the practical necessity for the functioning of socialist production. (Ledeneva 1998, 86)

The system of *blat* collapsed together with the socialist system of distribution, undermined by the free-market reforms at the beginning of the 1990s. However, the moral permissiveness of exchange of favors that had permeated socialist society

---

<sup>49</sup> A.Ledeneva defines *blat* as “the use of personal networks and informal contacts to obtain goods and services in short supply and to find a way around formal procedures” (Ledeneva 1998, 1).

remained, albeit shorn of its Soviet-era mask of friendship. To paraphrase the classic, in modern Russia the spirit of nascent capitalism developed an elective affinity with the [a]morality of *blat*. Not only goods and services can now be sold or bought, but favors, as well.

How can favors for sale translate into contract enforcement for small firms? There is a multitude of ways in which state institutions can affect a business in a negative (or positive) way. Health inspection can always find a reason to shut down a café or a restaurant; fire inspection can find a violation and shut down a manufacturing enterprise, and tax inspectors have the authority to seize assets of a firm for “inspection” for an indefinite length of time even for a minor book-keeping mistake. Even a police officer can instill enough fear to pressure management of the offending firm to comply with the terms of an agreement<sup>50</sup>. The owner of a construction firm says that when he has problems with contract enforcement his policeman friend contacts the offender and “asks” them to live up to the agreement (Firm #2, Personal interview, June 2002). Non-compliance with such a “request” is rare, the respondent says.

Tax inspectors and the tax police are particularly feared by Russian entrepreneurs. A powerful and vindictive version of enforcement is “to set the tax inspectors” on a firm. With his advance to power in 1999, President Putin made an effort to increase tax revenues, and in the following years tax inspection has become one of the most powerful structures in the contemporary Russian state, especially, in large cities like St.Petersburg and Moscow. Raids by tax police, who can arrive without any warning, in masks and with machine guns, can easily end with the management in jail, the firm’s activity halted

---

<sup>50</sup> See Appendix 2 “Luba’s story” for some additional examples.

and assets confiscated. Many of the raids are triggered by a phone call, or a letter from a competitor or disgruntled client of the firm<sup>51</sup>. Bribing tax inspectors to conduct an extra careful inspection of a firm is also not uncommon.

One interviewee reported a particularly ingenious solution that a firm she worked for found to deal with enforcement (and other kinds of) problems:

This firm only appeared two years ago. And now they are leading in the area of advertising banners manufacturing, no one can compete, or would risk a conflict with them. How did they achieve this? They paid a huge bribe to the City Center of Advertisement Placement, made friends there. Then they hired the son-in-law of the director of the Center to be the director of their firm. Smart move. Now he walks around, does not understand a thing about what they do, but has a salary and status. And the real director – the owner of the firm – is officially unemployed. But he does drive a Mercedes (Firm #32, Personal interview, June 2001).

It has to be understood that the City Center of Advertisement Placement is perhaps of little importance to many firms, but for firms involved in advertising it is omnipotent. It distributes rights to advertisement placement on the streets of St.Petersburg to various firms, in theory on the grounds of fair competition, but not in practice. The interviewee claims the firm she works for now has a virtual monopoly on the most lucrative streets of St.Petersburg, due to its connection to the director of the Center. This connection is quite instrumental in the firm's contract enforcement strategy, as well, she says.

The owner of a firm that manufactures advertising posters says he only used his connections once to recover a debt: "The sum of money was really large, so I could not just let it go. I happen to have some acquaintances in the government in Moscow, and I had to ask them to do us a favor and help with the debt recovery. They successfully

---

<sup>51</sup> For an illustration, see the Appendix 2 "Luba's story".

settled the matter, and we paid them with our services” (Firm #24, Personal interview, July 2002).

Those firms that work with large post-Soviet enterprises and that are lucky to have influential acquaintances in Moscow, still can use “Soviet-style” types of pressure to handle a debt situation. The respondent from a firm that develops geophysics equipment says about the owner of the firm:

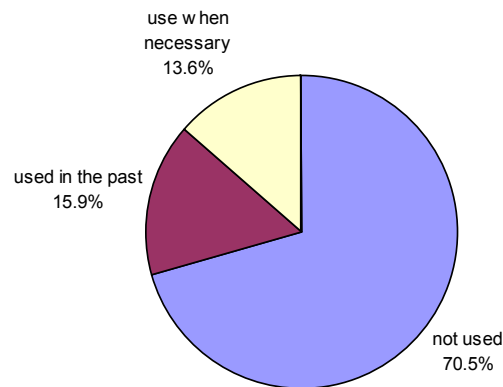
If something goes really wrong, my boss can always pressure the offender through his connections in the Ministry. He has lots of connections, from his old job. He used to manage a large enterprise before perestroika, and knew all relevant people in Moscow. Many of them are still there. Our clients are all large enterprises, and they are very dependent on the government. Although the Ministry does not have its former power, it still is essential to the survival of those enterprises. It distributes state orders and allocates loans (Firm #9, Personal interview, July 2002).

The respondent says that most of the time they manage to sort things out peacefully, and it is rare that his boss has to “pull strings” in Moscow. Such favors have a steep price, the respondent says, and the owner of the firm cannot really afford it.

Answers to a few questions from the questionnaire were used to determine frequency of usage of this strategy. Question #4.1.3.1 asked whether a firm’s decision makers ever contacted a friend or a relative who works in a state agency to help to pressure a business partner in case of a conflict. Question #4.1.5.1 asked whether a firm’s decision makers ever paid a state official for unofficial help in solving problems with business partner. Question #4.11 helps to assess the possibility of using this strategy in the future by asking whether or not a firm has connections in tax inspection, state inspection organs, city administration or other public organizations, and whether these connections potentially

could, or even were in the past (question #4.12) exploited to exert pressure on a business partner in a conflict situation.

Overall, I found fewer instances of using this strategy than I expected. Respondents from only six firms said that they resort to using state officials to pressure an offender, most frequently to recover a debt. Figure 4.4.1 shows that another seven firms (16% of studied firms) used this strategy in the past, but indicated that it is unlikely they will use it again:



**Figure 4.4.1.** Usage of Threat of punitive actions by state officials contract enforcement strategy among studied firms (n=44), in %.

Almost a third of interviewees said that they have the ‘right connections’, without implying that they ever intend to use them for enforcement purposes. Firms that use, or used, the Threat of punitive actions by state officials as a contract enforcement strategy capitalize on different kinds of connections with different results. They can bribe low-level officials from state regulatory organizations to conduct unscheduled check-ups and then bury the offender in fees and fines; or they can use high-level state officials to threaten the offender in various ways. The use of this strategy among the studied firm has occasional rather than regular character; no firm uses “ties to state officials” as the main



contract enforcement strategy. No explanatory variable out of the five suggested seems to be an effective predictor of the probability of the strategy's use.

It appears that the Threat of punitive actions by state officials is more a relic of the past for small firms than a viable alternative to other available contract enforcement strategies. By no means do I want to imply that corruption is on the decline in Russia; in fact, quite the contrary is likely to be the case, as other research shows (Sergeyev 2001; Radaev 1998; Levin and Satarov 2000; Khlebnikov 2000). But small firms seem to be much less engaged in building alliances with state structures than more weighty economic players. The overarching impression that I received from my interviews is that small entrepreneurs have neither the resources, nor desire to get involved with state officials any more than it is absolutely necessary. I will discuss the issues that entrepreneurs have with state institutions in more detail in chapter 6.

## 4.5. Financial tools

Most small business owners and managers I interviewed do not like taking risks. Their businesses operate in a fragile balance between the liquid resources that come in and go out. Any unforeseen expense puts an immediate strain on this balance, and one unpaid debt can push a firm into a bankruptcy. Lack of reliable information about trustworthiness of other economic actors and widespread dishonesty put business owners and managers in a very difficult position of having to make badly informed decisions regarding the choice of their business partners. The risks taken by suppliers and customers are perceived to be uneven: “the customer’s ability to pay is much more difficult to ascertain than the supplier’s ability to produce” (Hendley, Murrell, and Ryterman 2000, 639).

Most suppliers opt for minimizing risks of potential loss, even if it comes at the expense of limiting the number of business partners and business transactions. The simplest and by far the most common way to achieve this end is to require up to a hundred percent pre-payment. The owner and manager of an advertising firm describes the policy of his firms toward new clients:

Question: What guarantees are you looking for to start working with a first-time client?

Answer: If we don’t know anything about this firm, they came as we call it “from the street” [= *was not introduced by someone known and trusted*], then we require 100% pre-payment.

Question: How do you process the next order from this new client?

Answer: If the first time went well, the payment was timely, and the order is of significant size, we may reduce the amount of pre-payment to 60%, occasionally even to 50%. But not less. (Firm #31, Personal interview, August 2002)

Respondents who use pre-payment as a warranty against default on contractual obligation stress that the amount of required pre-payment depends on the level of personal trust they have toward their customers. As trust grows with the experience of working together, the amount of pre-payment goes down. Thus prepayment serves as a safe-guard strategy in dealings with new firms, while trust of Information and the closed exchange networks strategy is used to deal with old-time customers. This type of combination of two strategies is quite common. An interviewee from a firm that designs and manufactures radiology equipment explains how their system works:

Question: How much pre-payment do you normally require?

Answer: When we begin to work with a new client, we always require 100% pre-payment. The first transaction is actually very important; we look at how people pay, how they communicate with us. If we like them, we decrease the amount of pre-payment, gradually, in subsequent transactions.

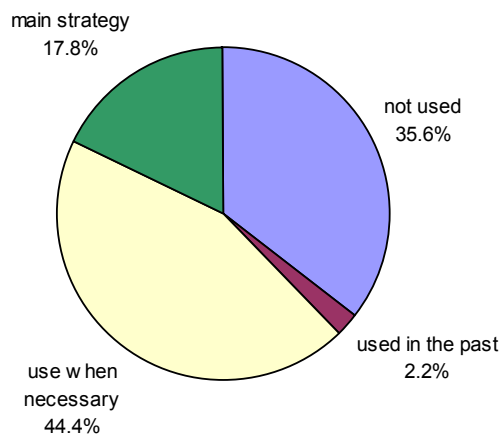
Question: You decrease it to zero?

Answer: No, we have standard pre-payment of 30% with our established and reliable clients. However, if we ever experience problems with payments of the remaining 70%, in the next transaction we will require 100% again. (Firm #42, Personal interview, August 2002)

If a firm is not capable of paying up-front in full, some firms may agree to accept collateral (Firm #27, Personal interview, August 2002), but it is not common. Most respondents stressed that they use different approaches with different clients. The amount of pre-payment is rarely rigidly preset, as described by the respondent quoted above. Most often, the amount of requested prepayment would vary from client to client, and even from transaction to transaction. Customers who make larger orders will typically be requested to pre-pay a smaller percentage of the total. Older customers who are perceived as more reliable tend to enjoy smaller, if any, pre-payments. Thus this strategy stands in opposition to the networks strategy in its inherent lack of trust. It is interesting to note, however, that trust does not preclude business partners from breaching the agreements:

the majority of respondents complained about delayed payments, non-payment problems, and breaking of the terms of delivery. Clearly, if first-time customers are usually requested to make 100% pre-payment, firms experience problems with those customers who are considered to be “trustworthy”. Some of the interviewees complained that the worst damage to their firms was done by business partners whom they considered to be the most reliable, with whom they worked together for significant period of time and whom they fully trusted (Firm #1, Firm #9).

There were two questions in the questionnaire that helped determine the frequency of usage of the Financial tools strategy: question #2.5 (“*How do your business agreements with your clients and suppliers look in terms of required prepayment? [If prepayment is required, how much?]*”), and question #7.12 (“*How do you establish relationships with new firms? [A firm is put on a ‘trial period’ with special conditions (100% prepayment)]*”). Answers to these questions served to evaluate the usage of this strategy among the studied firms. Figure 4.5.1 shows the distribution using four-point qualitative scale:



**Figure 4.5.1.** Usage of Financial tools contract enforcement strategy among studied firms (n=44), in %.

Almost two-thirds of interviewed firms' representatives said that their firms rely on the Financial tools strategy to protect themselves against potential loss due to non-payment, delayed payment or other violations of contract. It is interesting to note that business owners and executive managers with higher education tend to choose this strategy over others<sup>52</sup>. Firms that have little or no possibility of using this strategy are mainly engaged in certain kinds of production, in the retail trade and in public catering; they take products from suppliers and pay suppliers back when the products are sold. Virtually every firm that can require pre-payment due to the nature of their activity does so, and 42% of all studied firms require 100% pre-payment when they deal with new customers. Business owners and manager stressed that the advantages of the financial tools strategy in loss prevention and its ease of use far outweigh any drawbacks: reduced turnover by limiting the number of potential customers.

---

<sup>52</sup> Correlation between level of education of firms' decision-makers and usage of Financial tools strategy for contract enforcement purposes has coefficients = .433 (Kendall's tau\_b) and .461 (Spearman's rho), significant at the .01 level, 1-tailed (due to small sample size, non-parametric correlations were used). Correlation coefficient shows that the higher the level of education of decision-makers is (ranked from high school diploma to graduate degree) the more likely they are to select this strategy as their main contract enforcement strategy.

## Conclusion

The proliferation of non-state strategies of enforcement among small firms has both positive and negative consequences for inter-firm and state/firm relationships. The main positive feature is that these strategies of enforcement make transactions possible. Among the negative consequences are the institutionalization of non-market relationships and the weakening of the state. I will discuss the general implications of non-state strategies of enforcement for the development of capitalism in Conclusion; here I will show some implications that they may have for relationships between small firms, and between the state and small firms.

The formation of information and closed exchange networks as an enforcement strategy makes entrance and exit a much more complicated process, preventing the development of healthy competition among firms. While on the one hand trading with only a fixed group of partners decreases transaction costs by minimizing information and enforcement expenses, on the other hand it does not create incentives for improving economic performance, and blinds firms to the possibility of better choices of trade partners which the market might have to offer. Closed exchange networks frequently evolve out of personal friendship, and can take years to form. To enter such a network is a very difficult task for a new firm. Information networks, on the other hand, are looser, and perform a function undertaken by credit rating agencies in developed capitalist societies. Exchange and information networks help small firms to survive in the world of an unstable economy and political chaos.

This enforcement strategy may also impact negatively firms' relations with the state. Self-enforcement by networks of trading partners makes managers view the state as an

irritating nuisance rather than a useful third party which can be referred to when needed, and corrupt officials further erode managers' trust in the state's fairness and impartiality.

The threat of violence by criminals works by creating a temporary or permanent "enforcement partnership" between businesses and criminal groups. This contract enforcement strategy brings criminal methods into the business conflict resolution process, ultimately giving advantage to those who can intimidate and spread violence. By violating most fundamental laws and norms set by the state this strategy of contract enforcement demonstrates the utter contempt for the power of the state and legitimacy of its authority. For all parties involved, the trust in the state's crime fighting abilities is eroded.

Arbitration by mutually agreed upon powerful individuals serves a positive function for business people involved in that it gives them an option in resolving their disputes. They may choose this strategy over state courts for numerous reasons, such as privacy, price and speed of resolution.

Informal ties between managers and government institutions are rarely visible to a firm's trade partners. Enforcement through the favors of corrupt officials lacks legitimacy and predictability, often complicating the exchange instead of facilitating it. Transaction costs as a result grow dramatically. Business owners and managers identify corrupt state agents with the state as an institution, their trust in impartiality and fairness of the state wanes. Corruption of state officials also eases tax evading<sup>53</sup>.

---

<sup>53</sup> There is a statistically significant correlation between using Ties to state officials as a contract enforcement strategy, and percent of concealed revenues to avoid taxation: coefficient = .231 (Kendall's tau\_b) and .277 (Spearman's rho), significant at the .05 level, 1-tailed (due to small sample size, non-parametric correlations were used). Correlation coefficient shows that firms that use connections to state

Financial tools used as an enforcement strategy, like prepayment, restrict entrance of new firms to the market by demanding extra resources, which start-up companies often lack. But at the same time, such measures may promote competition. This strategy also appears to be chosen by most law-abiding entrepreneurs: the level of tax paying among those who use Financial tools as their main contract enforcement strategy is significantly higher than among those who do not use this strategy<sup>54</sup>.

To sum up, the major negative consequence of firm-based strategies of contract enforcement for inter-firm relations is the serious entrance restriction they present to new firms. All discussed strategies disadvantage new firms because they may lack social capital to participate in the information and closed exchange networks; have no connections to state institutions, powerful individuals and criminal groups; and have inadequate financial resources to provide full prepayment for every service they need to purchase.

Table 4.1 summarizes characteristics and origins of each firm-based contract enforcement strategy, shows what types of firms tend to use this strategy, and lists the implications it has for infirm and firm-state relations.

---

officials for contract enforcement are likely to conceal a higher percentage of their revenues from tax authorities than firms that do not use this strategy, within the given sample.

<sup>54</sup> The correlation between using Financial tools as a main contract enforcement strategy, and percent of concealed revenues to avoid taxation is negative: coefficient =  $-.231$  (Kendall's tau<sub>b</sub>) and  $-.268$  (Spearman's rho), significant at the .05 level, 1-tailed (due to small sample size, non-parametric correlations were used). Correlation coefficient shows that firms that use Financial tools as a main contract enforcement strategy are likely to conceal smaller percent of their revenues from tax authorities than firms that do not use this contract enforcement strategy, within the given sample.



**Table 4.1. Summary of characteristics, origins and implications of firm-based enforcement strategies.**

FIRM-BASED ENFORCEMENT STRATEGIES	CHARACTERISTICS OF STRATEGY	ORIGINS OF STRATEGY	FIRMS USING STRATEGY	IMPLICATIONS FOR	
				INTERFIRM RELATIONS	FIRM/STATE RELATIONS
1. Information and closed exchange networks.	Business-to-business relations; trust, reputation and threat of sanctions are the keys to enforcement.	Russian values of collectivism reinforced by Soviet-style “survival networking”.	Small firms that were organized in the early 1990s and that do not have criminal involvement.	(-) Restricts entry and exit; (+) gives stability and predictability to exchange.	(-) The strategy is resorted to because the state is perceived as incapable of guaranteeing protections.
2. Threat of violence by criminals.	“Enforcement partnership” between businesses and criminal groups.	Underground criminal world methods of the Soviet time.	Firms with criminal involvement on the level of investment or personal ties.	(-) Brings criminal methods into the business environment	(-) Inherent opposition to the power of the state in its disregard for the law; erodes managers’ trust in state’s crime fighting ability.
3. Arbitration by mutually agreed upon powerful individuals.	Respect for the personality and position of an arbitrator ensures enforcement of his decisions.	Norms of pre-perestroika criminal world.	Insufficient information.	(+) Gives an option in resolving disputes.	(-) The strategy is resorted to because the state courts are perceived as less efficient.
4. Threat of punitive action by state officials.	Business-to-governing institutions, unofficial ties; used for information and enforcement favors.	The Soviet economy of shortages brewed grassroots corruption ( <i>blat</i> ) and reinforced pre-existing norms of corruption.	Insufficient information.	(-) Corruption introduces non-market ways of competition, makes difficult to predict outcomes.	(-) Provides ease of evading; erodes firms’ trust in fairness and impartiality of the state.
5. Financial tools (prepayment, ‘hostages’).	‘Arm’s length’ business-to-business, based on competition relationships.	Desire to minimize losses due to non-payment or other violations of contract: withhold work until payment received.	Most firms that can use it due to the nature of their activity.	(-) Restrict entrance by demanding extra resources; (+) promotes competition.	(-) The strategy is resorted to because the state is perceived as incapable of guaranteeing protections.

## Chapter 5: EXTRA-FIRM ENFORCEMENT STRATEGIES

### Introduction

This chapter will discuss four strategies of contract enforcement that are widely available to all firms in the marketplace, origins of institutional forms that they took, and the patterns of their use by small Russian entrepreneurs from my sample. In the end of this chapter, an additional section will outline complementarities among all nine contract enforcement strategies, and give a general summary of their use by Russian entrepreneurs.

The strategies in the focus of this chapter include professional associations, private protection agencies, private arbitration (*treteiskii*) courts, and state *arbitrazh* courts. These strategies provide contract enforcement services for a fee: professional associations require membership fees, protection agencies collect monthly fees and separate fees for each contract enforcement service performed, and both private and state courts charge numerous fees for dispute resolution.

While the presence of alternatives in the contract enforcement services market is certainly a positive thing, how much the four strategies are actually in competition can be questioned. As the analysis below will hopefully demonstrate, each of the four strategies has a very different way of operating. Professional associations are really just formalized networks, and their enforcement tool is the threat of exclusion from future transactions with association members. Protection agencies have various means of achieving their goals, from (decreasingly) reliance on physical violence to (increasingly) usage of their own networks among agents of state and non-state institutions. Finally, the private

arbitration court is a formal version of the arbitration by mutually agreed upon powerful individuals, although just like state *arbitrazh* courts they rely on state enforcement power to enforce their rulings.

two types of courts are best at addressing different kinds of problems with contractual obligation.

The chapter is structured in the same way as the chapter 4. Each contract enforcement strategy is explained in the words of the respondents, and the origins of the various strategies are described. The data on frequency of strategies' usage among the studied firms is presented in the same manner as in the chapter 4.

## 5.1. Professional associations

In Weber's definition, professional associations belong to the category of "economically regulative organizations" that seek to regulate both the ends and the procedures of economic activity (Weber 1999, 210). They do so by collecting and disseminating information, promoting high professional standards, advocating cooperation, imposing sanctions, and providing various types of assistance to its members.

In the present work, I am particularly interested in the contract enforcement capabilities of professional associations. There are well-researched historical examples of professional associations functioning as an important, if not exclusive, contract enforcement institution. For example, Greif (1993) in his research of eleventh-century Mediterranean trade shows how a coalition of Jewish merchants (known in the Arab world as "Magribi traders") established contractual relations with their agents overseas. If an agent violated an agreement with a merchant, the whole association would react against him by ostracizing him. It was essential for the success of sanctions that all merchants would join in.

A study of merchant guilds in the late medieval period by Greif, Milgrom, and Weingast (1994) provides another illustration to how a professional association can be a powerful contract enforcement institution. This institution evolved as a response to serious security problems faced by foreign merchants in medieval European trading centers, when local rulers could at will abuse or withhold legal protections from foreign merchants. Merchant guilds were able to solve this commitment problem by coordinating

the responses (typically, an embargo) of a large portion of the merchants to an offence. Merchant guilds represented the legal rights of their member merchants in all communications with local rulers; they provided merchants with leadership and the strategies of information transmission.

In the course of the development of capitalism in Western European countries, other institutions have emerged that took upon themselves enforcement functions of formal professional associations. However, in post-Soviet Russian capitalism professional associations once more perform the role of contract enforcers. Among the forty-five firms that I studied, four firms used professional associations to help them solve contractual disputes. Two of these four used this contract enforcement strategy only once in the past, and are not members of any professional association. They appealed to an association that the party they had a dispute with was a member of (firm #7 and firm #42). The other two firms are members of professional associations, and quite frequently resort to the association's help. The executive manager of a firm that sells beer and soft drinks explains how the association his firm is a member of works:

There is this association of firms that sell alcohol, in St.Petersburg. If some firm ever fails to pay to a firm that is a member of this association, or breaks a contract in other way, no other firm from the association will sell its goods to this firm. This is a condition of a membership in our association. Almost 90% of firms that sell alcohol in St.Petersburg are members of the association. (Firm #13, Personal interview, July 2002)

The interviewee makes it clear, however, that in case of non-payment the association has no ways of making the offender pay. The most it can do is withdraw the business of its members, and this strategy is certainly effective for those firm owners who came to business with honest intentions and long-term plans. But clearly it cannot be effective

against dishonest opportunists whose main goal is to rip short-term benefits and disappear.

Another function that professional associations perform is dispute resolution. The executive manager from an advertising firm says that her firm repeatedly used the Association of Advertisement Makers in St.Petersburg for dispute resolution with their clients. As a rule, both disputing firms would agree to abide by a decision of the association representative, the interviewee says (Firm #4, Personal interview, July 2002)<sup>55</sup>.

Despite such essential services that professional associations can offer to their members, their popularity among entrepreneurs remains quite low. Apart from four respondents whose firms used this strategy already, only four other said they knew about existence of professional associations in their area of business in St.Petersburg, and thus potentially may become members and use professional associations for contract enforcement purposes in future.

The Leontieff Centre of economic and sociological research evaluated in 1999 that only about 6% of small firms in St.Petersburg were members of any association at that time (quoted in Kihlgren 2001, 462). One possible explanation is historical weakness of civil society in Russia. Under the Soviet regime, various associations and voluntary organizations were typically not initiated from the grassroots level, but instead instituted from above, by party authorities at various levels, and were considered important tools of Soviet propaganda. Even though nowadays associations can be completely different from those of the Soviet epoch, the average Russian entrepreneur is still reluctant to trust them.

---

<sup>55</sup> This case is discussed in more detail in the section of informal arbitration of chapter 4.

## 5.2. Private protection firms

### 5.2.1. *The beginning of private protection firms*

In the period of time between 1992 and 1993 the Russian state voluntarily gave up its monopoly on the means of violence by legalizing private security firms and private protection agencies. It happened partially as a result of structural pressures from within the state institutions themselves, and partially because protection agencies had already existed *de facto* for a number of years. The structural pressures mounted as the restructuring of state security services continued throughout the beginning of 1990s, spurred by both popular demand and fiscal crisis that made it difficult for the state to pay the salaries of an army of special service agents. In just a few months between September 1991 and June 1992 more than 20,000 officers were discharged or left the service, and many others left before and after this time. All these specially trained agents needed employment. New laws allowed private agencies to sell protection and security services, informational support, dispute resolution, and contract enforcement (Volkov 2000, 485).

Private protection agencies that existed *de facto* before these laws were passed were by and large criminal groups that infiltrated the business environment of St.Petersburg at the end of 1980s and brought in the practice of using force in business relations. Many of the first Russian private business owners had been operating in a shadow economy before private business activity was legalized, and they often had fallen victims to organized criminal groups who would extort payments from them under the threat of violence. As private businesses were moving from the shadow economy to more open and legal forms

of activity, so did criminal groups (Volkov 2000, 2002; Radaev 2000). Eventually they started offering protection to those firms that they extorted money from, first from other criminal gangs, and eventually against the dishonest actions of other economic actors<sup>56</sup>.

Many such criminal groups were subsequently legalized by registering as either private protection companies, or private security services. In the six years between 1993 and 1999 the number of private protection agencies in Russia grew from 0 to 11,652, most of them concentrated in large urban centers. Some of them were former criminal gangs, some were composed of former athletes, and many of the agencies were headed, or even entirely composed of former KGB or other state law enforcement or military personnel. Overall, private protection and security firms employed nearly 50,000 former officers of the state security and law enforcement organs (Volkov 2000, 487-489).

The law, in fact, established the difference between the private security services, which could be set up by private and state enterprises and financial institutions for physical and economic protection, and the private protection companies, that could be set up as an independent enterprise. However, few Russian business people pay much attention to this distinction. Most of them, just like ordinary citizens and the media, refer to both types as “protection agency” or “protection service”. In this work I will discuss those protection agencies that are specified in the law as “private protection companies” because these are the ones that small businesses normally deal with. Small firms have neither the necessity, nor resources to form their own security services which thus remain outside of this analysis.

---

<sup>56</sup> Contract enforcement strategy Threat of violence by criminals is discussed in detail in chapter 4, section 2.



The discussion of private protection agencies is made difficult by the fact that they are not always clearly differentiated from criminal gangs engaged in the same business<sup>57</sup>, or that they may lose the state's license for some violation and still continue to operate. These factors make it hard to distinguish Private protection agencies as a contract enforcement strategy from the Threat of violence by criminals strategy. Many participants of my study who use the services of a protection agency were not able to tell whether their agency is officially registered, or not. To make the analysis possible, in differentiating the two I used the assumption that all mentioned private protection agencies are legal, state licensed entities, unless respondents would definitively state otherwise. This assumption is based on the general trend toward more legality and transparency in Russian business, noted by some experts (Volkov 2000; Hendley, Murrell, and Ryterman 2000).

Conceptually the relationship between private protection agencies and small businesses is in some aspects similar to those between criminal gangs and businesses, described in section 2 of chapter 4. Russian sociologist Vadim Volkov (1999, 2000, and 2002) calls this relationship an “enforcement partnership” which is a strategic alliance formed by agencies capable of violence, and entrepreneurs. Both criminal gangs and private protection agencies can be hired by entrepreneurs to perform debt recovery, contract enforcement, dispute settlement, and negotiations of various kinds, including those with state officials. Besides the obvious emphasis on the legality of private protection agencies and the illegality of criminal gangs, I distinguish between the two on the basis of availability, and methods of operation. Officially registered and licensed

---

<sup>57</sup> See Appendix 2 “Luba’s story” for an illustration of this point.

protection agencies typically make their services available to any potential client, while criminal gangs operate in much more closed and secretive manner. The method of operation of protection agencies will be discussed in the next section.

### *5.2.2. Private protection agencies as contract enforcers*

Interviews with business owners and managers reveal three major patterns of collaboration between private protection agencies and small businesses. In the first one a firm – typically a store or an office with some valuable equipment – hires a protection agency to perform basic security services. A protection firm supplies its client with a requested number of specially trained security personnel, usually for a flat daily rate, or provides a “panic button” that ensures a rapid response by security personnel in case of emergency. A café owner says that a contract with a protection agency is a necessary condition of operation of all cafes and restaurants that sell alcohol in St.Petersburg. He says that he hired a local protection agency that is police-based. They installed a “panic button”, and the owner pays them \$100 monthly for this service, although so far he did not need to use it (#44, Personal Interview, August 2002).

This type of arrangement has nothing to do with contract enforcement. Firms that need help with contract enforcement, debt recovery and help with negotiations in case of a dispute form an “enforcement partnership” with a private protection agency. This type of service entails a much more trustful and involved relationship than simple office security. Realizing that not only the life of their business, but sometimes their own life can depend on their enforcement partners, business owners say they rely a lot on the recommendations of someone they trusted when selecting a protection agency. The

executive manager from a firm that sells consumer electronics describes how his protection agency operates:

Question: You have on the door of your store a plate that says that this store is under protection of such and such protection agency. This agency also supplies you with these guys who work as security in the store?

Answer: No. The security guys I hire myself, they are either ex-police officers, or ex-military. They protect the store from you know, teenagers who want to steal a player, or the like. But what the plate says, that we are under protection, those guys “solve problems”<sup>58</sup>. They can create problems for those who created problems for us. They can, of course, “beat out” the money from a debtor, if they find him. If someone owes us and does not pay, they will find him and say “You owe money”. A debtor can say yes, I know, I will pay. Or he can say no, I disagree, and call his own protection agency. The most interesting thing, I think, is that when two protection agencies meet to represent the interests of their partners, they nearly always come to a consensus! It is like in the West they show in movies, where disputing parties send their lawyers to negotiate and try to settle. We have a similar thing here, although not with lawyers, but with protection agencies. They are not all gangsters, you know; in fact some protection agencies have regular lawyers on their staff. Although, from what I understand, they rarely use formal law in their negotiations, most of the time they rely on plain common sense. (Firm #23, Personal interview, June 2001)

In the third type of relationship between a firm and a protection agency the firm purchases the whole “package” of services, from office security to “problem solving” if necessary. The co-owner and executive manager of a firm that manufactures and sells hiking equipment says that they hired their protection agency at the very beginning of their operation, in 1992. At that time, he says, everyone needed to be affiliated with a protection agency, otherwise a firm would be constantly harassed by competing criminal groups. They found one after the recommendation of a friend in a police department, and worked with them ever since. At first, he says, they provided protection against both

---

<sup>58</sup> To “solve problems” is a common euphemism in Russian business vernacular that refers to contract enforcement, debt recovery, conflict resolution and other types of responses to activities that grievously hinder a firm’s functioning. The term frequently, although not always, implies illegal means of achieving a desirable outcome for the firm. Firms may hire external help to “solve problems”, or may have a special person in staff whose job is to resolve conflict situations.

criminal elements and dishonest partners, but now they only provide office and store security. The interviewee said that the owners prefer it this way; they fear the leverage that the agency can acquire if asked to help with debt recovery or other problems (#45, Personal interview, August 2001).

The first and the second patterns of firm-agency relationships are the most common. Interestingly, many firms hire one agency for office security, and another agency for “problem solving”. In looking for a security service, firms typically shop around for what’s cheapest, and this service is quite inexpensive: from a hundred to a few hundred dollars a month, depending on a level of security provided. “Problem solving”, on the other hand, is a much more expensive service, and the price, as several respondents noted, depends on the turnover of the client firm. Entering an “enforcement partnership” with a protection agency, a firm must be prepared to pay up to 1% of monthly turnover as a monthly fee, plus a bonus for each successful operation. The most common problem - debt recovery – costs a client from 30% to 50% of the sum in question (Firm #19, firm #43, firm #10, Personal interviews).

In the position of contract enforcers, protection agencies use different methods. Fewer and fewer agencies use brute force and the threat of physical violence in attempts to recover a debt or settle a dispute. The executive manager from a firm that sells beer and soft drinks says that methods of physical violence do not pay off for two reasons: first of all, the offender may simply not have money, so no amount of intimidation can make him repay the debt. Second, the offender may at any time contact the police and report threats of violence. With the general strengthening of state enforcement institutions in recent years, police forces are much more capable of causing problems for both business firms

and private protection agencies than a decade ago (Firm #13, Personal interview, July 2002). Few business firms perceive such risks as worth taking, and those firms tend to cooperate with criminal gangs.

A much more common method of contract enforcement used by protection agencies involves pressuring an offender through various state institutions (like tax or sanitary inspection), or non-state establishments (for example, commercial banks or professional associations). In this scenario, a protection agency has a wide network of useful contacts in state organs, like tax inspection, sanitary inspection, and city administration, and non-state organizations, like banks and professional association. Through these connections, a protection agency can create a credible threat of damage to one's business in a short time. The head of a finance department in a firm that sells computers explains in detail how their protection agency operates:

We typically sell computers wholesale on credit, to distributors. Sometime distributors stop paying. We check out if the debtor has money to pay, and normally they do. Such cases we pass to our protection people. We call them "roof", but in fact they are a protection agency. They are not criminals, and not former police or KGB, they are very well-connected people. Their main "weapon" are credible threats of the kind "it will be worse for you if you don't pay". They won't physically assault anyone, but kill their business through various inspections, check-ups and the like. It works marvels.

Question: Do you use their services often?

Answer: From time to time. Strangely, it happens more frequently with long-time customers, who probably think that because of good relationships we are just going to let it go. When we have an unpaid debt of over \$10,000 we always contact our protection people. If between \$5,000 and \$10,000 we consider contacting them, depending on the circumstances. If the debt is smaller, we usually don't bother.

Question: What if a debtor does not have any money?

Answer: If it is a good distributor, and he tells us honestly that he has problems, we try to help, sometimes giving additional credit. In any case, we won't pressure them to sell their personal property, or something, like some other people do.

Question: How effective is your protection agency?

Answer: Practically 100%. (Firm #10, Personal interview, July 2002)

The interviewee stressed that her firm deliberately stayed away from police-based and gangster-based agencies, whom they don't trust. They opted instead for a new kind of protection that uses their own firm-based enforcement strategies, most commonly ties to state officials. In effect such an agency serves as a middle-man who connects a buyer and a seller of a particular kind of service using their own extensive contacts. Thus a contract enforcement request entails three sets of negotiations for such an agency: negotiations with their client regarding the nature of the enforcement request, negotiations with appropriate state or non-state officials who can create problems for a debtor, and finally negotiations with a debtor.

There are virtually no examples in my study of protection agencies using threats of physical violence against an offender in the past three to four years. Most respondents describe it as a change from the beginning of the 1990s and attribute this change to two factors: an improved business environment, and strengthened state law enforcement agencies. The business environment improved in the sense that there are significantly fewer cases of premeditated non-payment, and also the fact that most firms that survived through the 1990s learned how to protect themselves against potential fraud. Strengthened law enforcement agencies provide a disincentive for open violations of the criminal code. Thus those business owners and managers who need speedy solutions based on the threat of violence choose criminal groups as their "enforcement partners".

Besides contract enforcement services, protection agencies are capable of a wide range of other services. The co-owner and executive manager of the firm that manufactures tents says that at first he cooperated with criminals who protected him

against other criminals. But when he encountered problems with tax inspection he had to look for a well-connected protection agency that could solve those problems. He found a police-based protection agency that had extensive connections with state inspection organs. “Today gangsters in Russia can only recover debts, and only some debts”, he says. “Police-based protection agencies can resolve any dispute with state inspection organs. The complexity of the problem will determine how much it costs. All problems are solvable, although some can be very expensive” (Firm #1, Personal interview, June 2002).

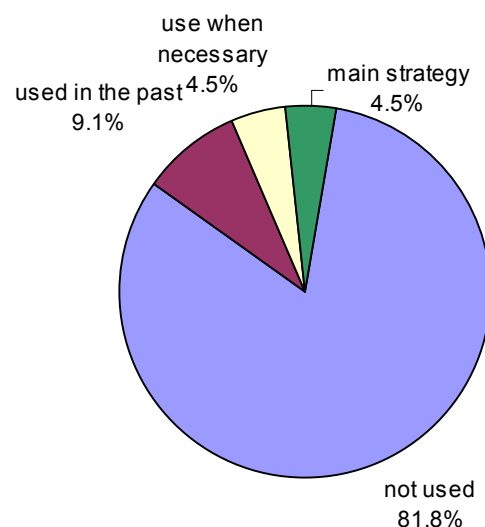
Sometimes private protection agencies can even be used to enforce court decisions. The co-owner and executive manager of an advertising firm recalls how one of his clients had to use their protection agency to enforce a court decision which was in their favor. The dispute was over premises, and judicial enforcers could not make the other party vacate them. Finally, the client of my respondent called their protection agency who arrived, broke in, caught the personnel of the other firm, showed them out and stood guard at the door until the transfer of premises was fully completed (Firm #31, Personal interview, June 2001).

The examples given above show that “protection” became a much more complex phenomenon compared to how it used to be a decade ago. Negotiations now appear to be the main function of protection agencies in the alliance between a business firm and a protection agency. Besides contract enforcement, most protection agencies are capable of providing a wide range of services on demand. Most firms distinguish between protection agencies who provide security for offices and stores, and those with whom they form an

“enforcement partnership” – a business-agency alliance in which a protection agency, among other services, helps enforce contracts. Differently from criminal groups hired for the same purpose, protection agencies tend to use negotiations and pressure on one’s business through state and non-state officials, not threats of physical violence.

### 5.2.3. Usage of the Private protection firms strategy among studied firms

As I discussed above, protection agencies can be used by a firm for different purposes, and contract enforcement is just one of them. A number of questions were used to identify whether, and if yes how, firms use protection agencies (questions NN 4.1.2; 4.3 – 4.8 of the Questionnaire) While eighteen firms out of forty-five (40%) indicated that they use the services of a protection agency, a significantly smaller number actually uses them for contract enforcement (fig.5.2.1).



**Figure 5.2.1.** Usage of Private protection agencies as a strategy of contract enforcement, among studied firms (n=44).



As figure 5.2.1 shows, only four firms (9%) use private protection agencies for contract enforcement rather frequently, and four firms used protection firms for contract enforcement once or more in the past. Out of those eighteen firms that use protection agencies for other kinds of services, two-thirds (69%) used them from the founding of the firm. Half of those who use protection agencies said they are quite happy with the collaboration and find their agency to be quite useful; the other half does not really use the agency that much, preferring to keep it available “just in case”. Two-thirds of respondents said that they found the agency themselves, usually through a recommendation from a friend or business partner.

All four firms that use a protection agency for contract enforcement are in trade. As I already discussed in chapter 2, firms in trade have a significantly higher profit margin than firms in production and in service. They tend to experience more dishonesty on the part of their partners, and consequently to survive they need to have more aggressive contract enforcement strategies<sup>59</sup>.

Interviewees from firms in trade and services say that most small firms they know use a protection agency for various purposes. Most respondents from firms in production say that their business friends and partners do not use a protection agency. Firms in production tend to have a smaller profit margin, and unless they are directly engaged in selling what they make, they rarely need security services for their premises.

The founding period of a firm also seems to have an impact on the probability of picking this strategy. Most of the firms that use, or have used protection agencies for

---

<sup>59</sup> Correlation between being in the trade area of business and usage of protection agencies for contract enforcement purposes has a coefficient = .280 (Kendall's tau\_b), and .288 (Spearman's rho), significant at the .05 level, 1-tailed.

contract enforcement started working in the first period (before 1995), and the remaining in the second<sup>60</sup>. This is possibly due to the fact that contract enforcement with the help of protection agencies was quite widespread in the beginning of the 1990s, and some firms keep using their services habitually.

Larger firms tend to use protection firms for contract enforcement purposes more frequently than smaller ones<sup>61</sup>, partly because this service is quite expensive, and many smallest firms cannot afford it, and partly because larger firms may feel a greater need for it. Neither criminal involvement, nor Soviet experience of management appear to have any connection with the choice of Private protection agencies as a contract enforcement strategy.

---

<sup>60</sup> Correlation between the founding period and usage of protection agencies for contract enforcement purposes has a coefficient =  $-.288$  (Kendall's tau\_b), and  $-.312$  (Spearman's rho), significant at the .05 level, 1-tailed. Correlation coefficient shows that firms that were founded earlier are significantly more likely to use protection agencies for contract enforcement purposes than firms founded more recently, within the given sample.

<sup>61</sup> Correlation between the size of the firm and usage of protection agencies for contract enforcement purposes has a coefficient =  $.263$  (Kendall's tau\_b), and  $.271$  (Spearman's rho), significant at the .05 level, 1-tailed. Correlation coefficient shows that larger firms are significantly more likely to use protection agencies for contract enforcement purposes than small firms, within the given sample.

### 5.3. Private arbitration (*treteiskii*) courts

Private arbitration is perhaps the most ancient form of dispute resolution. In chapter 4, I already discussed unofficial private arbitration that some firms find more appealing; this part is about the same service, but performed by government licensed private arbitration (*treteiskii*) courts.

The first law that legalized private arbitration on Russian territory was passed on June 24, 1992<sup>62</sup>, and very soon after the first official private arbitration courts appeared in Moscow. State courts at that time were slow, expensive, corrupt, and could not satisfy the demand for dispute resolution from a rapidly growing private sector. In the thirteen years after the first law, over 400 private arbitration courts were created all over Russia, most of them concentrated in the North-West of Russia. St.Petersburg has thirty-two functioning private arbitration courts, one of which was created by the Agency of Support for Small Business specifically for the needs of small business.

The law that currently regulates private arbitration courts was passed on July 24, 2002<sup>63</sup>. According to this law, any private enterprise can found a private arbitration court, and appoint judges. The only requirement about the qualification of judges is that they must have a legal degree. Private arbitration courts can also be created by private enterprises for a particular dispute, and then dismissed. Parties who decide to bring their

---

<sup>62</sup> Vremennoye polozhenie o treteiskom sude dlia razresheniya ekonomicheskikh sporov, postanovlenie Verhovnogo Soveta Rossijskoi Federatsii ot 24 iunia 1992 g. (Provisionary regulation of *treteiskii* courts for economic disputes, adopted on June 24, 1992).

<sup>63</sup> Federal'nyi zakon o treteiskikh sudakh v Rossiiskoi Federatsii, №102-Ф3 (Federal Law about Private Arbitration Courts in Russian Federation), adopted on July 24, 2002.

dispute to a private arbitration court must sign a bilateral agreement (*treteiskoe soglashenie*) in which they agree to be bound by the arbitrators' decision. There can be no appeal. In the case of the arbitrators' decision not being voluntarily complied with, the plaintiff can petition to the state arbitration court, which then proceeds to enforce the private court's decision.

Private arbitration courts are cheaper, faster (most decisions are typically achieved within 20 days, while state *arbitrazh* court can sometimes take years to process a single case) and are considered to be more secure in terms of guaranteeing privacy. All these reasons should make private courts very appealing to private entrepreneurs. Nevertheless, most of the participants in my study said that they never heard of these courts. There are a number of reasons why this may be the case. First, in St.Petersburg the majority of existing private arbitration courts have been created by large enterprises, banks or commodity exchanges for their own private use, and they do not advertise their services to outsiders. Second, a fundamental distinction of private courts from state *arbitrazh* courts is that the former requires an agreement signed by both sides for the proceeding to be initiated. The most serious problem for small entrepreneurs is non-payment, and it is common that the debtor simply cannot be found: the office is closed and phones don't answer. Clearly, in such cases private courts become quite useless.

In interviews with business owners and managers I asked them whether they ever used a private arbitration court, whether they know of someone who used a private court, and I asked the respondents to evaluate costs, corruption and effectiveness of private courts. No participant of my study used private courts, but four respondents knew

someone who did. All respondents said they could not evaluate private courts because they did not have sufficient knowledge of them to make any kind of assessment.

Although very few small firms in St.Petersburg use private arbitration courts, as a contract enforcement strategy it is extremely important, since it is the only strategy that breaks the state's monopoly on dispute resolution and thus potentially decreases transaction costs (Greif and Kandel 1995). Competition in this area will probably become more beneficial to Russian entrepreneurs as the Russian market matures.

#### **5.4. State *arbitrazh* courts**

Currently, there are two types of state courts where a firm can bring a dispute: a regular state court, and a state court of economic affairs (*arbitrazh*). The regular state court has remained virtually unchanged since Soviet times, and mainly serves to resolve disputes between ordinary citizens. The *arbitrazh* court was transformed from the old *Gosarbitrazh* at the beginning of the capitalist reforms in Russia, and was supposed to answer the demand for dispute resolution among new private firms. This type of courts deals only with disputes regarding economic affairs and managerial issues, and the disputing parties are either registered firms or self-employed businesspeople. The hearings in this type of court are faster than in regular state courts, and significantly more expensive.

Courts should be, perhaps, the most significant state institution for dispute resolution for entrepreneurs. A quarter (24.4%) of all participants of my study said that their firm sued, or was sued by another firm or organization. The most common reasons for suing a business partner is non-payment. It may seem that the number of firms that used court litigation as a strategy of contract enforcement is rather high, but in fact it is low, given that over a half (51.1%) of all studied firms have been victims of non-payment, and 89% reported having experienced various violations of terms of contract by their business partners. Many respondents said that they do not even consider courts as an option. “I know that it is completely useless,” - says a manager from an advertising firm. “The thing is, there has been no positive precedent that one firm would sue another for non-payment, and the victim would receive a big compensation in a timely manner. We all know what’s

going on with other firms, and if such thing ever happened, everyone would know. But it's never happened" (Firm #5, Personal interview, June 2001).

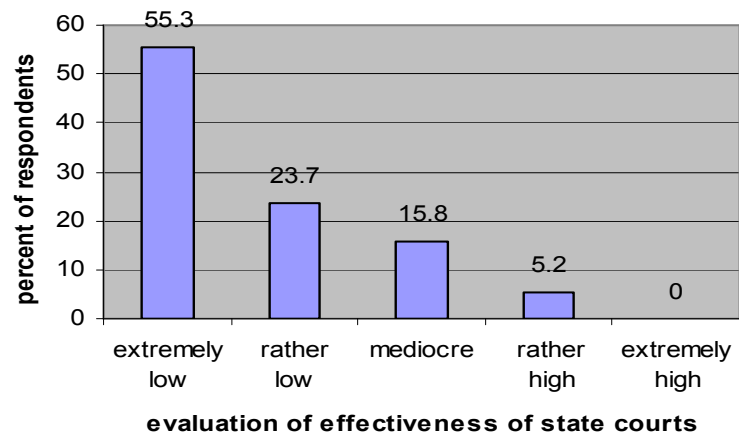
The issue of timeliness appears to be of particular importance to entrepreneurs. The owner of a publishing company explains that a skilled lawyer can stretch a court hearing for a number of years, and even if the injured party wins in the end, inflation will eat up most of the penalty payments (Firm #6, Personal interview, July 2002). In fact, most of those respondents who said that they used courts, could not report the results of the hearing because it was still in process, in most cases for more than a year. Entrepreneurs need their disputes resolved within weeks or months, not years, so they could deal with the consequences and get on with their business.

The executive manager of a firm that sells beer and soft drinks thinks that the problem with the court system is not only the speed of procedures, but enforcement of court decisions. He says, his firm tried suing a number of dishonest partners, but having won the cases, has never been able to get penalty payments from the offenders (Firm #13, Personal interview, July 2002).

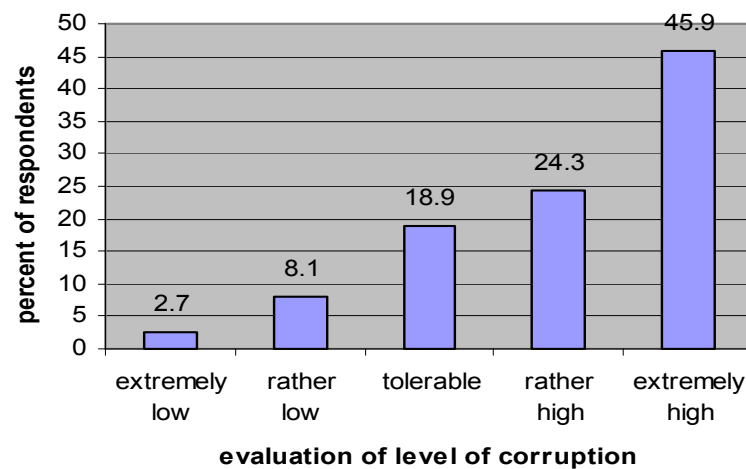
This inability of courts to enforce their rulings probably is an important factor in why so few respondents believe in the state courts' effectiveness (fig.5.4.1). Corruption among judges and judicial enforcers is also perceived by respondents as being a serious problem (fig.5.4.2)<sup>64</sup>:

---

<sup>64</sup> For an example of corruption among court officials, see Appendix 2 "Luba's story".



**Figure 5.4.1.** Perceptions of effectiveness of state courts by respondents from studied firms, in % (n=38).



**Figure 5.4.2.** Perceptions of corruption of courts officials among the respondents from studied firms (n=37), in %.

While both those interviewees who have dealt with the court system, and those who have not evaluate its level of effectiveness and corruption similarly, the evaluation of how expensive it is depends on experience. Most respondents said that they think the state court system is too expensive, while those respondents who actually used the system said it is not. This is a good example of how people’s preconceptions can sometimes be at

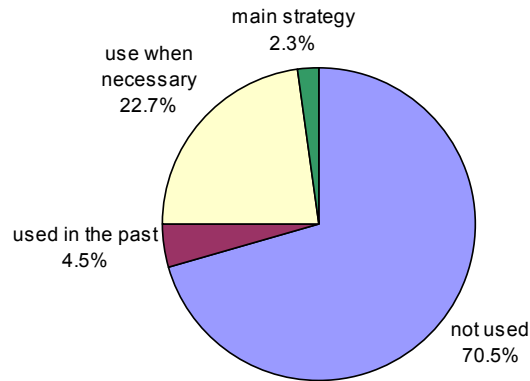


odds with reality. It is also interesting to note that managers and owners who use courts as a contract enforcement strategy on average have higher education than those who do not<sup>65</sup>. This is probably due to the fact that higher education gives managers confidence that they can deal with the system of state courts and use it to their advantage.

Not all of those entrepreneurs who tried using state *arbitrazh* courts for contract enforcement purposes were happy and satisfied with the courts' performance. However, there are more entrepreneurs willing to give it a try now than there were even a few years ago, respondents themselves admit. Figure 5.4.3 shows that only 25% of my interviewees said they would readily consider an *arbitrazh* court option if they were faced with a serious violation of contractual obligations. However, an additional 29.5% of respondents said that while they would be very reluctant to do so, they do not dismiss *arbitrazh* courts as a possibility. These firms are grouped together with 40.5% of firms whose owners or managers said that would never consider state courts as a contract enforcement option, under the category "not used". Perceived costliness, corruption and low effectiveness of state courts were cited as the reasons, as well as a lack of trust in state institutions in general. Finally, those 4.5% of firms described as having "used the strategy in the past" said that they had such a negative experience that they are unlikely to use it again.

---

<sup>65</sup> Correlation between the level of education of the firm's owner/manager and likelihood of picking state courts as a contract enforcement strategy is statistically significant, coefficient = .299 (Kendall's tau\_b) and .317 (Spearman's rho).



**Figure 5.4.3.** Usage of State *arbitrazh* courts as a strategy of contract enforcement, among studied firms (n=44).

Overall, performance by the state judicial system is perceived by entrepreneurs as poor, particularly concerning enforcement of court rulings. It makes entrepreneurs feel vulnerable to the dishonest behavior of others. However, for those firms who cannot or do not want to rely on criminals and protection agencies, and who do not have connections to powerful state officials, *arbitrazh* courts remain the only hope for retrieving money lost to non-payment or other kinds of fraudulent behavior.

Out of five explanatory variables only area of business seems to have an effect on the probability of a firm's decision to use state courts as a contract enforcement strategy: firms in service seem to be less likely to use state courts<sup>66</sup>, while firms in trade seem to be more likely to use them<sup>67</sup>. As discussed in the previous chapters, trade remains the most profitable area of business, and it also attracts more opportunists than other areas, thus

---

<sup>66</sup> Correlation between service as a business area of a firm and likelihood of picking state courts as a contract enforcement strategy has a coefficient =  $-.269$  (Kendall's tau<sub>b</sub>) and  $-.276$  (Spearman's rho), it show that firms in service are significantly less likely to use state courts.

<sup>67</sup> Correlation between trade as a business area of a firm and likelihood of picking state courts as a contract enforcement strategy has a coefficient =  $.267$  (Kendall's tau<sub>b</sub>) and  $.275$  (Spearman's rho), it show that firms in trade are significantly more likely to use state courts.

requiring more versatile and aggressive contract enforcement strategies on the part of the management of firms in trade. These firms frequently use courts as a last resort strategy, when networks, financial tools and other strategies fail to protect them against contractual violations.

Quite opposite to firms in trade, firms in service typically have lots of small transactions that they rarely document properly, relying instead on informal business agreements. As a result, when a violation occurs, they rarely can use a state court to seek redress because of the lack of a proper contract. In addition, the small scale of transactions makes litigation not worth the investment.

## **5.5. Complementarities among strategies, and summary of their use**

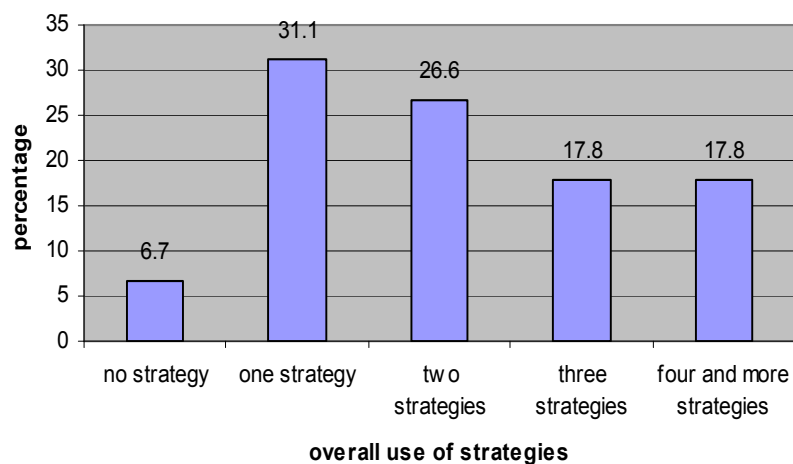
Now that we have discussed a method of operation for each of nine contract enforcement strategies available to small Russian entrepreneurs we can look at how they work together. This section of the chapter will start with the analysis of the patterns of usage of contract enforcement strategies among studied firms, then will present the analysis of complementarities of these strategies, and conclude with the summary of their use, compared across all studied firms.

It is rare that a firm does not use at least one contract enforcement strategy. The choice of what contract enforcement strategy to use is largely predetermined by two circumstances: the frequency of contract enforcement problems (typically determined by the nature of a firm's business) and associated losses experienced by a firm, and the availability of social and financial resources at firm's disposal to address these types of problem.

There are three firms that did not use any contract enforcement strategy at the time of interviews (Firms ## 28, 37, and 40). One of these firms is a café (Firm #40) whose owner purchases goods for cash. The two other firms do suffer losses due to contract violations, but they lack appropriate resources to take either preventive or punitive measures toward contract violators; their self-described approach is to "beg and wait".

Fourteen firms (31% of all studied) have used only one contract enforcement strategy, twelve firms (27%) have used two strategies, eight firms (18%) have used three strategies, and remaining eight firms have used four or more strategies, with seven

strategies being the maximum used by one firm (Firm #13). None of the studied firms have used all nine contract enforcement strategies. Figure 5.5.1 shows the distribution of the number of contract enforcement strategies used by firms over their lifetime, out of nine contract enforcement strategies analyzed in this work. Each category includes information about strategies that firms used in the past, but don't use anymore, as well as currently used strategies.



**Figure 5.5.1.** Number of contract enforcement strategies used by firms over their lifetime, among studied firms, in % (n=45).

Figure 5.5.1 includes both strategies that have been used by firms in the past, but not considered any more at a time of interviews, and strategies that constitute the contract enforcement repertoire of each firm at the moment of interviews. Firms that have used more than two contract enforcement strategies have both the need and the resources for it. They are typically larger; they either were founded in the beginning of the 1990s and accumulated significant resources that help them deal with all kinds of problems (Firms ## 2, 3, 17, 24, 36, 42, 45), or they were founded quite recently but operate in a high-risk business area in which it is imperative to aggressively tackle contract enforcement

problems – wholesale trade (especially alcohol), the highly competitive real estate business, and some areas of manufacturing (Firms ## 13, 27, 32, 43).

To evaluate which strategies were actively used by firms at the time of interviews I combined responses to questions about what strategies had been used in the past (section 4.1 of the questionnaire) with the hypothetical question about a possible course of action if a respondent's firm faced a contract violation today (question #4.3 of the Questionnaire). So, for example, if a firm used its connections to state officials for contract enforcement in the past, but does not indicate this course of action as possible in an event of a contract violation in the future, then Threat of punitive actions by state officials is not considered to be actively used by this firm. Alternatively, if a firm's representative indicates that if a case of violation he or she intends to use a state *arbitrazh* court, then State *arbitrazh* court is considered an active strategy of this firm, even if they did not use it before. Calculated in this manner, thirty-four firms out of forty-five (75.6%) actively employ one or two contract enforcement strategies (figure 5.5.2).



**Figure 5.5.2.** Number of contract enforcement strategies currently used by studied firms (n=45).

The overall characteristics of firms actively using more than two contract enforcement strategies are similar to those of firms having used multiple contract enforcement strategies in their life course: they tend to be older, larger and have a higher need for enforcement solutions due to the nature of their business.

In chapter 3 I briefly touched upon how all nine contract enforcement strategies can be seen as following one of three logics of operation: logic of prevention (financial tools), logic of positive incentive (networks and professional associations), and logic of coercion (criminals, state officials, arbitration, courts and private protection agencies). These differences among strategies are particularly illuminating in explaining the patterns of usage of strategies among firms, in terms of temporal dimension of transactions. Strategies of prevention (financial tools) and positive incentive (networks, associations) are typically employed by firms routinely, in the majority, if not in all, transactions, *prior* to the occurrence of the transaction. Many potential problems are prevented with the help of these strategies. If a problem with contract enforcement then arises, firms can turn to strategies of coercion (use of criminals, state officials, arbitration, courts and private protection agencies), to seek the redress. The following table shows the distribution of nine contract enforcement strategies with regard to the three logics of operation:

ENFORCEMENT TYPES	Stage I: Action prior to transaction (seeks prevention)		Stage II: Action after transaction (seeks redress)
	PREVENTIVE	POSITIVE INCENTIVE	COERCIVE
Firm-based strategies	* Financial tools.	* Information and closed exchange networks.	* Threat of violence by criminals; * Arbitration by mutually agreed upon powerful individuals; * Threat of punitive action by state officials.
Extra-firm strategies	-	* Professional associations.	* Private protection firms; * Private arbitration courts; * State <i>arbitrazh</i> courts.

The choice of action at the stage of redress is determined by a number of factors. First and foremost, it is the firm's social resources – like pre-existing access to state officials or criminals - and the availability of the financial means necessary to initiate a court hearing or hire a protection agency. Another factor of significance is the amount of actual damage done to a firm by a contract violation. Most managers say that they will only proceed with active attempts to retrieve lost funds through coercive measures in a case of a severe damage. For some firms, it may mean as little as \$500, and for others it can be \$10,000.

Table 5.5.1 demonstrates that the data generally supports this proposition of a two-stage system of contract enforcement. Eighteen firms that actively use only one contract enforcement strategy (40% of studied firms) chose either the strategy of prevention (financial tools), or a strategy of positive incentive (networks). Formal associations – the other strategy of positive incentive – are still not very common in Russia, so it should not



surprise us that few entrepreneurs choose to rely on them as part of their approach to contract enforcement.

Those twenty-four firms that actively use more than one contract enforcement strategy (53.3% of all studied firms) show all kinds of variation with regard to complementarities among strategies. Almost all firms use either networks or financial tools for the first – preventive – stage of contract enforcement. Firms' available resources predetermine the choice of coercive strategies utilized in the second stage.

**Table 5.5.1. Usage of contract enforcement strategies by studied firms (n=45).**

#	FIRM'S ACTIVITY	FOUNDED IN	# OF STAFF	A1 = criminal ties networks	A2 = criminal ties	A3 = private arbitration	A4 = state connections	A5 = financial	B1 = associations	B2 = protection firms	B4 = state courts	Number of strategies used in the past	Number of currently used strategies
1	manufacturing of tents	1992	105	0	0	0	0	2	0	1	0	two	one
2	construction	1993	35	3	1	0	2	0	0	1	0	four	two
3	media retailer	1991	3	2	2	0	1	0	0	3	0	four	three
4	advertising	1996	13	2	0	2	0	3	2	0	0	four	four
5	advertising	1995	12	2	0	0	2	2		0	0	three	three
6	publishing	1999	6	2	0	0	0	3	0	0	0	two	two
7	business consulting	1992	200	2	0	2	1	0	1	0	0	three	one
8	art gallery	1992	2	0	0	0	0	3	0	0	2	two	two
9	geophysics equipment development	1997	8	2	1	0	2	2	0	0	0	four	three
10	computer wholesale	1991	200	0	0	0	0	2		3	0	two	two
11	packaged bread snacks production	1998	20	0	0	0	3	0		0	2	two	two
12	construction	1997	35	3	0	0	0	2		0	0	two	two
13	beer, soft drinks wholesale	1996	35	2	1	0	1	2	2	2	2	seven	five
14	restaurant	1987	12	2	0	0	0	0	0	0	0	one	one
15	mobile phone retail	2000	7	2	0	0	0	0	0	0	0	one	one
16	design and manufacturing of furniture	1994	28	3	0	0	0	2	0	0	0	two	two
17	oil refinery parts manufacturer	1992	19	3	0	0	1	2	0	1	2	five	three
18	labels, packaging manufacturing	1996	40	0	3	0	0	2	0	0	0	two	two
19	chemicals wholesale	1991	120	0	1	0	0	2	0	2	2	four	three
20	engineering	1992	8	3	0	0	0	2	0	0	0	two	two
21	import and wholesale of lime	1995	2	0	0	0	0	3	0	0	0	one	one
22	medicinal cosmetics wholesale	1997	10	3	0	0	0	2	0	0	0	two	two
23	sales of consumer electronics	1995	54	3	0	0	0	2	0	1	0	three	two

#	FIRM'S ACTIVITY	DATE	STAFF	A1	A2	A3	A4	A5	B1	B2	B4	PAST	ACTIVE
24	manufacturing of advertising banners	1992	40	2	0	0	1	3	0	0	0	three	two
25	fur and leather clothing retail	1998	19	3	0	0	0	0	0	0	3	two	two
26	publishing	1999	2	2	0	0	0	3	0	0	0	two	two
27	manufacturing of beer packaging	1998	110	3	0	0	0	2	0	0	1	three	two
28	lease of offices	1997	7	0	0	0	0	0	0	0	0	zero	zero
29	musical instruments wholesale	1999	2	2	0	0	0	0	0	0	0	one	one
30	sales of musical instruments	1992	30	2	0	0	0	0	0	0	0	one	one
31	advertising	1995	2	3	0	0	0	1	0	0	0	two	one
32	manufacturing of advertising banners	1998	200	0	2	0	2	2	0	0	0	three	three
33	consumer electronics retail	1994	150	0		0		2				one	one
34	telecommunications	1993	100	0	0	0	0	3	0	0	2	two	two
35	ship electronics repair service	1987	20	3	0	0	0	0	0	0	0	one	one
36	business consulting, market research	1991	25	2	0	0	0	2	0	0	1	three	two
37	construction parts manufacturing	1995	4	0	0	0	0	0	0	0	0	zero	zero
38	consulting, market research	1995	15	1	0	0	0	2	0	0	0	two	one
39	sales of construction goods	1996	10	3	0	0	0	0	0	0	2	two	two
40	convenience store and cafeteria	1995	14	0	0	0	0	0	0	0	0	zero	zero
41	sales of video and audio equipment	1993	100	0	0	0	2	0	0	0	2	two	two
42	radiology equipment design, manufacturing	1989	150	3	0	0	1	2	1	0	0	four	two
43	realtor	1999	180	0	2	0	1	2	0	0	2	four	three
44	café	2000	6	2	0	0	0	0	0	0	0	one	one
45	hiking equipment retail and wholesale	1992	20	2	0	0	0	3	0	0	2	three	three

Empty cells denote missing data. Eight out of nine strategies are listed; the ninth (B3 private courts) has no occurrences. Each strategy is assigned a value from zero to three, based on the information from interviews. In total, four types of strategy usage are identified:

0 = never used;

1 = used once or more in the past but unlikely to be used again;

2 = currently used to some extent, when necessary or possible;

3 = currently used as a main strategy.

Green font (A1; B1) denotes the strategies of positive incentive; blue font (A5) denotes the strategy of prevention; red font (A2-A4; B2; B4) denotes the strategies of coercion.

Firms may actually use more than one strategy in addressing a problem with contractual obligations. A manager from the firm that sells chemicals says that he was hired to deal with such problems – primarily with non-payment – and over the time that he was with that company he saw many interesting combinations. He describes the general pattern of how his firm deals with contractual disputes:

Question: How do you deal with contractual violations, especially with non-payment?

Answer: Well, typically I first get on the phone and try to find out whether a debtor has a legitimate reason for the delay of payment, and has all intentions of paying, or he does not. Frequently he does not. Then I submit my findings to our lawyer, and she initiates a court hearing. After we win the hearing, the court typically cannot do anything to get our money back, the firm can be officially bankrupt, with zero funds on their account. In such cases we pass the information on to our protection service, they know people everywhere, in the police forces, among criminals, everywhere.

Question: But what can your protection agency do to obtain the debt if the debtor is bankrupt?

Answer: They find out whether the debtor has money “unofficially” – say, in cars or multiple houses, bought stuff before declaring bankruptcy. If yes, they will get on the case. First of all, they will find out whether the debtor has a ‘roof’. If the debtor does not have it, they will organize ‘negotiations’ (basically, threaten the debtor), in which they try to settle. They could send their criminal associates to ‘beat out’ the money. In one of my cases, they seized three Mercedes cars from the debtor to settle the debt, counting \$10,000 per car.

Questions: How much would it cost to the firm?

Answer: Half of the debt. (Firm #19, Personal interview, July 2002)

This example demonstrates how a firm uses multiple strategies in a case of a single contract violation. In fact, according to the respondent, at first this firm uses a preventive strategy - partial prepayment. Then, if the violation does occur and the losses are significant, the management resorts to using the state court and to its private protection agency that in turn can employ criminals or use their connections to state officials (for

example, in tax inspection or police forces) to achieve the goal. Other respondents also reported instances of criminals acting through corrupt state officials, as means of intimidation. Such usage of a number of strategies in a single case of contract violation is not very common among small firms. Only a few respondents said that their firms have capabilities to use multiple means to obtain redress. More commonly, the management consider themselves lucky if they can afford being proactive in pursuing a debtor at all, be it going to a court, or calling friends for help.

Another way of looking at complementarities among contract enforcement strategies is to identify the functional resemblance between strategies under certain circumstances that may result in the merging of two analytically separate strategies to the point that it becomes hard to distinguish one from another. Such merging is particularly apparent in three instances. First, as I have already discussed in earlier chapters, the distinction between organized criminals and private protection agencies can at times be murky, since the latter can move in and out of legality by holding or losing a state license, by using legal or illegal means in achieving their goals, and by documenting properly their activity or not.

Second, the distinction between state courts as a contract enforcement institution, and treat of punitive action by state officials can also disappear if the state officials who are used through connections are actually a part of a state court system. A corrupt judge issuing a verdict that was paid for by one of the disputing parties clearly belongs to a category of corrupt state officials, but in the eyes of a disputing party that had lost and is unaware of corruption, he or she belongs to the state court system.

Third, in practice it may be difficult to distinguish instances of private arbitration that in theory appear as a separate strategy. Arbitration by mutually agreed upon powerful individuals can actually be the same as private court's arbitration, but with formalities skipped. To make the distinction even more difficult, professional associations can by law establish their own private arbitration courts, or they can instead offer private arbitration services without formally creating private courts. In a close-knit web of social relations permeating all institutions and organizations involved, participants may themselves not realize what kind of arrangement they are involved in.

Figure 5.5.3 illustrates these different types of complementarities. Green solid arrows denote the merging between different strategies. Red dashed arrows show the links between strategies that are created when one strategy operates through another.

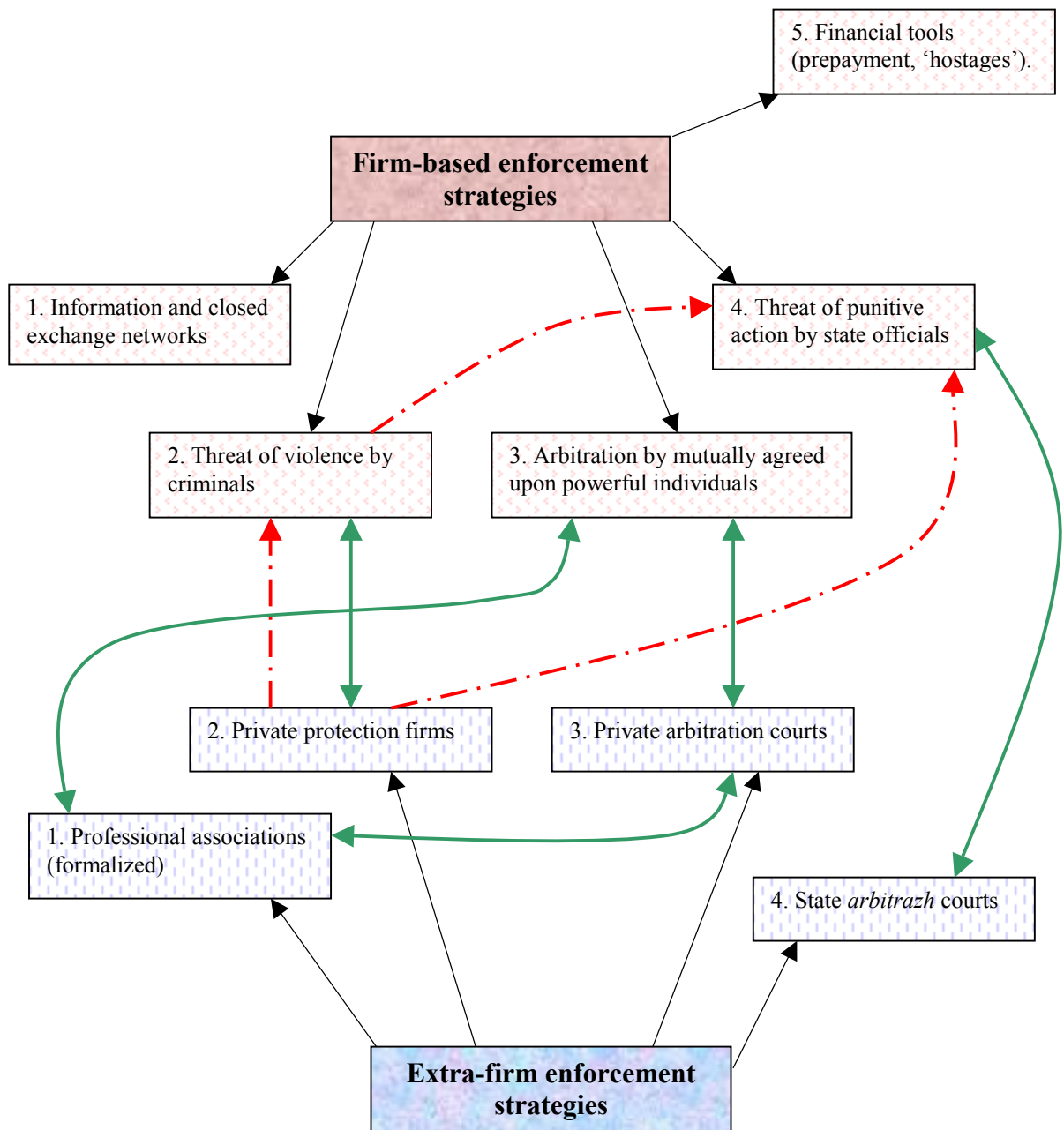
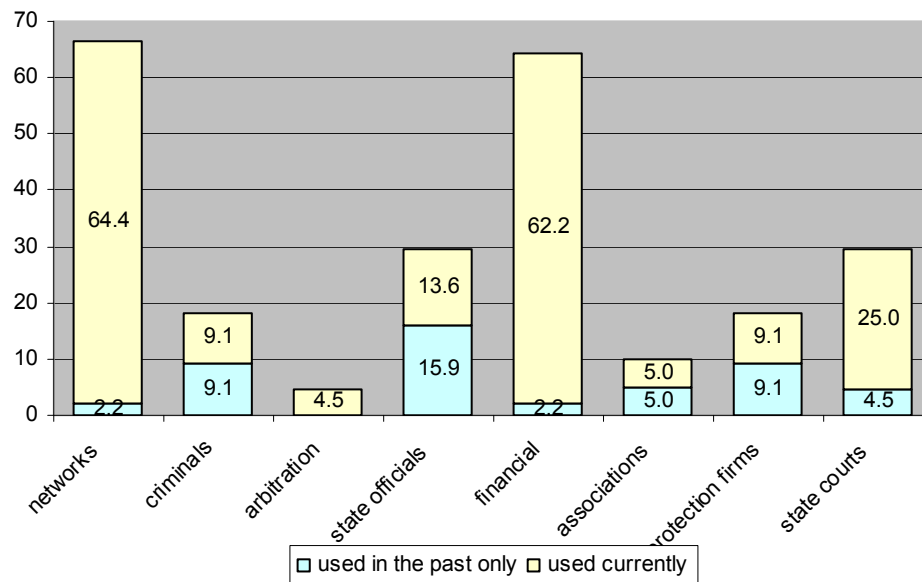


Figure 5.5.3. Overlapping of contract enforcement strategies.

It is quite apparent from the analytic description of each of the nine contract enforcement strategies offered in chapters 4 and 5 that they are not equally popular among small Russian entrepreneurs. For various reasons, chiefly being the availability of a strategy, its costliness and effectiveness, and also the perceived need for its deployment, entrepreneurs select some strategies more frequently than others. Figure 5.5.4 shows the comparison of use of eight contract enforcement strategies among the studied firms. The ninth strategy – private arbitration courts – had no instances of use.

This figure was constructed in the following manner. First, each contract enforcement strategy was evaluated in relation to each firm, to determine whether the firm ever used this strategy (see Appendix 3). Second, each strategy was evaluated in relation to each firm, to determine whether a strategy is currently actively used (mainly through a direct question regarding a firm’s course of actions if a contract violation occurs today). Then, the two corresponding numbers were computed for each strategy.



**Figure 5.5.4.** Comparison of use of contract enforcement strategies among studied firms, in the past and in the present time, in % (n=45).



It is clear from this figure that networks and financial tools are the unquestionable leaders among strategies. Only one firm used to use networks as a contract enforcement strategy and does not do it anymore, and only one firm used to use financial tools but stopped. The reasons for their popularity were discussed earlier in this section, primarily the availability of these strategies, ease of use, an preventive nature of these two strategies.

The use of strategies changes with time; some strategies retained their popularity among entrepreneurs far better than others. The Threat of punitive action by state officials appears to have had the most dramatic change: more firms used this strategy in the past but stopped than actively use it now. Information from interviews with the business managers and owners indicates that “violent” strategies – Threat of violence by criminals and Protection agencies – are also on decline due to the strengthening of state enforcement bodies and the overall development of more civilized business relations in the market. Half of those respondents that said that their firms used to use one of these two strategies do not use them anymore.

The strategies that are gaining recognition as effective are state *arbitrazh* courts, and professional associations. Increasing levels of education among small entrepreneurs, as well as continuous legal reform have had a positive impact on the level of use of state courts for contract enforcement purposes. Professional associations slowly gain weight, too, as more and more entrepreneurs become aware of their existence, and the benefits that their membership may offer.

Finally, I would like to draw some conclusions with regard to the explanatory power of the five explanatory factors laid out in chapter 2. These five factors include the sector

of economy in which the firms operates (trade, service, production), the size of firms (small or medium), period of founding (1990-1994; 1995-1998 (crisis); 1998-2001), Soviet experience of the management, and criminal involvement on the level of investment or personal connections. In the analytic description of contract enforcement strategies in chapters 4 and 5 each factor was considered in relation to the usage of each strategy, by means of non-parametric correlations between intensity of usage of strategies, and each factor as a characteristic of a firm. Overall, the sector of economy, size and criminal involvement were each found to be significant in explanation of usage of two contract enforcement strategies; the period of founding helped predict the usage of one contract enforcement strategy; and Soviet experience of management was not found to be significant at all.

The sector of economy was found to be significant in relation to usage of state courts and private protection agencies. Firms in trade were found to be more likely to use both, private protection agencies and state courts, while firms in service were found to be less likely to use state courts as a contract enforcement strategy.

Size mattered in explaining the usage of Information and closed exchange networks strategy, and private protection agencies. While bigger firms were found to be more likely to use private protection agencies, they were significantly less likely than smaller firms to use networks to enforce their contracts. It is partially consistent with the prediction made in chapter 2 that bigger firms are more likely to use more expensive strategies. The usage of other contract enforcement strategies that are considered to be expensive by respondents, like state court system, and state officials, were not found to be determined by the firms' size.

The only strategy whose usage strongly correlates with the period of founding is the usage of private protection agencies. Consistent with the predictions made in chapter 2, protection agencies are used overwhelmingly by firms that were founded in the first period (1990-1994), when their use was common practice among private firms. The use of other strategies that were thought to be related to different periods of founding (like networks or state officials in the first period, and financial tools and courts in the third period) did not show any significant correlation.

Soviet era experience of upper management was not found to be a determinant of any particular contract enforcement strategy, even the Threat of punitive action by state officials. The documented instances of its usage are distributed among all types of the studied firms. And lastly, criminal involvement was found, as expected, to correlate with the usage of the Threat of violence by criminals strategy. Interestingly, it was also found to correlate negatively with usage of the Information and closed exchange networks strategy.

Thus, out of five specified explanatory factors, three (sector of the economy, size and criminal involvement) were found to be rather powerful. The other two (period of founding and Soviet experience of upper management) were not found to have any significant impact on the choice of contract enforcement strategies by studied firms.

## Conclusion

This chapter presented an analytic description of four extra-firm contract enforcement strategies and analysis of some complementarities among strategies. Overall, these strategies have a positive effect on inter-firm relationships by providing options in contract dispute resolution, and a mostly negative effect on state-firm relationships. Professional associations, just like information and closed exchange networks, aid contract enforcement mainly through the threat of exclusion from future transactions, but differently from the latter this strategy does not hinder entrance of new firms. One of the major incentives for firms to enter professional associations is the perceived inability of the state to protect firms against dishonest behavior in the marketplace. Professional associations facilitate contract enforcement by spreading information about the reliability of firms, ostracizing dishonest firms, and assisting firms in settling their contractual disputes.

Private protection firms play an ambiguous role in inter-firm relationships. They may be viewed positively since they do help legitimate contracts get enforced. However, the means they use to achieve this goal are far from legitimate. Whether they use the threat of violence against the other party, or the threat of financial punishment through corrupt state officials, such types of enforcement are clearly illegal. Entrepreneurs employ this strategy out of frustration with the inefficiencies of the state legal system that cannot resolve contractual disputes quickly and fairly. Since the contract enforcement services of private protection agencies are very costly, the state's claims to taxation are perceived as

unjust<sup>68</sup>. Another negative implication is the dispersion of the state's authority. The state has traditionally been defined in terms of its monopoly over means of violence (Tilly 1986; 1990), and the fact that other third parties now serve as enforcers of rules means that the state's authority is diminished (Volkov 1998; 2002).

Private courts operate within the legal framework defined by the state, so they may be in competition with, but not in opposition to the state court system. Breaking the state's monopoly on dispute resolution can be seen a good thing in the long run, insofar as it reduces costs, increases effectiveness and thus may lead to decreasing transaction costs for firms. But so far for small firms private courts do not appear to be functionally essential.

Contract enforcement via state *arbitrazh* courts should in principle have an overall positive effect on inter-firm relationships and state/firm relationships. In reality, however, state courts are perceived as ineffective and corrupt, and this reputation reinforces negative attitudes towards the state. I will discuss entrepreneurs' attitudes to the state in the next chapter.

Table 5.1 summarizes characteristics and origins of each extra-firm contract enforcement strategy, shows what types of firms tend to use each strategy, and lists the effects a strategy has for inter-firm and firm/state relations.

---

<sup>68</sup> There is a correlation between having an "enforcement partnership" with a private protection agency and the percentage of concealed revenues to avoid taxation: coefficient = .215 (Kendall's tau\_b) and .259 (Spearman's rho), significant at the .05 level, 1-tailed (due to small sample size, non-parametric correlations were used). Correlation coefficient shows that firms that have an "enforcement partnership" with a private protection agency are likely to conceal a larger percentage of their income from tax authorities than firms without connections to private protection firms, within the given sample.

**Table 5.1. Summary of characteristics, origins and implications of extra-firm enforcement strategies.**

EXTRA-FIRM ENFORCEMENT STRATEGIES	CHARACTERISTICS OF STRATEGY	ORIGINS OF STRATEGY	FIRMS USING STRATEGY	IMPLICATIONS FOR	
				INTERFIRM RELATIONS	FIRM/STATE RELATIONS
1. Professional associations	Operates by the threat of exclusion from future transactions with members.	Desire to provide information to members about contract violators and thus minimize losses.	Insufficient information.	(+) Provides an incentive for honest behavior.	(-) State is perceived as not doing enough to punish contract violators
2. Private protection firms	Can rely on violence like organized criminals, or create threats through connections to state officials.	Extortion forces in Soviet shadow economy in conjunction with inflow of former special forces into the protection business.	Mostly medium-sized firms in trade that were created in the early 1990s.	(-) Brings non-capitalist means into business relations. (+) Contracts get enforced.	(-) Firms perceive state's attempts to collect revenue as illegitimate. (-) The state's authority is diminished.
3. Private arbitration ( <i>treteiskii</i> ) courts	Operates like private arbitration, but state regulated and supported.	Developed in response to inefficiencies of state courts.	Insufficient information	(+) Gives an option in resolving disputes.	(+) Enhances the state's image because it helps resolve disputes legally.
4. State <i>arbitrazh</i> courts	Relies on the legal code and state legal system.	Was transformed from the old <i>Gosarbitrazh</i> at the dawn of capitalist reforms in Russia	All firms; in particular firms in trade. Firms in service are least likely to use courts.	(+) Resolves disputes in a legal manner.	Can foster either negative, or positive attitudes to all state institutions, depending on experience.

In the last section of this chapter I first offered an analysis of the patterns of usage of contract enforcement strategies among firms, complementarities among strategies, and the summary and trends of their use. The patterns of strategy usage among firms were explained through three logics of strategy operation: logic of prevention (financial tools), logic of positive incentive (networks and professional associations) and logic of coercion (criminals, state officials, protection firms, arbitration and courts). Almost all firms were shown to apply strategies of prevention or positive incentive to their transactions, and some firms then proceed to coercion strategies if prevention fails. The choice of strategies was explained by firms' need and available resources.

I described two types of complementarities among strategies. One type has to do with a strategy operating through other strategies (protection agencies using either criminals or state officials to achieve their goals; criminals using state officials). The other type of complementarity is based on the functional resemblance between some strategies under certain circumstances that may occasionally result in their merging.

Finally, in the summary of the strategies' use I showed that while two-thirds of all studied firms use the preventive networks and financial tools strategies, significantly fewer firms use other strategies. Some strategies – Threat of punitive action by state officials, Threat of violence by criminals, and Protection agencies – appear to be on the decline in popularity among small entrepreneurs, while state courts and professional associations are getting used more often than before. This part concluded with an overview of the explanatory power of five factors that were specified in chapter 2 as possibly having a substantial impact on the choice of contract enforcement strategies by the studied firms. Three out of five explanatory factors were found to matter most: sector

of the economy the firms are in (trade, service, production), the size of the firms, and criminal involvement on the level of investment or personal connections.

My general conclusion concerning the dynamics of the use of contract enforcement strategies was that they are developing from more primitive and cruel, like bribing and use of violence, toward more “civilized” ones, like using associations and state courts. This finding contradicts popular belief of currently occurring de-formalization of Russian economy, supported by some scholarly work (Radaev 2001).

In the next chapter I will discuss the attitudes of Russian entrepreneurs toward the state with regard to contract enforcement, and their implications for the development of Russian capitalism.



## **Chapter 6: ENTREPRENEURS AND THE RUSSIAN STATE**

### **Introduction**

Scholars of contractual relations may ask how the extensive reliance by Russian entrepreneurs on informal means of contract enforcement differs from informal contract enforcement strategies documented by Macauley (1963), Uzzi (1997) and Ellickson (1991). Those authors also described how economic actors rely on informal means of contract enforcement, in the context of developed western economies. The difference between the Russian ways of enforcing contracts, and their western counterparts is profound in what these ways are formed as a response to, what undergirds their functioning, and what effect they have on the market institutions. While non-state contract enforcement strategies in western economies developed within a political and legal system that offers reliable and impartial legal ways of dispute resolution and protections against the unlawful actions of other actors, in Russia the situation is dramatically different.

As this chapter will attempt to document, the Russian ways of enforcing contracts are formed in the context of, and largely by, what entrepreneurs perceive as the state failure to secure a stable and lawful business environment and provide adequate property rights protection. The state is seen by entrepreneurs as a hostile entity, capable and willing to harm private businesses through its agents. Strategies that small firms develop to protect their property and enforce their contracts are formed as a response to the environment of economic, political and legal uncertainty and instability that the state is

deemed to be responsible for. In addition, predatory behavior by state agents reinforces entrepreneurs' negative opinions of the state, further widening the gap between the two.

Since the state is frequently defined by social scientists in terms of authority and enforcement and viewed as critical in economic development, the problem of obtaining support and obedience on the part of its subjects makes it necessary to analyze it in its relations with society (Migdal 1997). Erosion of authority occurs when the state fails to live up to the expectations of its subjects regarding provision of the most fundamental services, including enforcement of contracts, provision and maintenance of infrastructure, accessible health care and education (Evans 1992).

State institutions undoubtedly play a central role in the processes of post-communist transformation, whether we look at these processes on the level of governance, on the level of the recipient populace, or on the level of state institutions that are themselves being transformed. Ever since the collapse of the Soviet regime and the launch of free-market reforms in Russia, Russian reformers have been widely criticized for failing to take "institutional factor" into account. Both western social scientists and Russian scholars observed the discouraging resilience of old Soviet models, and surprising normative hybrids that resulted from the imposition of new rules onto old blueprints (Nelson, Tilly, and Walker 1997; Stark and Bruszt 1998; McDaniel 1996; Rona-Tas 1998). Along with other factors shown in chapter 3, the old Soviet normative structure compromised the ability of the state institutions to function well and thwarted the government's efforts to advance free-market reforms.

But what made state institutions even more incapable of carrying out their functions is the general 'mood of distrust' among Russian people toward the state and its agents.

This mood emerged from years of increasing poverty, unexpected and unjust monetary reforms, unrestrained crime, the withdrawal of social support that the Soviet state was committed to, and finally the state default of August, 1998, that robbed millions of people of their savings and bankrupted thousands of businesses.

The most crucially important factor, perhaps, unrealized by the actors themselves, that spurred the hostility and distrust among both entrepreneurs and the general populace toward the state was the rapid destruction of essential social norms and institutions, a cruel “unmaking” of an accustomed way of life (Humphrey 2002). It created many chances for opportunistic behavior that people were neither used to, nor knew how to deal with. Some observers claim that it is this condition of normlessness resulting from the manner in which both economic and political reforms were conducted, that was mainly responsible for the failure of the reforms:

One of the most difficult parts of a transformation, such as the transition from socialism to a market economy, is the transformation of the old ‘implicit social contract’ to a new one. If ‘reformers’ simply destroy the old norms and constraints in order to ‘clean the slate’ without allowing for the time-consuming processes of reconstructing new norms, then the new legislated institutions may well not take hold. Then the reforms will be discredited and the ‘reformers’ will blame the victims for not correctly implementing their ill-considered designs. (Stiglitz 1999, 8-9)

Much of the present work is about just that – how new norms, practices and attitudes appear to address the failures of both the state and the market. Such norms cannot be imposed from above; they arise spontaneously when people are faced with new kinds of challenges, like small Russian entrepreneurs were throughout the 1990s. The state however is not absent from this process; state-society relations powerfully influence it.

The state's legitimacy<sup>69</sup> determines how much the new norms will deviate from the letter and the spirit of the legal code. When a state experiences a crisis of legitimacy, noncompliance with the law tends to be deep and universal (Fish 2001). This noncompliance gets encrypted into the new normative structure and gets reproduced through new sets of practices and attitudes.

Entrepreneurs' perceptions of the state are particularly important because of the symbiotic relationship between the state and private business. The state depends on the tax revenue from firms while firms need the state to provide security and predictability of the business environment. When entrepreneurs perceive the state and its legal system as untrustworthy they are not willing to support it by compliance with the law. In his "Tax Morale in Transition Countries", Torgler (2003) argues that it is lack of trust in the government and state institutions in the countries of the former Soviet Union that accounts for much lower "tax morale" in these countries than in Central and Eastern European countries. According to Torgler, governments' ability to create a proper "structure of interaction" for firms directly influences entrepreneurs' willingness to accept the rules of the game suggested by the state.

The first section of this chapter will analyze the attitudes of small Russian entrepreneurs toward the Russian state and those state institutions that are pivotal for economic exchange, on the basis of interviews with owners and managers of the studied firms. These attitudes may not necessarily reflect the objective reality concerning, say, effectiveness of the police or corruption of tax inspectors. What they do reflect are the

---

<sup>69</sup> In socio-economic literature the legitimacy of the state is rarely discussed as an important variable; more commonly it is either ignored, or assumed to be unvarying. Some political scientists talk about legitimacy as a "generally positive orientation among the populace toward the political regime" (Fish 2001, 18).

perceptions that many economic actors share with regard to state institutions, and the state itself. Understanding these perceptions is critical if we want to gain insight into why the state plays such an insignificant role in the contract enforcement of small firms, as discussed in chapters 4 and 5. The second section of this chapter attempts to search for the roots of current state/entrepreneurs relations beyond the events of the past decade. Three main sets of traditions are considered: weak traditions of property rights, of civil society, and of rule compliance in Russia.

## 6.1. Attitudes of Russian small entrepreneurs to the state

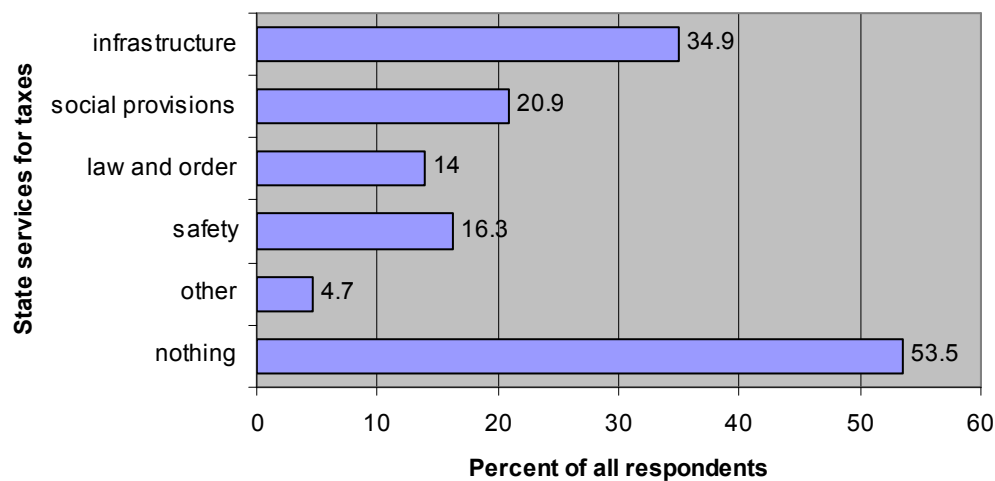
My grandmother, who used to be an ardent communist in her time, always used to keep a portrait of the current Party leader on the wall in her living room. She believed all the slogans and spent her life building communism, just to discover in the end of it that the king was naked. The last leader whose portrait she had on the wall was Gorbachev, who told the country that communism is a lie, and ain't gonna happen. Now she has an icon on her wall instead of a poster of the president.

The personal journey of my grandmother through the ideological rollercoaster of Stalinist repressions, Khrushchev's thaw, Brezhnev's stagnation, Gorbachev's reformation, and finally the realm of total confusion of post-perestroika is very typical in Russia. Since the Bolsheviks' revolution of 1917 people's attitude to the state was filled with emotions. Today, most people talk about the Russian state<sup>70</sup> with anger and disappointment. A majority of entrepreneurs in my sample spoke of how the state "betrayed" them, violated its obligations to provide quality education, medical care, pensions to the elderly, quality infrastructure. Social benefits provided by the state during the Soviet era are seen by many Russians as natural rights of citizenship that people can demand from the state. Over half of all respondents claim that they do not receive

---

<sup>70</sup> It has to be made clear that in their attitudes to the state Russian people tend to identify the state with state institutions and state officials, and rarely with the main executive office and the head of the state. This peculiarity of Russian culture has been discussed in numerous works of the 18<sup>th</sup> – 19<sup>th</sup> century Russian historians who puzzle over the question why the czar was portrayed in the folklore as a "father-protector" who would save the simple people from the arbitrary rule of the bureaucrats, if only he knew how his people suffered. This attitude was also quite common in Soviet Russia, with many people believing that the heads of the state were unaware of what was going on. It persists up to this day; in the last presidential elections Putin was reelected with 69% of votes, despite the fact that public opinion polls show that Russians share very low opinion of the Russian state in general.

anything from the state for the taxes they pay (figure 6.1). The remaining respondents believe they receive infrastructure (roads, communication, etc); social provisions (free education, free medical care, unemployment and disability benefits, etc), law and order in society, and personal safety provided by police forces<sup>71</sup>.



**Figure 6.1.** Perceptions about state services being received for taxes, among the respondents from studied firms (n=43), in % (multiple choices were possible).

From the latter group, most respondents specified that they are not satisfied with the quality of services provided by the state (bad roads and corruption of state officials were particularly frequently mentioned). Two-thirds of the respondents (62.2%) said that they don't believe they should pay taxes at all because they are not happy with how the state treats them.

Taxation indeed seems to be a major stumbling block in the relationships between the Russian state and small entrepreneurs. Entrepreneurs' grievances are not only about the amount of taxes demanded by the state, however, but also about tax collection procedures and about corruption among tax inspection officers. This is the most common

<sup>71</sup> For the wording of the question, see Question 6.7 of the Questionnaire.

complaint that I heard from my interviewees concerning state institutions and officials. The respondent from a firm that manufactures beer packaging says: “I cannot even say that the level of corruption is high, because in truth it is more than high, it is the maximum possible! And you never know whether the amount of bribes they extorted from you is going to be enough. Someone can always ‘order’ you: pay to the tax police or a tax inspector to organize an unscheduled and biased revision<sup>72</sup>. It is a quite common tool for dealing with competitors today, especially in more lucrative areas of business, like tobacco or alcohol sales” (Firm #27, Personal interview, July 2001). The owner of a real estate firm admits that bribing tax inspectors to conduct an extra careful inspection is a viable option in dealing with his competitors:

Say, you have problems with another firm, can be because they did something to you, or infringing on your market share. You can go to a tax inspector and say: “Here is \$1,000, I want you to check that firm”. A tax inspector would not say no, it is all the same to them which firms to check.

Question: Have you done it?

Answer: Myself and a few partners... We shared the cost. We had to deal with one firm that went against us on the market. It actually worked out quite cheap, less than \$500.

Question: Did you approach just a random tax inspector?

Answer: Well, not quite. One of my partners knew someone in tax inspection. (Firm #43, Personal interview, August 2001)

The executive manager from a firm that sells consumer electronics explains why bribing tax inspectors, as well as officials from other regulatory institutions, became such a common thing. The law is written in such a way, he says, that it is impossible to fulfill all the requirements, especially for a small business. So why even bother, spending time

---

<sup>72</sup> These practices have been documented in some of the academic literature; see, for example, Levin and Satarov (2000).



and money for endless paperwork, if it is so much easier just to give tax inspectors \$100 and they will 'overlook' the problem? "We simply have to share [with tax officials], and in the end everyone will be happy. In the beginning of my career I did my darnedest to have all certificates, pay all taxes, follow all regulations... The only lesson that I learned, and the hard way, is that if you want to do it, you may as well just hang yourself. Because it is impossible" (Firm #23, Personal interview, June 2001). He maintains that it is common among state officials to feel entitled to all the 'contributions' received from entrepreneurs, and they are willing to offer their assistance in exchange. "Tax police officers, however, are afraid to take identifiable gifts, or even money. They do it differently. They came to me once and said: 'Could you make a donation to our department, we really need mobile phones'. So we presented them with a number of mobile phones. In the process of presenting I said: 'If I have questions about taxes, can I contact you?' They said 'Of course'. And like this connections with them are built."

The executive manager from a firm that imports and sells lime says that ever since he graduated from business school a few years ago and got his job to run this firm, he was determined to keep his books as transparently and honestly as he could. However, the first tax inspector, he says, skillfully found a few minor mistakes and threatened to hit his firm with a large fine. The inspector made it clear that he was looking for a bribe, the respondent says. The respondent did not offer a bribe, but instead found a friend with extensive connections who negotiated the fine to be reduced. Since then, while not giving up his attempts to reach faultless book-keeping, the respondent instituted a special budget category to cover such 'unforeseen expenses' as bribes to state officials (Firm #21, Personal interview, August 2001).

Not only tax inspectors are notorious for corruption among Russian entrepreneurs. Public health inspectors, fire inspectors, environmental inspectors, and all the others in whose power it is to make entrepreneurs' life miserable provoke bitter complaints. For example, the owner of a roadside cafeteria says that his business suffers far more from extortion by state officials than from extortion by criminal gangs:

I pay a monthly "protection fee" to a criminal gang, just to avoid trouble. All the cafeterias in the area where mine is do so. I am used to it, and don't mind that much. The price has not changed for years already, and I know what to expect from them for this price, and what not to. But with state officials you never know what to expect. They are insolent. The head of the local public health service stops by my cafeteria every time she has a party, she takes food, alcohol, cakes, as much as she wants, and never pays. When I asked for payment once, she impressed on me how easy it is for her to close down my café. Even though I keep everything in order, I know that I will never win against her. That's why I say that state inspectors are worse than criminals. (Firm #40, Personal interview, August 2002)

It is typical that business owners do not perceive such clearly unlawful actions of public servants as episodic, but see them as inherent in state institutions. It is hardly surprising given the daily allegations in the media about corruption of prominent public figures that have become so common they are considered almost a norm (Levin and Satarov 2000, Sergeyev 1998). According to the Corruption Perception Index 2004 by Transparency International<sup>73</sup>, Russia occupied an abysmal 90<sup>th</sup> place, out of 145, 1<sup>st</sup> being the least corrupt (Transparency International 2004). Owners of small businesses seem to be affected the most by corruption of state officials on all levels. Experts from the National Institute of Systematic Research of Problems of Entrepreneurship estimate that owners of small businesses in Russia spend a minimum of half a billion dollars *monthly* on bribes to state officials, which constitutes about 6 billion dollars annually

---

<sup>73</sup> The Index is based on surveys of business people, academics, and risk analysts.

(Shestoperov 2003). Newly organized firms suffer the most; starting a new business entails obtaining various licenses and permits from about 50 bureaucrats. As one of the respondents in my study observed, “Our whole state apparatus is preoccupied with only one thing: how to enrich themselves using their positions of power” (Firm #5, Personal interview, June 2001). The combined corruption-related payments to both state and non-state organizations are estimated in the range of \$10-20 billion a year (Levin and Satarov 2000).

Many respondents pointed out pieces of legislation that they find bewildering, and the only explanation that appears reasonable to them is that such legislation is designed to generate revenue for a particular state office. For example, to obtain a license to engage in construction one is supposed to demonstrate three or more previously completed building projects. How is one supposed to build them without a license? A common bribe is \$200 to circumvent the requirements and get a license (Firm #1, Personal interview, June 2002). The fire department is also notorious for the large number of permits that one is required to obtain from them in order to open a store or a small workshop (Personal interviews: firm #16, July 2002; firm #39, August 2001). The problem of confusing and unintelligible legislation was listed as the second most serious problem for small businesses after taxation.

Many respondents gave examples from their work experience where state officials used the power of their position for personal enrichment. The executive manager of a chain of stores that sells fur and leather clothing describes how shortly after having reported to the police an incident of theft in the store, she was paid a visit by police officers. Their visit was not about theft in the store, however, but about the clothes that

the store sells. Police officers asked a “favor” – permission to purchase goods that they desired for the wholesale price [that the store pays to the suppliers]. “We never do it, not even to friends or family,” the respondent says. “At best, assistant buyers receive up to 10% discount, and managers get up to 15%. And here we see these guys who we don’t even know come in and request a huge discount! In response, we asked them – ‘Did you catch our thief? No, you did not. So why do you want a reward?’ It was a very unpleasant episode” (Firm #25, Personal interview, July 2002).

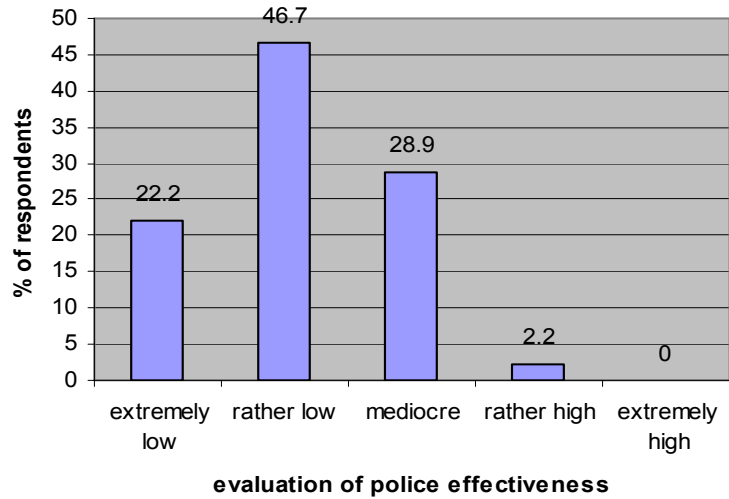
Another respondent had an even more negative experience with the police. An owner of an art-gallery, he came to the local police station to report some violation against his firm that in his knowledge was a criminal offense. A police officer on duty refused to take a report from him:

The conversation was very short. “Are you a businessman?”, - he asked me. I said yes. “Then please go to our protection department, they are dealing with private businesses.” Meaning that if you are in private business, you are no longer eligible for free protection against the unlawful actions of others. Their “protection department” competes with private protection firms; they offer the same set of services, and for a similar price. It happened in 1999, and I don’t believe things have changed since then. (Firm #8, Personal interview, July 2002)

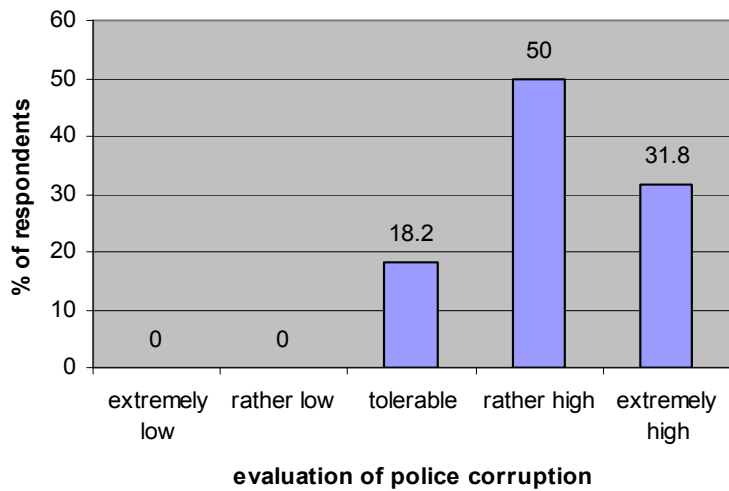
A similar attitude from the police was reported by a respondent whose full story was included in the Appendix 2 (“Luba’s story”). When she was attacked by gangsters, the police refused to accept a report from her, on the grounds that business people should themselves sort things out with criminals.

A third of all respondents (31.1%) had to deal with the police for various reasons as firm representatives, and over a half (57.8%) as individuals. The majority of the respondents evaluated their experience with this principle civil protection agency as very negative. Over two-thirds (68.9%) of all respondents in my study evaluate police

effectiveness as low or extremely low, and 81.8% evaluate corruption among police officers as high or extremely high (fig.6.2 and fig.6.3).



**Figure 6.2.** Perceptions of police effectiveness among the respondents from studied firms (n=45), in %.



**Figure 6.3.** Perceptions of police corruption among the respondents from studied firms (n=44), in %.

It is interesting to note, however, that those respondents who went to the police for personal reasons, also tended to use police services to address their firms' problems<sup>74</sup>, despite the fact that they had just as low an opinion about their effectiveness as those who never had any contacts with the police. Those respondents who evaluated police effectiveness as very low, tended to rate its level of corruption as very high<sup>75</sup>.

Respondents point out that the main reason why corruption is so detrimental to the development of private business in Russia is that it creates an environment of destabilizing unpredictability. Actors are never sure what to expect from state institutions. The executive manager of a chain of stores that sell consumer electronics says: "I need fully functioning executive power. We need firm rules, and even if these rules are tough, we will figure out how to live with them. Right now we have a situation when one day we have rules, and the next we don't, in one situation the state regulates, and in another it does not. It is completely destabilizing" (Firm #23, Personal interview, June 2001). It is hardly surprising that most business owners and managers find long-term planning difficult: two-thirds (67.4%) of all respondents said that they do not make business plans for more than a year ahead, and only two respondents said that they attempt some kind of long-term (four years and more) planning of their firms' development.

The owner of a firm that manufactures and sells tents views the corruption problem from the point of view of market competition. Some firms that have connections to state

---

<sup>74</sup> The correlation between the fact of having gone to police to report a personal problem, and to report a firm's problem is statistically significant at 0.05 level (one-tailed), coefficient = .283. Due to small size of the sample, non-parametric correlations (Kendall's tau\_b and Spearman's rho) were used.

<sup>75</sup> Correlation is statistically significant at 0.01 level (one-tailed). Kendall's tau\_b correlation coefficient = -.467, Spearman's rho = -.519.

institutions have an unfair advantage, he says: “If you have serious connections in the tax inspectorate or higher, you can skip paying taxes and various regulatory fees, and nothing bad will happen to you. I on the other hand don’t have such connections, and am forced to pay. Who do you guess will have a competitive advantage in the market? That’s the problem, that unlawful and dishonest behavior is being rewarded” (Firm #1, Personal interview, June 2002). The respondent admits that he evades taxes, but claims that he does so to equalize his chances in the market with those who have an unfair advantage. “I would very much like to pay all the taxes, it itches me that I don’t, but I cannot afford to put my company in such a disadvantaged position. I wish everyone paid.”

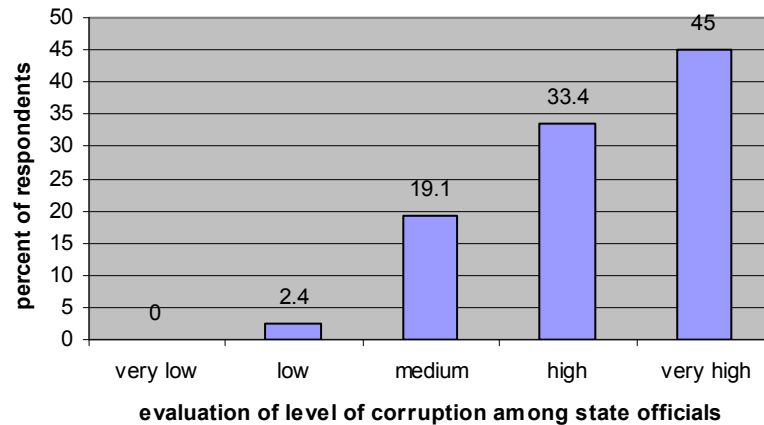
It is common among entrepreneurs to perceive state institutions as predatory, seeking not to fulfill their public duties, but instead to maximize rents that state officials can collect<sup>76</sup>. As a result, the corruption of state officials undermines the rule of law in society by making law enforcement much more difficult. Over a half (60%) of all respondents in my study disagree or strongly disagree that the Russian state is currently capable of enforcing its own laws and only 10% think that it is in fact capable of enforcing its laws. Almost a half of all respondents (47.5%) also think that the state is too weak to be able to maintain law and order and a third of the remaining 52.5% said that they do not perceive the state as weak because state officials have the power to destroy their business.

Most of those respondents who own and run their own businesses said that they feel they are victims of extortion from state institutions on the one hand, and from organized crime on the other. Like the owner of the roadside cafeteria who was quoted earlier,

---

<sup>76</sup> On the subject of predatory states see Levi (1988), Tilly (1985; 1990).

many find that criminal gangs are easier to deal with. Overall, most respondents in my study find the level of corruption among state officials in Russia high or very high (fig.6.4).



**Figure 6.4.** Perceptions of level of corruption among state officials by respondents from studied firms (n=42), in %.

The majority of respondents talk about what they see as extortion on the part of the state and/or its agencies with the mixture of desperation and defiance, but invariably very emotionally. The head of the finance department at a firm that sells computers says that she “hates and despises” tax inspectors, because “it is only the worst scum that can work as a tax inspector. They rob people. That’s why the state pays them so little, because everyone knows that they will collect bribes” (Firm #10, Personal interview, July 2002). Other respondents reason the opposite way: “It is the state’s fault that we have so much corruption among state agents. They have tiny salaries; people cannot survive with such salaries if they don’t take bribes. Look at police officers, for example. The average monthly salary of a road police officer is about 2,000 rubles [= \$62], sufficient only to pay utility bills, and not to feed the family” (Firm #22, Personal interview, July 2002). The emotions regarding the state and its agents often dictate how firms’ leaders deal with tax



paying. A co-owner who runs his firm that manufactures packaged bread snacks shares his experience:

There was a time, back in the middle of the 1990s, when I earned a good income on shares and short-term government bonds. I paid all the taxes I was supposed to. But then there was the 1998 crisis, and I lost everything. I sued the state, and won, but the state paid the penalty only in 2000, and after inflation it was only a fraction of what I had lost... And so I stopped paying taxes: if the state is so ugly with me, why should I be good? (Firm #11, Personal interview, July 2002)

Many other owners of small business reported that they started their firms in good faith regarding honesty of their book-keeping, and had a change of heart when they realized how much extra cash all the regulatory requirements, bribes and additional payments would take. The restaurant owner and executive manager says that it is *retroactive* taxes that kill her: “We already lived through that time, and now suddenly we get notified that this new tax is introduced, and we have to pay it for all the time while we were in business!” (Firm #14, Personal interview, July 2002) Most (87%) respondents admit that their firms do not declare a significant part of the firm’s income to tax authorities; 40% say that they hide over 80% of their total revenue to avoid paying taxes<sup>77</sup>.

Business owners and managers in my study identified taxation as the direst problem that they face today. Taxation is not simply a problem of the excessive payments that the state demands, and of corrupt state officials; it is a problem of taxation procedures and of an extremely confusing tax code that a person without special training has difficulties figuring out. The owner of an art-gallery is convinced that the tax code is *purposefully*

---

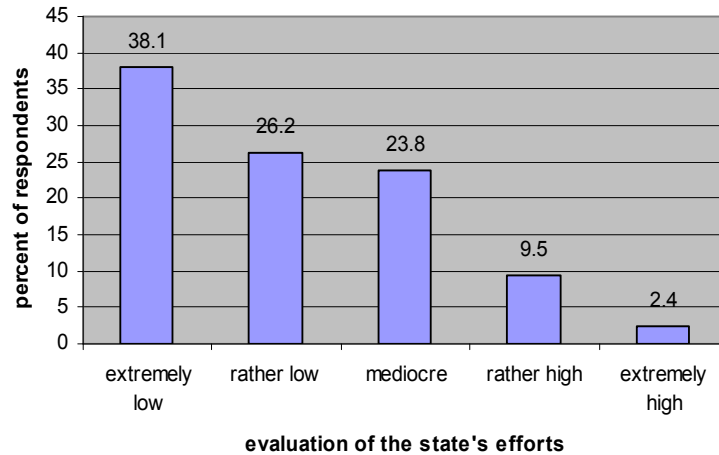
<sup>77</sup> See chapter 3 for more details on tax evasion.

designed in such a manner, to secure a sure source of income for the state from all the fines and penalties for mistakes that small entrepreneurs will invariably make. “It is the unnecessary complexity of tax legislation that pushes small entrepreneurs into the shadow economy. They cannot afford to hire a qualified accountant to keep books in a perfect order, and they cannot do it themselves. Hence the outcome: either go bankrupt because of all the fines that you will accrue, or skip the books altogether. So in my opinion, it is our state that pushes honest people into dishonest business” (Firm #8, Personal interview, July 2002). He points out that the main problem with tax legislation is not even that it is so complicated, but that it changes constantly, and it is indeed a full-time job to keep up with it.

To draw some conclusions, we can identify four major grievances regarding state institutions expressed by the interviewees, in addition to the problems with the state court system discussed in the previous chapter:

- Extortion by state officials. It is viewed by most respondents as both an injury, and an insult.
- Corruption on all levels of public authority. It compromises the legitimacy of state institutions, and distorts market competition.
- Confusing and frequently changing tax legislation and a high level of regulatory involvement are seen by entrepreneurs as tools of a predatory state to generate more revenue, and are perceived as unjust.
- Finally, an unreliable police force leaves entrepreneurs unprotected against organized crime.

All these are serious concerns, and explain why the majority of entrepreneurs think that the Russian state attempts to destroy rather than develop small business (fig.6.5).



**Figure 6.5.** Perceptions of the Russian state's efforts to create favorable conditions for the development of small business by respondents from studied firms (n=42), in %.

The complaints of private entrepreneurs about the state's policies and institutions are undoubtedly valid. However, much of the emotion and hostility that entrepreneurs feel toward the state is a legacy of the past. The next section of this chapter will attempt to look at both historical and institutional roots of contention between small private entrepreneurs and the Russian state.

## **6.2. The Russian past as a factor in shaping attitudes to the state**

Since the collapse of the Soviet regime, there has been much discussion among scholars about the effect that legacies of that regime will have on new political economies. Advocates of the path-dependency thesis have argued that preexisting institutional structures plays a crucial role in both institutional and organizational development. While formal rules can be changed (or so claimed) overnight, we cannot expect the same rapidity from the normative structure, from culture specific “strategies of action”, because they are deeply ingrained in people’s minds, into patterns of social behavior and relationships, they grow from cultural heritage and are supported by such strong sentiments as nationalism and religion. Three elements of historic legacy influence the relationships between Russian entrepreneurs and the state: a weak property rights tradition, a weak civil society tradition, and weak norms of rule-compliance.

Hundreds of years of capitalism in the West allowed organizations to develop relatively efficient structures, which are based on the inviolability of private property on the one hand, and the balance of political power to secure protection of rights of all economic actors on the other. In the West, corporate and individual sovereignty was fought over by the state, the church and nobility, and in the process of this struggle social, legal and political institutions were built. Russian history is in many ways different from its Western neighbors. While capitalist institutions were developing in the West, Russia was an autarkic expansionist empire, economically based on agricultural slavery. In the twentieth century it became an authoritarian expansionist superpower, with a planned industrial economy. Never in its history were property rights strong or important. Post-

Communist Russia inherited four centuries of a system of rule in which political authority presupposed substantial (often nearly complete) control not only of the nation's economy but of the individual property of the state's subjects as well.

Civil society never existed in Russia in a developed form either. Virtually to the day of its sudden collapse, the totalitarian old regime relentlessly sought to extirpate, suppress, subvert, or co-opt voluntary organizations in which the habits of self-governance, personal responsibility, and reconciliation of interests could have been instilled and reproduced: trade unions, community associations, clubs. Although it was argued that Soviet totalitarian regime had not succeed in ultimate atomization of individuals that would have been particularly difficult and time-consuming to overcome (Gibson 2001), it certainly left a tradition of poor civic engagement.

At the moment, the level of participation in public affairs among general public is very low, professional associational life is only starting to appear, and strong points of grass-roots voluntary organization, like churches and community associations, are nearly absent. Endemic corruption further weakens interpersonal trust. Contrary to the optimistic analyses and prognoses of Westerners scholars who observed a large amount of social capital in Russia (Marsh 2000) and predicted quick development of democratic society on the foundation of extensive informal social networks that cross family and class structure (Gibson 2001), we instead see the reverse process in many areas of social, economic and political life. Civic Forum held in Moscow in November 2001 by twenty-six major Russian NGOs adopted a resolution that says:

A system of so-called "managed democracy" is developing in Russia instead of a democratic society predicated on civil institutions. Under this system, citizens are gradually restricted from decision-making processes which may have direct impacts on their interests, and society in general is deprived of the

opportunity to control governmental activities. Consequently, a situation emerges in which governments do not serve the public interest and are not controlled by the public. On the contrary, the public becomes more and more subordinate to the government. (Civic Forum 2001, 1)

A feeling of estrangement from decision-making processes is clearly heard in the words of my respondents. In their own assessment, small business owners continue to be most excluded and victimized economic players in Russian business world, with little hope of gaining any real political leverage in near future.

And finally, the centuries of absolutism first, and Soviet authoritarianism second, left the country with exceptionally weak normative patterns of rule-compliance. Corruption and *blat* have been features of Russian economic life for centuries, and the Soviet era was not an exception. Since the rigidities of the socialist command economy in Russia required a significant degree of rule circumvention in order to succeed, individuals developed a largely predatory attitude to the law: use it when it is possible and profitable, and forget about it at all other times. The history of lawbreaking in pre-perestroika Russia created a negative environment for the new generation of laws and policies, this time intended to facilitate free market development. Another side of this process is its self-reinforcement:

Evasion of rules in one area tends to induce responses in other areas. For example, the possibility for policemen to earn money through bribes lowers their official salaries. And while firms are evading their legal obligations to the state in tax payments, the state is evading its legal obligations to firms in terms of payments for goods, which in turn is partly responsible for delayed or nonpayment of wages and further tax evasion, and so on. (Leitzel 1998, 125)

Feige (1998) argues that those economies that had pre-transitional norms of noncompliance and distrust of the state, like Russia did, can increasingly find themselves

accepting a wide range of protective and predatory behaviors that impose severe adjustment costs on the transformation process. In Russia, a lack of strong property rights and civil society traditions exacerbate the predatory attitudes of both entrepreneurs and the state, where the state's agents display a lack of respect for entrepreneurs' property, and entrepreneurs act opportunistically toward state property, and toward fellow entrepreneurs.

As illustrated in quotations from interviews with entrepreneurs in the previous part of this chapter, those who are determined to keep their business 'clean' find the costs of compliance with the official regulatory system in Russia extremely high. The first reason for this is the constantly changing legislation which causes uncertainty and frustration even among the best-intentioned economic actors. The state fails to fulfill its main function for the market: provision of an institutional system beneficial to economic actors, stable and fair legislation and protection against criminal elements (Murrell 2001; Frye and Zhuravskaya 2000; Hass 1999). The reciprocal nature of rule evasion that Leitzel points out in the quotation above creates a vicious circle: entrepreneurs regard the state's claim to taxes as unjust because the state does not follow the rules that it laid out while the state cannot afford to keep all its promises because the tax revenues are insufficient.

Antagonism between public servants and private entrepreneurs is profoundly embedded in Socialist norms and practices. Before perestroika, private entrepreneurship was called 'profiteering' and *netrudovyye dohody* [unearned income], and constituted a criminal offence. The general populace was subjected to extensive propaganda about the evils of individualism as a foundation of capitalism. In the accepted moral code, it was

wrong to care about individual success and personal enrichment. Instead, the masses were taught to sacrifice individualist desires for the sake of the collective good. Many Russians still uphold those values.

Still, a small private sector has always existed in a shadow economy despite relentless persecution by police and extortion by criminal gangs. Many of those illegal entrepreneurs from Soviet times legalized their activity as soon as private entrepreneurship was permitted, with the first laws on private property at the end of the 1980s<sup>78</sup>. It is hardly surprising, though, that the mutual distrust and animosity between these entrepreneurs and state officials has lingered for a long time after that. On the other hand, those private entrepreneurs who came from the state sector, also had little trust in the state. The issue of the credibility of the state's promises has been at the center of managers' grievances:

From the beginning of the century, since the actual interpretation and enforcement of state law was arbitrary, the Soviet manager had become very suspicious of government edicts and regulation. Both the communist regime and the tsarist regimes would backtrack on their word, as both groups were concerned with their survival and considered their survival to be above the law. (Randall 2001, 57)

Concerned with its own well-being, the post-Soviet Russian government has done little to improve its credibility with both the general public, and the business world. Just like the Party *nomenklatura* under the Soviet regime, the new capitalist elites have no regard for formal laws, largely because the two groups overlap enormously (McDaniel 1996; McFaul 1997, Hedlund 2001). The change of regime brought not the rule of law, but the rule of the strong. The attitudes of a new class of private entrepreneurs toward the state reflect that.

---

<sup>78</sup> For an example, see Luba's story (Appendix 2).



## Conclusion

There is a popular saying in Russia: the severity of Russian law is mitigated by the ease of its circumvention. This saying was mentioned to me by several of my respondents, and the others would probably agree with it, too. This folk wisdom becomes especially true when public servants are the chief offenders. Both the state and entrepreneurs display predatory behavior and a lack of regard for the law. This is an important distinction from the circumstances in which non-state contract enforcement strategies get shaped and operate in developed western economies.

In this chapter, I showed that the contention between Russian entrepreneurs and the state has both contemporary reasons and historical causes that include weak property rights and civil society tradition, weak norms of rule-compliance, and a lack of credibility of the state in the eyes of entrepreneurs.

State officials and reformers in Russia should realize that without the good will of the entrepreneurial class it will be much more difficult to achieve the changes that the Russian government is attempting. With the ultimate goal of building a system of smoothly functioning capitalism, the state must reach out and connect to society, ultimately bridging the immense gap that exists now.

# CONCLUSION

## Research Findings

It has been over a decade since free market reforms and political restructuring were embarked upon in Russia, and a great deal has been written about the painful and uneven process of change. This dissertation attempted to shed light on a particular aspect of transition – the problem of contract enforcement, experienced by a particular group of actors – small entrepreneurs. The goal of the dissertation was to show what kinds of problems small Russian entrepreneurs experience with contracting, where these problems come from, and how they are solved on the ground. In doing so, I hopefully succeeded in demonstrating the significance that state contract enforcement institutions have for economic exchange.

While it was argued by many scholars that economic actors can successfully develop self-governing organizations to enforce their contracts and protect their property rights (Ellickson 1991; Frye 2000, Macauley 1963), my research shows that non-state contract enforcement strategies developed by small entrepreneurs in Russia at best create as many problems as they solve. I argued that it is the proximity of reliable state enforcement institutions that makes non-state enforcement in developed western economies successful. What distinguishes Russian ways of contract enforcement from somewhat similar strategies found in other places is that they are formed in the context of failing state enforcement institutions, and contentious relations between private entrepreneurs and the state. Entrepreneurs still perceive Russian state enforcement institutions as unable

to guarantee impartial and reliable enforcement services to economic actors, and view the state and its agencies in an overwhelmingly negative light, for reasons both historical and contemporary. Historically weak traditions of property rights, a weak civil society and weak norms of rule compliance, in conjunction with the Soviet legacy of prosecuting entrepreneurship negatively affect relations between entrepreneurs and the state. Today, according to my data, corruption on all levels of public authority and confusing and constantly changing legislation are seen by entrepreneurs as among the most serious problems they face. The contentious relations between the state and entrepreneurs impact strategic choices that entrepreneurs make, including the problems of dispute resolution and contract enforcement. The enormous gap that exists now between small businesses and the state is likely to result in an unfavorable business climate, as well as implicit grass-roots resistance to reformation.

As my research shows, most Russian entrepreneurs rely on non-state ways of enforcing their agreements. These strategies are either based on a given firm's own resources (financial or social), or come from various agencies that offer enforcement services for sale, which vary from government licensed private courts to criminals. Non-state enforcement strategies are mostly network-based, are rooted in preexisting norms, practices and attitudes, and develop in response to specific kinds of state failure to provide contract enforcement. For example, the ineffectiveness of police agencies contributed to the spread of criminal involvement in business relations, as a violent means of redress. Corrupt and omnipotent state officials opened avenues for bringing state institutions onto one's side through bribery.

The third major question that I asked and attempted to answer in this dissertation concerns the consequences that reliance on non-state enforcement strategies has for new Russian capitalism. The obvious virtue of non-state enforcement is that it facilitates transactions by giving them certain security. The major negative consequence of firm-based strategies of contract enforcement is the considerable entrance restriction they present to new firms who may lack social capital to participate in the information and closed exchange networks, have no connections to state institutions, powerful individuals or criminal groups, and cannot afford to prepay for every service they need to purchase. Other negative consequences include the contamination of the business environment with criminal methods in contract enforcement and dispute resolution, and further diminishing the legitimacy of the state's claims to taxation.

The state's legitimacy becomes a particularly important issue when we turn to the impact that non-state enforcement strategies have on the building of new market institutions. As chapter 6 showed, the everyday frustration of economic actors with the endemic corruption of state officials, confusing tax legislation, high levels of regulatory involvement, and a lack of reliable protection from state legal institutions against crime and fraud amass to a rejection of state authority in other areas as well, including tax collection and policy implementation. However, contrary to the arguments by some scholars who characterize changes in the Russian economy as a process of de-formalization (Radaev 2001), I found that in fact the opposite is true – more firms now rely on contract enforcement and dispute resolution through formal procedures by state institutions than a few years ago.

Finally, in the attempts to answer the fourth research question – why firms choose a particular course of action over others – I looked at two reasons that can be seen as complementary. The first explanation was offered on the level of the explanatory factors that were discussed in detail in chapter 2, and then referred to in chapters 4 and 5. These factors are certain attributes of firms that help us better understand firms' needs in enforcement strategies on one hand, and their available resources to deal with disputes and contract enforcement problems on the other. Three out of five explanatory factors were found significant in predicting the use of non-state enforcement strategies, one of which is reflective of firms' internal resources (connections to criminals), one serves as an indicator of a firm's needs in enforcement (area of business) and one is described as an indicator of both (a firm's size). Firms' need in contract enforcement determines whether or not a firm would develop a specific strategy or strategies for dealing with contractual problems, while the available resources largely shape the response the firm chooses.

The other important factor that was found to impact firms' choices of contract enforcement strategies is the temporal dimension of the transaction. Out of nine described strategies three work by prevention, and two of them are the most commonly used strategies among the studied firms. The other six strategies are "coercive", they get employed after the fact of a transaction and a violation of the terms of contract, and they mainly aim to obtain redress. The firms with most acute needs and available resources tend to have elaborate approaches to dealing with contract violation that combine preventive and coercive contract enforcement strategies.

## Theoretical contributions of the study

The lessons concerning the powerful structuring role of enforcement institutions which my dissertation draws from Russian experience have much wider implications not only for analysis but also for policy, and provides valuable contributions to our understanding of processes of post-communist transition, the role of the state in capitalist development, to economic sociology and organizational analysis.

First and foremost, my research contributes to the debate on transition in a number of ways. While some existing research supports the claims that state enforcement institutions fail to guarantee enforcement of business agreements, few scholars looked at how small firms with no leverage adapt to this environment. My dissertation demonstrated that enforcement institutions have a dominant role in the development of organizational structure and capitalist exchange. The research evidence supports the claims of neostatists that in the market economy, a strong state is indispensable (Kochanowicz 1994), and lays emphasis on enforcement institutions and the rule of law. In Russia the predictability of market exchange is undermined by the state's failure to provide contract enforcement – the basic prerequisite for the functioning of a modern economy.

A focus on 'small people' gives ground for another important contribution that the study makes to this literature. Differently from most research on transition that concentrates on elites, my study shows that everyday actions of small businesspeople should also be treated as very significant, because they *create* a new environment of capitalistic exchange and give shape to new market institutions.

The study's central argument of the powerful structuring role of enforcement institutions also connects this research to the body of literature on state and development. State is defined here in terms of authority and enforcement (Rueschemeter and Evans 1985), and viewed as critical in economic development (Evans et al. 1985). The research evidence contradicts the neoliberal claim of sufficiency of self-regulating markets for smooth functioning of the economy in favor of the argument that the capability to provide independent enforcement services for business is an indispensable feature of the modern state, and failure to do so undermines the state's legitimacy and creates an unfavorable business environment. In the dissertation I argued that contract enforcement is one of the fundamental services that are expected from the state, and failure to provide it contributes to a rejection of state authority in other areas as well, including tax collection and policy implementation, thus compromising the development of capitalist institutions in Russia.

My study also contributes to network analysis. While insightful with respect to the significance of both inter-firm and intra-firm networks in which economic exchange is embedded, authors tend to omit the embeddedness of networks of economic actors in a larger structure. My research emphasizes the importance of embeddedness of entrepreneurs in the networks both outside and inside of the business community.

The study also makes a contribution to organizational analysis. There has been little research done to show how new routines of organizational behavior (Hannan and Freeman 1977) get established in conditions of changing institutional structure. The evidence from this research shows how such routines emerge from survival strategies under a perceived failure of state enforcement institutions, and the cultural roots of these

strategies. Explanatory variables in this research also help reveal how sector, size and available resources affect choice of enforcement strategies used.

## **Future Research**

One of the important findings that emerged from my dissertation research is the enormous role that social networks play in capitalistic exchange in Russia. Reliance on business-to-business ties as a means to reduce uncertainty is typical of the initial stage of market institution building (Frye 2000). But what I found different about the structure of networks that private firms develop in Russia is the significance of structural embeddedness of firms in networks *outside* of the business community. Touching upon this question only marginally and in relation to the contract enforcement problem, my dissertation research showed the importance of extensive outside connections for firms' functioning. Firms' mostly informal ties to criminal groups, to officials in various state institutions, to professional associations, to financial organizations and even political parties were mentioned to me by my respondents as at times crucial to a firms' survival. In the future research, I will further explore this issue. Specifically, I am interested in investigating the role that agents outside of business community play in facilitating economic exchange, in the context of post-communist political economies, and examining how institutional uncertainty in the business environment relates to the significance of such networks. The character, quality and structure of these ties and the influence they exert over economic activity need to be studied. The first goal of such research would be to specify a relationship between the successful economic activity of a



private firm, and its embeddedness in social networks outside of the business community, in the context of post-communist political economies.

Based on my PhD dissertation research, I suggest that such embeddedness must have a substantial positive impact on the economic activity of private firms because ties to outside agents give firms additional resources in addressing problems with contract enforcement, dispute resolution, licensing, loans and credit lines, and also may provide essential information regarding other economic actors. The reason why a firm's embeddedness in networks outside of the business community seems to matter so much in new capitalist economies is that the institutions that are supposed to perform the tasks of facilitating economic exchange are weak, poorly defined, and perform inconsistently. For example, in Russia credit rating agencies are virtually non-existent (Guseva and Rona-Tas 2001), state contract enforcement institutions are unreliable (Frye 2001; Frye and Zhuravskaya 2000; Hass 1998, 1999; Rona-Tas 1998, Hendley 2001, Solomon and Foglesong 2000), and corruption among officials from state regulatory institutions is high (Levin and Satarov 2000).

While my field research on contract enforcement provides ample evidence of firms' embeddedness in social networks outside of the business community, more empirical data may be needed to specify the character of such network operation, its role in economic exchange, and the impact of institutional uncertainty on such networks' activity. I intend to study a sample of private firms in Russia, with regards to their involvement in social networks outside of their immediate business community.

On a more general note, further comparative research of non-state forms of contract enforcement and dispute resolution as a strategic response by economic actors to various challenges of business environment is needed. What are general forms of non-state contract enforcement that can be observed across various institutional settings, and what accounts for their development, and degree of their influence over economic exchange? My work provides a partial answer to this question, but only in the context of Russian economy. However, without systematic comparison it is hard to make claims regarding specificity of institutional forms of non-state enforcement found in Russia at the present time. Works by scholars on non-state contract enforcement in African countries (Kahkonen and Meager, 1998) or in China (Xin and Pearce, 1996) demonstrate that many of enforcement solutions are not unique to Russia, and are found in other countries, as well. Further research is needed to map out the relationships between institutional legacies, forms of state enforcement mechanisms, and non-state enforcement solutions in various institutional contexts.

## APPENDIX 1: QUESTIONNAIRE

### Content of the questionnaire:

1. **General information about the firm/respondent**
2. **Nature of contractual relations**
3. **Nature of the problems with enforcement of contracts/business agreements**
4. **Types of solutions to enforcement problems (strategies of enforcement)**
5. **Attitude/knowledge of state enforcement institutions**
6. **Attitude toward the state**
7. **Relationships with other firms**
8. **Personnel, investments in growth**
9. **Criminal involvement**

IV = Independent Variable

NOTE ON THE INTERVIEW PROCEDURES: The interviews started with the Introductory words explaining to the respondents the purposes of the research, then assuring them as to the complete confidentiality and anonymity of the process, and signing the Informed Consent form. The respondents were asked not to mention any names during the interviews that could lead to their identification:

#### Introductory words:

*The research you are about to participate in aims to investigate strategies of contract enforcement that small firms in St.Petersburg currently use. Several dozen firms in various fields of activity participate in this study. I PERSONALLY GUARANTEE FULL CONFIDENTIALITY OF OUR CONVERSATION.*

*The procedures of the field research were approved by the Institutional Review Board of the University of Maryland, USA. With your permission, I will tape-record our interview; it then will be transcribed and tapes will be destroyed.*

*To ensure anonymity, I would like to ask you not to mention any last names, names of companies or any other information that can lead to the identification of your firm during the tape-recorded interview.*

I then asked respondents questions from the questionnaire, and while tape-recording their full answers, coded their answers in the multiple choice questionnaire. During interviews, I tried to encourage respondents to give comments and examples from their personal experience. Thus the final result of interviews was two-fold: a completed questionnaire on one hand, and tape-recorded comments and examples on the other. The latter component of the interview materials was treated as qualitative data, analyzed separately, and used as illustrations and explanations throughout the dissertation.

## 1. General information about the firm/respondent

1.1. What is the main business activity of a firm (IV1)

<i>code</i>	<i>Sector</i>	<i>Specify</i>
1	Trade	
2	Service	
3	Manufacturing	

1.2. When was the firm founded (IV2)

<i>code</i>	<i>time period</i>	<i>Specify</i>
1	Before 1995	
2	1995-1998	
3	1999 – 2000	

1.3. Was the firm previously part of a state enterprise?

<i>code</i>	
1	Yes
2	No

1.4. What is the number of full time personnel employed by your firm? (IV4)

<i>code</i>	<i># of employees</i>	<i>Specify</i>
1	2 – 50	
2	51-200	

1.5. Position of respondent in the firm

<i>code</i>	<i>position</i>
1	Single owner
2	Co-owner
3	General manager
4	Manager
5	Accountant
6	Other: specify

1.6. Age of respondent

<i>age</i>

1.7. Sex of respondent

<i>code</i>	
1	Female
2	Male

1.8. Education of respondent

<i>code</i>	<i>Highest achieved education</i>
1	Graduate degree
2	College degree
3	Professional diploma (PTU)
4	High-school diploma

1.9. Have you ever held a managerial position (if yes, for how long)?

**Note:** if the respondent had not worked as a manager before her/his present employment, then zeros in the second column.

<i>code</i>		<i>Specify total # of years</i>
1	Yes, before 1990	
2	Yes, after 1990	

1.10. Have you ever held a managerial position in a state enterprise? (IV3)

<i>code</i>		<i>Specify total # of years</i>
1	Yes	
2	No	

## 2. Nature of contractual relations

2.1. With what types of firms and with how many firms do you have contractual relations (clients, suppliers, partners, contractors)?

		<i>Yes / No and the # of firms</i>
1	Clients	
2	Suppliers	
3	Partners	
4	Contractors	
5	Other ( <i>specify</i> )	

2.2. With how many of them do you have long-term relationships (with whom you have worked a long time and continue to do so)?

		<i># of firms</i>
1	Clients	
2	Suppliers	
3	Partners	
4	Contractors	
5	Other ( <i>specify</i> )	

**NOTE: Throughout this questionnaire, the term “contract” refers to those agreements between your firm and its business partners that are signed for each separate deal, and not for a specific time period. [To indicate here if the firm signs *only* time-based contracts.]**

2.3. How ‘real’ are the contracts you sign? Do they report the sums of money and other conditions accurately?

<i>code</i>	
1	Do not indicate at all neither sums of money, nor time frame
2	Indicate sums of money and/or time frame, but incorrectly
3	Indicate exact sums of money and time frame with any factual changes constituting breach
4	Other ( <i>specify</i> )

2.4. How frequently do you sign a contract after the deal has already taken place, solely for the purposes of reporting to state officials?

<i>code</i>	
1	All the time or almost all the time
2	More than 50% of all deals
3	Less than 50% of all deals
4	Never or almost never
5	Other

2.5. How do your business agreements with your clients and suppliers look like in terms of required prepayment?

<i>Code</i>	
1	Always or most of the time pay in full after the deal
2	Always or most of the time prepay 100%
3	Always or most of the time prepay less than 50%
4	Always or most of the time prepay more than 50%
5	Always different, without any pattern
6	Always cash at the time of the deal

2.6. Does it ever happen that you delay payment? If so, how do your business partners react to this? How have you solved this problem (describe in detail)?

<i>Code</i>	<i>(multiple selection is possible; detailed explanation of cases to be recorded)</i>
1	If happened to delay payment, the business partner would understand it was a necessity
2	If happened to delay payment, personal negotiation would follow, which is a part of routine
3	If happened to delay payment, personal negotiation would follow, often leading to spoiled relations
4	If happened to delay payment, the business partner would use his protection agency to negotiate
5	If happened to delay payment, the business partner would appeal to police or courts
6	If happened to delay payment, the business partner would threaten with severe prosecutorial actions to obtain payment
7	If happened to delay payment, the business partner would use connections with other members of the trade network to exert pressure
8	Never delayed payment because always pay in full beforehand
9	Never delayed payment although prepay only partially or not at all
10	Other ( <i>specify</i> )

### **3. Nature of the problems with enforcement of contracts/business agreements**

3.1. Have you ever experienced the problem of non-payment or other violation of contract (*list all*)?

<i>code</i>	
1	Yes, non-payment
2	Yes, delayed payment
3	Yes, breach of terms of delivery
4	Yes, other ( <i>specify</i> )
5	No

3.2. If not, what do you think are the reasons (given how widespread is the problem in Russia right now)? (detail reasoning and description of strategies employed by managers to protect the firm from contract violation)

<i>code</i>	
1	Always require 100% prepayment
2	Trade only with few long-term partners
3	Have been in business for a short time
4	Don't know
5	Other

3.3. How often do you have problems of this kind?

3.3.1. Before the crisis of 1998?

<i>code</i>	
1	All the time or almost all the time
2	More than 50% of all deals
3	Less than 50% of all deals
4	Never or almost never
5	Firm did not yet exist

3.3.2. After the crisis of 1998 (September 1998 – 2001)

<i>code</i>	
1	All the time or almost all the time
2	More than 50% of all deals
3	Less than 50% of all deals
4	Never or almost never
5	Firm did not yet exist

3.3.3. Now (this year)?

<i>code</i>	
1	All the time or almost all the time
2	More than 50% of all deals
3	Less than 50% of all deals
4	Never or almost never

3.4. How often does your firm breach written and verbal business agreements (include delayed payment, delayed delivery, etc)?

WRITTEN AGREEMENTS

3.4.1. Before the crisis of 1998?

<i>code</i>	
1	All the time or almost all the time
2	More than 50% of all deals
3	Less than 50% of all deals
4	Never or almost never
5	Firm did not yet exist

VERBAL AGREEMENTS

3.4.4. Before the crisis of 1998?

<i>code</i>	
1	All the time or almost all the time
2	More than 50% of all deals
3	Less than 50% of all deals
4	Never or almost never
5	Firm did not yet exist

3.4.2. After the crisis of 1998  
(September 1998 – 2001)

3.4.5. After the crisis of 1998  
(September 1998 – 2001)

<i>code</i>	
1	All the time or almost all the time
2	More than 50% of all deals
3	Less than 50% of all deals
4	Never or almost never
5	Firm did not yet exist

<i>code</i>	
1	All the time or almost all the time
2	More than 50% of all deals
3	Less than 50% of all deals
4	Never or almost never
5	Firm did not yet exist

3.4.3. Now (this year)?

<i>code</i>	
1	All the time or almost all the time
2	More than 50% of all deals
3	Less than 50% of all deals
4	Never or almost never

3.4.6. Now (this year)?

<i>code</i>	
1	All the time or almost all the time
2	More than 50% of all deals
3	Less than 50% of all deals
4	Never or almost never

3.5. If you have to delay payment/delivery to one of two business partners, one of whom is 'old' and the other is 'new' (all other conditions being equal), whom do you think you are more likely to delay payment/delivery to? (explain why)

<i>code</i>	
1	'Old' one (explain why)
2	'New' one (explain why)

**4. Types of solutions to enforcement problems (strategies of enforcement)**

4.1. How do you react to a problem of violation of contract/business agreements? (detail the story)

4.1.1. Go to the police (outcome?)

<i>code</i>	
1	Yes, resolved positively
2	Yes, resolved negatively
3	Yes, unresolved
4	No

4.1.2. Go to a protection agency (outcome?)

<i>code</i>	
1	Yes, resolved positively
2	Yes, resolved negatively
3	Yes, unresolved
4	No

4.1.3. Ask friends, relatives who can help to pressure the violator (outcome?)

[Where 1 = yes, resolved positively (for the firm); 2 = yes, but resolved negatively (for the firm); 3 = yes, but unresolved; 4 = no.]

<i>code</i>	<i>(multiple selection is possible; explanation of cases to be recorded)</i>	<i>Outcome</i>			
		<i>1. (+)</i>	<i>2. (-)</i>	<i>3. (-)</i>	<i>4. (no)</i>
4.1.3.1	Friend, relative in state organization (police, city administration, etc.)				
4.1.3.1	Friend, relative in a non-state organization (trade association, etc.)				
4.1.3.3	Someone who can physically threaten the violator				
4.1.3.4	Other (specify)				



4.1.4. Apply to the state court/private court (**outcome?**)

<i>code</i>	
1	Yes, resolved positively
2	Yes, resolved negatively
3	Yes, unresolved
4	No

4.1.5. Hire somebody so they would resolve the dispute (a person in state institution; person(s) who can physically threaten the violator) (**outcome?**)  
**[Where 1 = yes, resolved positively (for the firm); 2 = yes, but resolved negatively (for the firm); 3 = yes, but unresolved; 4 = no.]**

<i>code</i>	<i>(multiple selection is possible; explanation of cases to be recorded)</i>	<i>Outcome</i>			
		<i>1. (+)</i>	<i>2. (-)</i>	<i>3. (-)</i>	<i>4. (no)</i>
4.1.5.1	Employee of a state organization (police, city administration, etc.)				
4.1.5.1	Employee of a non-state organization (trade association, etc.)				
4.1.5.3	Someone who can physically threaten the violator				
4.1.5.4	Other (specify)				

4.1.6. Negotiated yourself (**outcome?**)

<i>code</i>	
1	Yes, resolved positively
2	Yes, resolved negatively
3	Yes, unresolved
4	No

4.1.7. Other solutions (specify) (**outcome?**)

<i>code</i>	
1	Yes, resolved positively
2	Yes, resolved negatively
3	Yes, unresolved
4	No

4.2. Why haven't you used other methods of addressing the problem?

<i>code</i>	<i>More than one selection is possible</i>
1	Lack of resources (both social and financial)
2	Lack of experience with other methods
3	Never tried other methods
4	Tried different ones, and now stick to what is known to work
5	Did not think of any other
6	Other ( <i>specify</i> )
7	Don't know

4.3. If you encountered the problem of contract enforcement now, how would you address it? (choose the most likely scenario and explain)

<i>code</i>	
1	Negotiate myself
2	Go to protection agency
3	Go to police or appeal to court
4	Call friends and ask to help
5	Don't know
6	Such situation cannot arise because work only with small number of trusted firms
7	Other ( <i>specify</i> )

4.4. Do you use services of a private protection agency?

<i>code</i>	
1	Yes
2	No ( <i>skip to 4.5</i> )

4.4.1. If yes, for how long?

<i>code</i>	
1	Since the founding of the firm
2	About half-way through
3	Started using only just recently
4	Don't know

4.4.2. How successfully?

<i>code</i>	
1	Agency was useful many times, happy with collaboration
2	Agency is useful occasionally, quite glad about collaboration
3	Agency is not really used, collaborate 'just in case'
4	Agency is not useful at all

4.4.3. How did you start using its services?

<i>code</i>	
1	Agency appeared one day and offered their services
2	Firm found this agency by recommendation
3	Firm knew about agency through personal ties
4	Other ( <i>specify</i> )

4.5. Have you ever had to ask your private protection agency to help you with contract enforcement?

<i>code</i>	
1	Yes, resolved positively for the firm
2	Yes, resolved negatively for the firm
3	Yes, unresolved
4	No

4.6. Among your friends who work for, or own, small firms, does everyone use the services of a private protection agency?

<i>code</i>	
1	Everyone or nearly everyone
2	About half
3	Less than a half
4	Nobody or almost nobody
5	Don't know

4.7. Please give examples of activity of private protection agencies which you personally witnessed (for your firm or other firm)?

<i>code</i>	
1	Help out with obtaining various licenses or permits
2	Help out with non-payment/delivery problems
3	Only security of the premises
4	Other ( <i>specify</i> )
5	Nothing

4.8. Have you ever been contacted by private protection agencies that work for other firms, regarding contract enforcement problem?

<i>code</i>	
1	Yes, about payment/delivery delays
2	Yes, other ( <i>specify</i> )
3	No

4.9. Have you ever appealed to a private (*treteiskii*) court to address a problem of contract violation? If yes, please, describe the case(s) and the outcome(s) in detail.

<i>code</i>	
1	Yes, more than once ( <i>describe each case</i> )
2	Yes, once ( <i>describe the case</i> )
3	No

4.10. Do you know any business owner or manager of a firm who would appeal to a private (*treteiskii*) court to resolve a problem of delayed payment/delivery/non-payment (or other problems connected to contract enforcement)?

<i>code</i>	
1	Yes, more than one person/case ( <i>describe each case</i> )
2	Yes, one person/case ( <i>describe the case</i> )
3	No, don't know anybody who would use a private court

4.11. Do you know personally anyone in

4.11.1. Tax collection office

<i>code</i>	
1	Yes, informal acquaintance/friend ( <i>indicate how you know this person</i> )
2	Yes, formal acquaintances (work-based relationships only)
3	No

4.11.2. State inspection offices of any kind

code	
1	Yes, informal acquaintance/friend ( <i>indicate how you know this person</i> )
2	Yes, formal acquaintances (work-based relationships only)
3	No

4.11.3. City administration

code	
1	Yes, informal acquaintance/friend ( <i>indicate how you know this person</i> )
2	Yes, formal acquaintances (work-based relationships only)
3	No

4.11.4. Any other person in a position to help you out with business contracts?

code	
1	Yes, informal acquaintance/friend ( <i>indicate the position of a person and how s/he can be helpful</i> )
2	Yes, formal acquaintances ( <i>indicate the position of a person and how s/he can be helpful</i> )
3	No

4.12. Have any of these people ever attempted to help you with problems concerning your business?

code	
1	Yes (explain how)
2	No

4.13. If a firm with whom you have continuous business relations has a dispute with another firm, how soon do you think you will find out about it?

code	
1	Very soon
2	Quite soon
3	May not necessarily find out at all
4	Don't know, hard to tell

4.14. If you have a dispute with some firm, will you inform your other business partners?

code	
1	Yes, always
2	Yes, but only to the best business partners
3	Maybe, depending on the circumstances
4	No

**5. Attitude/knowledge of state enforcement institutions**

5.1. Have you ever dealt with police in St.Petersburg?

5.1.1. For personal reasons

code	
1	Yes
2	No

5.1.2. As a representative of a business firm

<i>code</i>	
1	Yes
2	No

5.2. What is your opinion of police forces in St.Petersburg (rate from 1 to 5, where 1 is the lowest and 5 is the highest):

5.2.1. Effectiveness (1 is useless, cannot implement its decision, and 5 is highly effective)

1                      2                      3                      4                      5

---

5.2.2. Reliability as law protectors (1 is very corrupt, and 5 is reliable protector of the law)

1                      2                      3                      4                      5

---

5.3. Have you ever dealt with state courts

5.3.1. For personal reasons

<i>code</i>	
1	Yes
2	No

5.3.2. As a representative of a business firm

<i>code</i>	
1	Yes
2	No

5.4. **(if not)** Do you know what would be the procedures and fees for a court hearing if you had to press charges against some other firm (*describe*)?

<i>code</i>	
1	Yes ( <i>describe</i> )
2	No

5.5. What is your opinion of courts in St.Petersburg? (**rate from 1 to 5, where 1 means you fully disagree with the evaluation, and 5 means you fully agree**)

<i>code</i>		<i>rating from 1 to 5</i>
1	Efficient	
2	Expensive	
3	Corrupt	
4	Other ( <i>specify</i> )	
5	No opinion	

5.6. Have you ever dealt with private courts

5.6.1. For personal reasons

code	
1	Yes, more than once ( <i>describe each case</i> )
2	Yes, once ( <i>describe the case</i> )
3	No

5.6.2. As a representative of a business firm

code	
1	Yes, more than once ( <i>describe each case</i> )
2	Yes, once ( <i>describe the case</i> )
3	No

5.7. **(if not)** Do you know what would be the procedures and prices for a private court hearing if you had to press charges against some other firm?

code	
1	Yes ( <i>describe</i> )
2	No

5.8. What is your opinion of private courts in St.Petersburg? **(rate from 1 to 5, where 1 means you fully disagree with the evaluation, and 5 means you fully agree)**

code		rating from 1 to 5
1	Efficient	
2	Expensive	
3	Corrupt	
4	Other ( <i>specify</i> )	
5	No opinion	

6. **Attitudes toward the state**

6.1. What do you think about the Russian state in relation to economy? **(rate from 1 to 5, where 1 means you are fully disagree with the statement, and 5 means you are fully agree)**

		rating from 1 to 5
6.1.1	State attempts to create most favorable conditions for private business	
6.1.2	State takes into account only interests of big business	
6.1.3	State officials are all corrupt	
6.1.4	Government cannot implement its own decision	
6.3.5	State is too weak	
6.3.6	Other ( <i>specify</i> )	

6.2. What do you think about the law enforcement abilities of the Russian state (=effectiveness of courts, police forces, and other executive institutions responsible for policy implementation and law enforcement)? Rate from 1 to 5, where 1 is the least effective and 5 is the most effective)

1                      2                      3                      4                      5

---

6.3. What are the biggest problems for small and medium-sized business firms in dealing with the Russian state that you can identify (rate each from 1 to 5, where 1 is a very serious problem and 5 is not a problem at all)?

		rating from 1 to 5
6.3.1	High level of taxation	
6.3.2	High level of regulation (number of necessary licenses, etc)	
6.3.3	Lack of protection from the state against unlawful actions of some economic actors	
6.3.4	Unreliable and corrupt police	
6.3.5	Inefficient and expensive courts	
6.3.6	General level of crime in the region	
6.3.7	Other ( <i>specify</i> )	

6.4. How serious are other problems small and medium-sized businesses experience at the present time in Russia, in your opinion, particularly, in your sector? (rate each from 1 to 5, where 1 is the worst problem and 5 is not a problem at all)

		rating from 1 to 5
6.4.1	Lack of investment	
6.4.2	Confusing law	
6.4.3	Bureaucracy (too high level of regulations: number of necessary licenses, etc)	
6.4.8	Other ( <i>specify</i> )	

6.5. What has changed in this regard in the past few years (after the crisis of 1998)?

		became worse	did not change	became better
6.5.1	Lack of investment	1	2	3
6.5.2	Confusing law	1	2	3
6.5.3	Bureaucracy (too high level of regulations: number of necessary licenses, etc)	1	2	3
6.5.4	Lack of protection from the state against unlawful actions of some economic actors	1	2	3
6.5.5	Unreliable and corrupt police	1	2	3
6.5.6	Inefficient and expensive courts	1	2	3
6.5.7	General level of crime in the region	1	2	3
6.5.8	Other ( <i>specify</i> )	1	2	3

6.6. Morally speaking, do you think you ought to pay taxes (not in general, but specifically you in your business situation, right now)?

code	
1	Yes ( <i>explain why</i> )
2	No ( <i>explain why</i> )
3	Don't know

6.7. What do you think the state gives you for the taxes (*multiple selection possible*)?

<i>code</i>	
1	Infrastructure (roads, etc)
2	Security (police, etc)
3	Law and order (government, legislature, etc.)
4	Welfare benefits (free education, medical care, pensions)
5	Other ( <i>specify</i> )
6	Nothing really

6.8. It has been estimated that if a small private firm in your business area pays all the required taxes it is hard for it to survive. Hence most firms have to misreport their operational and financial results. Could you approximate misreporting in your business area?

6.8.1. hidden sales as a percent of actual sales  
 \_\_\_\_\_ (*percent*)

6.8.2. hidden salaries as a percent of actual salary \_\_\_\_\_ (*percent*)

## 7. Relationships with other firms

7.1. What kind of relationships do you form with your business partners (clients, suppliers, contractors, etc)? How informal are they?

<i>code</i>	
1	Mostly business-like, formal
2	Formal with 'new', personal and informal with 'old'
3	Mostly personal, informal
4	Don't know

7.2. How much do you trust your business partners (that they would not breach a contract or let you down in some other way)?

<i>code</i>	
1	I trust them
2	I trust my 'old' partners, but not 'new'.
3	I don't trust anybody
4	Everything depends on the circumstances, 'trust' is a wrong word in business
5	Don't know

7.3. What is the approximate ratio of stable (continuous) clients/suppliers to new/revolving ones?

<i>code</i>	
1	Only stable
2	1 to 1
3	1 to 2
4	1 to 5
5	1 to 10 and more
6	Other ( <i>specify</i> )



7.4. Of those continuous clients/suppliers, with how many do you have informal, personal relationships?

<i>code</i>	
1	With nearly everyone of continuous clients/suppliers
2	With about half of them
3	With less than a half of them
4	With no one
5	Hard to say

7.5. With how many of them (continuous clients/suppliers) do you socialize on a regular basis (meet in informal environment, not for business purposes)?

<i>code</i>	
1	With nearly everyone of continuous clients/suppliers
2	With about half of them
3	With less than a half of them
4	With no one
5	Hard to say

7.6. Do you think that these informal and personal relationships help you to avoid potential problems with breach of contract?

<i>code</i>	
1	Yes, undoubtedly
2	Maybe
3	I don't think there is a connection
4	Don't know

7.7. Are contracts with those continuous clients/suppliers written or verbal most of the time?

<i>code</i>	
1	Written all the time
2	Sometimes written, sometimes verbal
3	Verbal at all times
4	Don't know

7.8. What is the approximate percentage of your total annual turnover that comes from trade with long-term clients/suppliers? (estimate)

<i>code</i>	
1	80-100%
2	60-80%
3	40-60%
4	20-40%
5	Less than 20%
6	Don't know

- 7.9. Please describe what was your primary source of information about these continuous clients/suppliers before they became your important client/supplier? (list per each firm)

<i>code</i>	
1	Client/supplier was a close friend/relative
2	Client/supplier was a personal acquaintance
3	Client/supplier was an acquaintance/partner from the previous job
4	Client/supplier was recommended by a friend/relative
5	Client/supplier was recommended by a business partner
6	Other ( <i>specify</i> )
7	Did not have any information about this client/supplier before started working with them.

- 7.10. Is there any difference in ways you build contractual relationships with continuous clients/suppliers, and firms that you do not have such ties to?

<i>code</i>	
1	Yes, with continuous clients/suppliers no formal contracts are made
2	Yes, with continuous clients/suppliers contracts are just a formality
3	There is no difference
4	Other ( <i>specify</i> )
5	Don't know

- 7.11. Is it more likely that you will be more tolerant of payments/delivery delays from continuous clients/suppliers, than from other firms?

<i>Code</i>	
1	Yes, we depend on continuous clients/suppliers so we have to be more tolerant
2	Yes, we trust our continuous clients/suppliers and delays are not a problem
3	No, our reaction is always the same
4	Other ( <i>specify</i> )
5	Don't know

- 7.12. How do you establish relationships with new firms? (Do you research a firm's reputation before signing the first contract?) (more than one selection is possible)

<i>code</i>	
1	Always attempt to obtain as much information about a firm as possible
2	Will not trade with a firm unless it was recommended by someone I know
3	Depends a lot on whether I like representatives of a new firm personally
4	A firm is put on a 'trial period' with special conditions (100% prepayment)
5	Other ( <i>specify</i> )

- 7.13. When you are entering into a deal with a firm, do you trust the reputation of a firm, or a manager with whom you sign the agreement?

<i>code</i>	
1	Trust a firm
2	Trust a person
3	Other ( <i>specify</i> )

- 7.14. Have you ever refused to conduct business with a firm simply on the grounds that you did not know anything about this firm?

<i>code</i>	
1	Yes
2	No
3	Don't know

## 8. Personnel and investments in growth

- 8.1. (if the respondent is not an owner) How did you find this job?

<i>code</i>	
1	By recommendation of a personal friend/relative
2	By recommendation of an personal acquaintance
3	By recommendation of a business acquaintance
4	Through ad or recruiting agency
5	Other ( <i>specify</i> )

- 8.2. Is there a high level of competition in your area of business in town?

<i>code</i>	
1	Yes, very high
2	Rather high
3	Not very high
4	No significant competition at all
5	Don't know, new in the field

- 8.3. What have you done in past few years to maintain your position on the market? What did you invest in to ensure growth of your firm (for example, raising salaries for personnel, buy new computers, more advertising, etc.)

<i>code</i>	
1	Investment in training personnel
2	Investment in equipment (computers, etc)
3	Raise salaries for key people so they would not leave
4	Invest in improving relationships with key clients/suppliers
5	Other ( <i>specify</i> )
6	Nothing

- 8.4. How far ahead do you plan your firm's activity?

<i>code</i>	
1	A few months
2	About a year
3	Two-three years
4	Four years or more
5	Don't know (don't plan, not in a position to plan, etc.)

- 8.5. What, in your view, is the 'recipe of success' for an owner/manger of a small private firm in contemporary Russia? (*open question*)

## 9. Criminal involvement

9.1. To the best of your knowledge, has there been any connection between the owner(s) of the firm and criminal business (please remember that the interview is anonymous and will be analyzed only in aggregate with dozens of other questionnaires)? **(IV5)**

9.1.1. connections on the level of personal relations

<i>code</i>	
1	Yes
2	No
3	Don't know

9.1.2. connection on the level of capital investments in the firm

<i>code</i>	
1	Yes
2	No
3	Don't know

## APPENDIX 2: LUBA'S STORY

*The interview below was taken as a part of the dissertation project “The Big Issue of Small Businesses: Contract Enforcement in the New Russia”, on the 4<sup>th</sup> of August, 2002, in St.Petersburg, Russia. The respondent – a middle aged Russian woman – was introduced to me by a common friend, in whose apartment the interview took place. The guiding questions are omitted from the text below. All the information concerning the respondent and her firm is retained in the text with the permission of the respondent.*

*This story of a failed enterprise is illustrative in many respects. It shows in detail a variety of problems that most small Russian entrepreneurs faced during 1990s; many of them are still present today. It also shows in action some of the strategies discussed in the dissertation, in the context of their application. But the main reason why I selected this story is because it is a stunningly candid account of one woman's journey into entrepreneurship Russian-style, with all her hopes and losses, and bitterness of defeat from the hands of those who were supposed to protect her. I present this story here in almost unabridged version.*

Everything started in 1985, when I was left alone with a little child, I was 28 then. I had no money, and it was sad: my little son asks me for an apple, and the only food I have at home is onions. I had to do something urgently. One day I counted all the remaining money, it was 60 kopeks. I took a little notebook and wrote down: “60 kopeks”. Two months later I had 2,000 rubles. How did I make it? I started with taking my golden necklace to a pawnshop, and buying some fabric with the money. Before the baby I worked as a costume designer at a theatre, and I knew how to sew and how to work with fabrics.

I have heard that winter parka jackets were fashionable, so I decided to try to sew them. I made up technology how to dye fabric effectively, how to sew these jackets. Made up a few, and gave them to ‘hawkers’ who were selling “imported” clothes on the main streets in St.Petersburg. But they brought them back, said they could not sell them. I

cried a little, of course. I used the remaining fabrics to sew pants, with the same result. Cried again, no money was left. Three weeks past, and then suddenly all three “hawkers” came by, and all three with orders. One wanted a batch of “Italian” pants, 20 pairs. The other ordered 50 jackets, and the third something else, don’t remember. They said that what I was making was not in demand, but they knew what was, and so I started sewing for them to sell. I sewed all these “Italian”, “French”, “American” and other “imported” clothes, that was impossible to find in stores. They were selling it on the street, for a nice price.

When they gave me the very first order, and very little time to complete it, I figured that there is no way I could sew it all by myself. So I called a few girls dressmakers, whom I knew from the theatre, and offered them to help me, for cash. Their salary at the theatre was from 80 to 100 rubles, and I was paid 30 rubles for one jacket, with costs of material around 5 rubles. So I could pay them really well. After we coped with the first order, we were in business.

And like this I worked for two years. These guys were very careful about secrecy, they never met in my place. They usually left their cars couple of blocks away and walked to my place by backyards, so nobody would notice them. What we were doing was totally illegal, and everyone was afraid of getting caught by police. They supplied accessories (buttons, zips, labels) and I had to take care of fabrics. It was quite difficult at that time even to buy decent fabrics, but I found ways. I concentrated on organizing everything, and cutting out – designing, and arranged people at my former work place to dye fabrics. Girls dressmakers sewed clothes the way I told them, they worked mainly at their homes, and some even at their workplaces.

I kept writing all the financial details in my little notebook. One of my “hawkers” saw it once, and was terrified. “Burn it immediately”, he told me, “this is a police file you are writing for yourself”! He was right of course, especially because at that time our local police officer started stopping by regularly. “I don’t understand”, he was saying, “how you can live so well without working”.

But I was working a lot, in fact. Very soon we manufactured more than my three guys could sell. Quality, to tell the truth, was appalling, but nobody wanted quality, just quantity. State stores were totally empty at that time, so people were buying anything that could be worn.

In three or four months I had enough money to buy a car, and it eased the problem of transporting ready clothes. Police officer started to stop by more often. Once my girlfriend and I were cutting fabrics in my kitchen, and someone let him in. I saw the uniform in the corridor and froze with fright. But my friend saved the situation: she quickly took off her pants and started screaming “No, no, you can’t come in, we are trying on something”! She was a beautiful girl, so the officer’s attention was on her, and thankfully not on loads of fabric lying around. We quickly stuffed everything under the couch, and he did not suspect anything. It was close call, though. At that time it was a criminal offence to do what we were doing, it was called “unearned income”. Although how can one call it unearned?! But we could go to prison for many years, and we were very, very afraid, all the time.

A day came when someone told me that now it is legal to have a private business. I could not believe it, of course. Then all the papers started writing about cooperatives, and about new law that would permit non-state forms of organization, and income. It was

spring of 1987. I was eager to get rid of the constant fear in which I lived for two years, and I was eager to work openly and honestly. So I started trying to register my own co-operative, I wanted to open a beauty salon (first in town, in fact, they only had hairdressers at that time). Wherever I would go though, in all official institutions, they were saying “go away with this rubbish”. Because they were all party people, they did not believe that it was happening. Then when I demanded to be registered on the basis of this new law, they rejected my application because of the name, because I wanted to call my salon with my own last name. They said to me: “Who are you, to call an enterprise after yourself?” So I had to change it to something neutral.

I still managed to register within a week since the law was adopted. My co-operative was among first ones in St.Petersburg. But this was just the beginning. After overcoming all the hurdles of registering, I had to endure many months ordeal of trying to rent a place for my beauty salon. Because the city was built to accommodate either big state owned stores, or apartments for citizens, there were very few suitable premises for small enterprises. These places were in the ownership of the district administration, and there was just one person there who could sign a contract of rent. I found a nice place that I liked, convinced the administrator to rent it to me, and started renovation. Hired workers, and we worked hard for a month. In the end of month, I come there to work one day, and all my locks are removed and someone else is occupying my premises! It turned out that the administrator changed her mind! I could not believe how it was possible, I had a signed contract!

But in reality I could not do anything, no matter how much I tried. There were no laws yet regulating these kinds of issues, so it was useless to try to go to court. On the



level of local or even city administration the resistance to co-operatives was huge. It was only in press and international conferences that things were changing to give people more economic freedom, in reality it was far from truth. It was virtually impossible to work. To start with, it was impossible to buy renovation materials, impossible to buy legally anything that one may need to organize a private business. There weren't even word "private" then in legislation.

After I lost that first place, I was looking for others, but somehow I never could get any. The administrator in charge seemed to hate me. Eventually, she offered me a horrible basement, which hosted homeless and drug addicts, and was 5 foot high. How could I make a beauty salon in such a place? – I asked her. But she said – either this, or none. So I had to agree. I spent all my savings trying to make that basement acceptable. We had to deepen it by 4 feet, remove some walls, change position of water pipes that ran through it... Lots of things. I would never have enough money for that now, but 15 years ago construction workers used to work for a bottle of vodka. If now dollars are the common currency, back than it was vodka.

The major problem turned out to be pipes of heating that were passing through whole basement, 2 feet above the ground. There was no official service that I could call and arrange them moved, so I had to hire a handyman from that building to do the job. He agreed to do it for 300 rubles (2 his monthly salaries), cut all the pipes away, took money and disappeared. The next day the central heating was supposed to come on in the whole district. The coincidence was that the head of the local administration lived in the same building with my basement. So when next day the central heating did not come on (the pipes were cut!), my basement became flooded with officials from all offices. Everybody

yelled and swore at me, and threatened me with jail, and finally some big boss tore my contract of rental of this basement into pieces. Well, the pipes themselves were fixed really quickly, officials looked to that, but what was I supposed to do without premises, already having invested so much in that basement?

So I tried to get my basement back. The big official who destroyed my contract of rental refused point blank to see me, so I started following him everywhere, like a shadow. Once after a few weeks I managed to get into his office and with lots of tears and begging persuaded him to give me back the basement.

The next problem after renovation was equipment – sewing machines. My idea was to make a beauty salon where women not simply could have their hair cut and skin taken care of, but also could rent a beautiful evening gown for a fancy party, because they were not available in stores. But again, professional sewing machines that I needed were not available in stores. The administrator who made me take the basement on the first place was probably feeling guilty, knowing about all the troubles I had with it, so she promised help. She sent me to sewing factory, asking local manager to help me. There I purchased a few sewing machines that were written off. I had to sell my car for that, I did not have any money left.

But now things were going. Evening gown rental turned out to be a losing idea, so in the end I had a beauty salon slash night club. Apart from hair cutting and alike, I had a bar, a pool, a piano, and on the weekends we had club-like evenings, with fashion shows, beauty contests, and things like that. The place became very popular, many “rich and famous” were regulars. I had about 40 people personnel working for my salon.

From 1998 to 1994 we did not have any major problems, and business was running smoothly. Although there were ‘funny’ incidents, of course. Once, for example, I had tax inspectors visiting, without warning. They came in and the first thing they saw was freshly polished hard-wood floor. And one of them says loudly: “Wow, here we will be taking money”. I did not understand why, I knew that I paid all taxes on time, out of the principle, because that was the reason I was registered and official, because I wanted to work honestly. But these tax inspectors obviously thought differently. After long search they managed to find three documents on which my signature was missing, simply because I did not get to those papers yet. And although factually everything was in order, they took formal approach. I was saying – please, let me sign them now, but they in response confiscated all the documents, and fined me 50 thousand rubles (= 10,000 dollars). For three missing signatures. Everybody told me that they just wanted money from me, but I never knew how to bribe, I am always afraid to insult a person by offering a bribe. So in the end I had to pay that fine, and also spend lots of time in police station, looking for my ceased documents. My lawyer, who is also my brother and worked for me from the beginning, was insisting that the fine was illegal, but I did not want to drag the matter to court.

In 1994 a new problem arose: gangsters. In the beginning of 1990s different gangs were fighting for areas of control in St.Petersburg, and they extorted money from enterprises on “their territories”. In the beginning they mainly paid attention to highly profitable types of business: casinos, night clubs, trade (especially alcohol, tobacco). Service sector was first of all underdeveloped, and second, never as profitable. But by 1994 new gangs from out of town started crawling in, and increased competition forced

gangs to look for revenue in new sources. One day the gangsters that controlled the “territory” where my salon was located, suddenly discovered that not only I don’t pay them for some reason, but that I don’t really have a “roof”.

It turned out that since my salon had such prominent clientele, they assumed that I had some serious protection. When they found out that I did not, they were furious. They came and said: “How dare you not to have any protection?” “Protection” services were of course their way of extortion. I answered to them that I did not need any protection, because nobody ever attacked me. So they quickly organized an attack on the premises, and then came by again and said “You see, you need protection”. Finally I agreed to pay to them for their “protection”.

So if at first gangsters simply wanted money on the regular basis, a few months later they started wanting more, they demanded ownership. But it was already different gang. My “protectors” were from some association of former soldiers who fought in Afghanistan, and these new were from Kazan. The latter looked at my business, figured how profitable it really was, and approached me with threats, demanding to give in my business. They offered me to be the executive manager on a nice salary, and give my ownership to them. Of course, I refused. Then they started to rob my salon. They would come in the afternoon, with guns, say “everyone on the floor” to personnel and clients, and take away everything that they could. What they could not take, like build-in walls mirrors, they would break. When I called my “protection agency” and they arrived, new gangsters offered my “protectors” a share in the profit from robbery, and they agreed! The boss of my “protectors” later was running for a deputy in a city hall.

Gangster came and robbed the place couple more times. Twice they attacked me – once I got a concoction, and once a bad knife wound. Many times I looking for protection from police, but in the police station I was told that “bandits” and “businessmen” start with the same letter “b”, so I should figure out how to solve my problems myself. All these times when my salon was robbed, or I was in a hospital after an attack, they refused to start a criminal investigation.

The gangsters, they did not understand that the business requires a lot of work to be profitable. Looking at the surface, they thought that everything is happening by itself, and ultimately my role was just to collect money. They found out that I had a teenage son and two baby girls, and said to me directly: “You have small children, so take care of them, and we will take care of your business”. When I refused again, they said that they will do whatever it takes to make me surrender. I immediately put my kids on the plane to Siberia, to my mother, and myself decided to fight to the end. By then I already had a habit of carrying two dictaphones with me at all times, one in the bag, and one on me. Occasionally they searched me and took them away, but some records I managed to save. For example, I still have a recording of that conversation between my “protectors” and Kazan gangsters, where the former agree to share profits from my business, and to “eliminate” me. When I went to the police with this recording, I again was told that it was my problem and they did not want to get involved.

This fight with gangsters lasted two years, when by robbing my business and attacking me they hoped to scare me into giving up. But I did not. Finally, they simply bankrupted me. For that they changed tactics. One day I received a order from the court to come to a hearing, where I am accused in not paying a certain firm a large sum of

money. At first I could not understand what was going on, I never heard of that firm. Having come to the court, I found familiar faces of those who had been after me for two years. I knew that I did not sign any of those contracts that these boys claimed I did, but after looking at the papers I realized that they were signed by one of six of my managers. So finally gangsters found a way to get to me. But I told to the judge that according to law, that manager did not have any right to sign financial documents, and plus he did not even work for me anymore for quite some time. Despite my objections, these fake contracts were taken as a proof that my firm owed money to their firm. Arguments of my lawyer were ignored, and when we attempted to submit documents that would prove that the contracts were fake, judge refused to consider them. The judge openly told me that if I had problems with gangsters it was my own fault that I did not sort it out with them, like others do. I simply could not believe this all was happening.

In one of my numerous conversations with gangsters they said to me that I cannot win my fight with them, because they “have it fixed” everywhere, including court. Now I remembered that, and it became clear that the judge was bribed. Through some of my friends I even knew how much this judge takes for the verdict: \$100. So little money, and I probably should have offered more to him, but I still believed then that I could win simply because I was right, and because I had all the documents to prove it, I only had to make them look at them. So I lost that case, but I appealed.

Meanwhile, since I refused to pay that large sum of money that gangsters wanted from me, the court ordered confiscation of all the assets of the firm. By law, if I paid the money, I would forfeit my right for an appeal. Theoretically, my property should have

been stored in the court's custody for the duration of the appeal, but instead I saw that my opponents got it right away.

A few years passed since that first hearing, but the case is still lasting. I am actually suing them now, but it is dragging very slowly. It's been about 20 meetings of the court on this matter, and something always prevents the judge from reaching the decision. Often some witnesses won't come, or something else will make the judge to put off the hearing. I wouldn't be surprised if these guys paid to this judge, too.

My basement is now empty, plundered, only rats running around. For that I blame not only those gangsters, but mostly actually the Committee of Management of State Property (KUGI in Russian abbreviation). When the major troubles hit me in 1996 with gangsters, I had to close the salon after all the property was seized. Clearly, I was short of money. By law, if the major renovation has been done in rented premises, the estimate of the costs of the renovation can be used toward the rent payment. I made a beautiful place out of tiny dirty basement, but KUGI refused to prolong the rent contract anyway. I had to stop working because of it. I am suing them now, too, because it was illegal. They are generally crooks over there. I remember how I once came there to prolong my contract of rent, it was just when my problems with gangsters started. The head of KUGI was Gref at that time, who is a minister in the Russian government now, famous person. I remember I came to his office, brought all the necessary papers, I thought it was just a formality really. And suddenly he tells me with a nasty smile: "This will cost you 10,000 dollars, for charity. Otherwise I already have an offer with 50,000 dollars, from such-and-such", - and he names those gangsters who were trying to take my business away from me. I was so angry at this blackmail, but I paid anyway, although my lawyer advised me

against it, and I could not really afford it. I learned later that by such means KUGI was raising money for renovation of the Philharmonic Hall.

Now of course I could organize a new enterprise. Everybody thinks that things are better now, with both street gangsters and state gangsters, but I don't believe it. I am afraid that I will work hard, and everything will be taken from me once again. Of course, I have to do something to support myself and my kids, but now I prefer to work like in old days – just with my sewing machine. Of course, I have too much energy and knowledge for such work, I did manage a successful enterprise for 10 years, and it is hard for me to simply follow somebody's orders. But I know that one thing that did not change in the past ten years is that it is still impossible to work honestly, without hiding anything. Taxes are still huge, laws are written in such a way that always leaves inspecting officials an opportunity to find a violation and fine you unless you bribe them, and I don't want to bribe anyone. I worked honestly for so many years, I paid all taxes, and what have I got from the state in response? Neither police, nor courts helped me against criminals, and I lost everything. And what is even worse, is that they destroyed me with the help of the state, of the state institutions and state officials. So the main lesson that I learned from my ordeal is that the state protects not honest people who work really hard, but criminals.

And so I am back “underground”, like I was in the middle of 1980s. Although I know I could organize a successful business and give jobs to many people. But then I would be out in the open again, a prey to all those vultures. In the “underground”, I make little money, of course, but at least I do not have fear that any day I can have visitors from tax office, from fire department, from sanitary control, from local gang, and that all



of them will be looking for a pretext to make me pay them. I don't want to work for these parasites anymore.

I think that my story is very typical for small firms that went bankrupt. Extortion by gangsters, coupled with extortion by state officials and venality of courts forced all honest people out of business, in my opinion. I consider myself lucky, because my kids are alive and well, and I got off without long lasting injuries. I lost money, of course. I estimate that I lost about quarter of a million dollars that I lost to gang robberies, to confiscation, to KUGI that never paid me for renovating their property, to courts for their bribed decision, all the money that I made in ten years of hard work. I do have two law suits pending, one against those gangsters, and one against KUGI. If I win them, or at least one of them, and the court will manage to ensure that the other party pays me what they owe, then I will be a rich woman. But I don't believe in it, although I do keep fighting. And I don't believe in doing business here anymore either. I am happy now because I am free, and the only thing that I want for myself now is to get married and to simply be a woman.

## **APPENDIX 3: Explanation of the coding technique**

In the data collection and analysis for this dissertation research I used multiple case study methodology developed by Charles Ragin (1994, 2000). I compiled a data set of forty-five cases and applied some of the techniques of multiple case studies in the analysis of the cases. One of Ragin's techniques that I used was his idea of partial set membership: instead of having a case fully 'in' or fully 'out' of the dataset on some attribute, a case can be assigned a partial membership, depending on the degree of its participation. In Ragin's view, this feature helps better capture the complexity of the real world because it helps avoid the homogenizing bipolarity and instead invites a range of in-between possibilities into the analysis. I apply this technique to the analysis of the frequencies of use of contract enforcement strategies by the studied firms. It allows me to follow the trends in the use of strategies, to distinguish between strategies that used to be popular in the past and those that are currently in common use, and also to estimate the intensity of their use.

Four categories of usage of each strategy were identified for each of forty-five studied firms:

“0” – strategy has never been used;

“1” – strategy has been used once or several times in the past but unlikely to be used it again;

“2” – strategy is currently used to some extent, when necessary or possible;

“3” – strategy is currently used as a main strategy.

Category “0” was the easiest to determine with regard to all strategies but one: Information and closed exchange networks, the coding for which will be discussed in detail below. A question or a set of questions were asked during the interviews that were designed to obtain information about past use of each contract enforcement strategy. For example, question 4.1 asked “How do you react to the problem of a violation of contract/business agreements?”, and a following subset of questions specified possible actions of a firm, like contacting protection agency or suing. An unambiguous answer was quite easy to obtain regarding some strategies, like for example the usage state courts.

Category “1” combined the information about a firm’s past use of a strategy with the information about a firm’s likely response in a case of a contract violation: question 4.3 “If you encountered the problem of contract enforcement now, how would you address it? Please choose the most likely scenario(s)”. If a respondent said that his/her firm had used, for example, its protection agency in the past, but it is not intending to use it again in the future (for any reason: bad experience in the past, changed relationships with the protection agency, does not have contacts with agency any more at all, etc), then the strategy “Protection agencies” is coded as “1” for this firm.

Categories “2” and “3” were the most difficult to assign. They both refer to those cases where a firm’s representative maintained that the strategy was being currently used, but the distinction between these two categories is supposed to capture the difference in the intensity of usage. This difference is however not identical for “preventive” and “coercive” strategies. As discussed in chapter 5, three out of nine strategies are “preventive” (Information and closed exchange networks, Professional associations and

Financial tools), and the remaining six are “coercive” and work by seeking redress after the fact of a transaction and violation. Consequently, the nature of the strategies’ usage also differs along these axes. Preventive strategies get employed routinely, on an everyday basis, while coercive strategies only get used at times of violations.

To determine whether a coercive strategy is used occasionally (code “2”) or routinely (code “3”), I primarily relied on the qualitative data from the interviews: the examples given by participants and the language that they used. If a respondent used an assertive language in talking about solutions that his/her firm had to address contract violations (question 4.3), gave recent examples and consistently referred to the same strategy (strategies) as dominant in their firm’s dealing with contract violations, then this strategy was coded as “3”. If however the respondent seemed much less certain about the course of action of his/her firm in a case of violation, used indecisive and uncertain language, did not have recent examples and/or specifically mentioned that a coercive strategy could only be used under extraordinary circumstances, then I coded such strategy for such firm as “2”.

To differentiate the usage of preventive strategies between categories “2” and “3” I looked at how each strategy was being used. For example, in evaluating the Financial tools strategy I looked if all firm’s transactions with clients required 100% prepayment and thus no room for a violation was left (question 2.5[2]; 3.2[1]; 7.12[4]), then the strategy was coded as “3” for this firm. If however the amount of prepayment was negotiable, could range between 0 and 100% with an average of 30% to 50% and thus definitely leaving the room for a violation, and was supplemented by other strategies,

then I coded such case as “2” for the use of Information and closed exchange networks as a contract enforcement strategy by this firm.

A similar rationale was employed for assessing the intensity of using Information and closed exchange networks. If a firm’s representative said that the firm would only trade with a few long-term business partners (questions 2.1; 2.2; 7.3; 7.8), would refuse to trade with someone new (questions 7.12[2]; 7.14), and said that the firm does not have or expect to have any problems with contract enforcement because they only work with a small number of trusted firms (question 3.2[2]; 4.3[6]) then this strategy was coded as “3” for this firm. However, if a firm was willing to trade with new partners (questions 2.1; 2.2; 7.3; 7.8; 7.14), but used its information networks to obtain information about new clients/suppliers (question 7.12[1]), had quite a high proportion of old business partners and expressed trust in old partners (question 7.2), then this strategy’s use was coded as “2”.

Out of all strategies, the usage of the Information and closed exchange networks was the hardest to code. Assigning codes to other strategies required little degree of subjective judgment, since it was possible to pose direct questions to respondents about specific strategies on the one hand, and determine standards for the coding on the other hand. For example, regarding coercive strategies it is all about facts: a firm either used protection firms for contract enforcement, or not; either sued another firm for non-payment, or not. With the usage of networks the story is much less clear-cut. Respondents may not necessarily recognize that they use networks as a safeguard strategy to protect themselves against potential losses due to non-payment or other contract violations. It is also harder to pinpoint the change in the usage of this enforcement strategy. Thus, to determine how

frequently participants of my study relied on the network strategy I asked a number of questions throughout the interviews. Apart from a few direct questions regarding the use of networks, a wide range of other questions were asked that were meant to indirectly indicate reliance on networks for contract enforcement. For example, question 3.5 asked whether long-term or new business partners are given priority in a tight financial situation (which happens often to nearly all firms); question 4.13 asked about the speed and reliability of the dissemination of information about contract breaches. Finally, section 7 of the questionnaire is fully devoted to relationships between firms and asks questions about the level of trust that exists between respondents and their business partners and clients, level of formality in communication, and sources of information about business partners. The inference about the degree of usage of networks as a contract enforcement strategy was made on the basis of all of these questions (2.1; 2.2; 3.2; 3.5; 4.13; 4.14; 7.1 – 7.14).

In making a decision about assigning a category of usage for each of eight strategies<sup>79</sup> (one strategy – Private arbitration courts – had no instances), at times it was a judgment call, when all available information did not present a clear-cut solution. I believe that the advantage of being able to assess changes in the use of strategies over time and intensity of their use is important and justifies bringing in the analysis a certain degree of subjectivity that unavoidably accompanied such coding procedures.

---

<sup>79</sup> The full list of codes that denote the use of contract enforcement strategies by all studied firms is found in Table 5.5.1 in chapter 5.

## REFERENCES

1. Aldrich Howard E. 1979. *Environments and Organizations*. New York: Prentice-Hall.
2. Amsden, Alice, Jacek Kochanowicz and Lance Taylor. 1994. *The Market Meets Its Match*. Harvard University Press.
3. Argenti, P. 1958. *The Occupation of Chios by the Genoese, 1346-1566*. Cambridge (England): Cambridge University Press.
4. Åslund Anders, ed. 1997. *Russia's Economic Transformation in the 1990s*. Pinter: London and Washington.
5. Atkinson, Rowland and John Flint. 2001. Accessing Hidden and Hard-to-Reach Populations: Snowball Research Strategies. *Social Research Update*, University of Surrey issue 33. <http://www.soc.surrey.ac.uk/sru/SRU33.html> (accessed on February 15, 2005).
6. Berdjaev, Nikolai. 1990. *Istoki i smysl russkogo kommunizma* [Sources and Meaning of Russian Communism]. Moscow.
7. Berliner, Joseph. 1988. *Soviet Industry from Stalin to Gorbachev: Essays on Management and Innovation*. New York: Cornell University Press.
8. Biggart, Nicole Woolsey, and Mauro F. Guillén. 1999. Developing Difference: Social Organization and the Rise of the Auto Industries of South Korea, Taiwan, Spain, and Argentina. *American Sociological Review* 64:722-747.
9. Bliahker, Leonid, ed. 2000. *Izmenenie povedeniya ekonomicheski aktivnogo naseleniya v usloviyah krizisa, na primere melkih predprinimatelei i samozaniatykh* [Behavioral Changes of Economically Active Population under the Conditions of Crisis, on the Example of Small Entrepreneurs and Self-Employed]. Moskovskii Obshestvennyi Nauchnyi Fond. Moskva.
10. Bonnell, Victoria. 2001. Russia's New Entrepreneurs. In *Russia in the New Century: Stability or Disorder?* Edited by V. Bonnell and G. W. Breslauer, 175-200. Westview Press.
11. Bonnell, Victoria and George W. Breslauer, eds. 2001. *Russia in the New Century: Stability or Disorder?* Westview Press.
12. Burawoy, Michael. 1996. The State and Economic Involution: Russia through a China's Lens. *World Development* 24 (6):1105-170.
13. \_\_\_\_\_. 2001a. Transition without Transformation: Russia's Involutionary Road to Capitalism. *East European Politics & Societies* 15 (2): 269-290.
14. \_\_\_\_\_. 2001b. Neoclassical Sociology: From the End of Communism to the End of Classes. Review Symposium in *American Journal of Sociology* 106 (4):1099-1120.
15. Burawoy, Michael and Pavel Krotov. 1992. The Soviet Transition from Socialism to

- Capitalism: Worker Control and Economic Bargaining in the Wood Industry. *American Sociological Review* 57 (1):16-38.
16. Burawoy, Michael and Katherine Verdery, eds. 1999. *Uncertain Transition: Ethnographies of Change in the Postsocialist World*. Rowman and Littlefield Publishers, Inc.
  17. Campbell, John L. 1996. *Legacies of Change: Transformations of Postcommunist European Economies*. Aldine de Gruyter: New York.
  18. Coase, Ronald. 1988. *The Firm, the Market, and the Law*. The University of Chicago Press: Chicago and London.
  19. Csaba, László. 2003. Transition as Development, *Post-Communist Economies* 15 (1): 3-26.
  20. Dañino, Roberto. 2003. The Importance of the Rule of Law and Respect for Contractual Rights in Transition Countries. Conference address. The World Bank Group. [http://www4.worldbank.org/legal/publications/Danino\\_EBRD.pdf](http://www4.worldbank.org/legal/publications/Danino_EBRD.pdf) (accessed on February 15, 2005).
  21. Dasgupta, Partha. 1988. Trust as a Commodity. In *Trust*, ed. D. Gambetta, 49-72. Basil Blackwell.
  22. *Delovoi Peterburg*, business newspaper published in St.Petersburg, Russia. March 2000.
  23. DiMaggio, Paul. 1994. Culture and Economy. In *The Handbook of Economic Sociology*, ed. N. J. Smelser and R. Swedberg, 27-57. Russell Sage Foundation.
  24. Dolgopyatova, Tat'yana. 2000. The Evolution of New Institutions in the Small Business Sector. In *Shaping the Economic Space in Russia: Decision Making Processes, Institutions and Adjustment to Change in the El'tsin Era*, ed. S. Harter and G. Easter. Ashgate.
  25. Dobbin, Frank. 1994. *Forging Industrial Policy*. New York: Cambridge University Press.
  26. Douglas, Mary. 1986. *How Institutions Think*. Syracuse, NY: Syracuse University Press.
  27. Easter, Gerald. 1996. Personal Networks and Postrevolutionary State Building: Soviet Russia Reexamined, *World Politics* 48: 551-578.
  28. Ellickson, Robert C. 1991. *Order Without Law: How Neighbors Settle Disputes*. Cambridge, Mass.: Harvard University Press.
  29. Evans, Peter. 1992. The State as Problem and Solution: Predation, Embedded Autonomy, and Structural Change. In *The Politics of Economic Adjustment: International Constraints, Distributive Conflicts, and the State*, ed. S. Haggard and R. R. Kaufman. Princeton University Press, Princeton, New Jersey.
  30. \_\_\_\_\_. 1995. *Embedded Autonomy: States and Industrial Transformation*. Princeton, NJ: Princeton University Press.
  31. Evans, Peter, Dietrich Rueschemeyer and Theda Skocpol, eds. 1985. *Bringing the State Back In*. Cambridge University Press.



32. Eyal Gil, Ivan Szelenyi, and Eleanor Townsley. 1998. *Making Capitalism without Capitalists: Class Formation and Elite Struggles in Post-Communist Eastern Europe*. New York: Verso Books.
33. Fedotov, Georgii. 1992. *Sud'ba i grehi Rossii* [Fate and Sins of Russia]. St.Petersburg.
34. Fish, M.Steven. 2001. When More is Less: Superexecutive Power and Political Underdevelopment in Russia. In *Russia in the New Century: Stability or Disorder?* Ed. V. Bonnell and G. W. Breslauer, 15-34. Westview Press.
35. Fligstein, Neil. 1996a. Markets as Politics: Political-Cultural Approach to Market Institutions. *American Sociological Review* 61:656-673.
36. \_\_\_\_\_. 1996b. The Economic Sociology of the Transitions from Socialism. *American Journal of Sociology* 101 (4):1074-1081.
37. Frye, Timothy. 1997. Contracting in the Shadow of the State: Private Arbitration Commissions in Russia. In *The Rule of Law and Economic Reform in Russia*, ed. J. D. Sachs and K. Pistor, 123-138. Westview Press.
38. \_\_\_\_\_. 2000. *Brokers and Bureaucrats: Building Market Institutions in Russia*. The University of Michigan Press.
39. \_\_\_\_\_. 2001. Keeping Shop: The Value and the Rule of Law in Warsaw and Moscow. In *Assessing the Value of Law in the Economic Transition from Socialism*, ed. P. Murrell. University of Michigan Press: Ann Arbor.
40. Frye, Timothy and Ekaterina Zhuravskaya. 2000. Rackets, Regulation, and the Rule of Law. *The Journal of Law, Economics, and Organization* 16 (2):478-502.
41. Gaidar, Egor. 2004. Recovery Growth and Key Features of the Current Economic Situation in Russia. *Russian Social Science Review* 45 (2): 41-58.
42. Gambetta, Diego. 1993. *The Sicilian Mafia: The Business of Private Protection*. Cambridge, MA: Harvard University Press.
43. Gans-Morse, Jordan. 2004. Searching for Transitologists: Contemporary Theories of Post-Communist Transitions and the Myth of a Dominant Paradigm. *Post-Soviet Affairs* 20 (4): 320-349.
44. Geertz, Clifford. 1978. The Bazaar Economy: Information and Search in Peasant Marketing. *Supplement to the American Economic Review* 68: 28-32.
45. Gibson, James L. 2001. Social Networks, Civil Society, and the Prospects for Consolidating Russia's Democratic Tradition. *American Journal of Political Science* 45 (1): 51-68.
46. Granovetter, Mark. 1985. Economic Action and Social Structure: The Problem of Embeddedness. *American Journal of Sociology* 91:481-510.
47. \_\_\_\_\_. 1994. Business Groups. In *The Handbook of Economic Sociology*, ed.N. J.Smelser and R. Swedberg, 453-475. Russell Sage Foundation.

48. \_\_\_\_\_. 2002. A Theoretical Agenda for Economic Sociology. In *The New Economic Sociology: Developments in an Emerging Field*, ed. M. F. Guillen, R. Collins, P. England, and M. Meyer, 35-59. New York: Russel Sage Foundation.
49. Greif, Avner. 1993. Contract Enforceability and Economic Institutions in Early Trade: the Maghribi Traders' Coalition. In *The American Economic Review* 83 (3):525-548.
50. Greif, Avner and Eugene Kandel. 1995. Contract Enforcement Institutions: Historical Perspective and Current Status in Russia. In *Economic Transition in Eastern Europe and Russia*, ed. E.Lazear. Hoover Institutions Press, Stanford University.
51. Greif, Avner, Paul Milgrom and Barry R.Weingast. 1994. Coordination, Commitment, and Enforcement: The Case of the Merchant Guild. *The Journal of Political Economy* 102 (4):745-776.
52. Guseva, Alya and Akos Rona-Tas. 2001. Uncertainty, Risk, and Trust: Russian and American Credit Card Market Companies. *American Sociological Review* 66:623-646.
53. Gvozdeva, Elena and Vladimir Gerchikov. 2002. Sketches for a Portrait of Women Managers. *Russian Social Science Review* 43 (4): 72-85.
54. Hass, Jeffrey. 1998. To the Undiscovered Country: Institutions, Authority, Culture and Russia's transition to the Market, 1988-1997. Doctoral Dissertation, Princeton University.
55. \_\_\_\_\_. 1999. The Great Transition: The dynamics of Market Transitions and the case of Russia, 1991-1995. *Theory and Society* 28:383-424.
56. Hannan, Michael T. and John Freeman. 1977. The Population Ecology of Organizations. *American Journal of Sociology* 82 (5):929-964.
57. Haveman Heather A. 1993. Organizational Size and Change: Diversification in the Savings and Loan Industry after Deregulation. *Administrative Science Quarterly* 38 (1):20-50.
58. Hedlund, Stefan. 2000. Path Dependence in Russian Policy Making: Constraints on Putin's Economic Choice. *Post-Communist Economies* 12 (4): 390-407.
59. \_\_\_\_\_. 2001. Property without Rights: Dimensions of Russian Privatization. *Europe-Asia Studies* 53 (2):213-237.
60. Hendley, Kathryn. 1994. Prospects for Legal Development in Post-Soviet Russia: Reflections on a Case Study. In *Law in Russia*, 28-43. Papers from the legal symposium. The Henry M. Jackson School of International Studies University of Washington.
61. \_\_\_\_\_. 1996. *Trying to Make Law Matter: Legal Reform and Labor Law in the Soviet Union*. Ann Arbor The University of Michigan Press.
62. \_\_\_\_\_. 2001. Beyond the Tip of the Iceberg: Business Disputes in Russia. In *Assessing the Value of Law in the Economic Transition from Socialism*, ed. P. Murrell. University of Michigan Press: Ann Arbor.
63. \_\_\_\_\_. 2004. Enforcing Judgments in Russian Economic Courts. *Post-Soviet Affairs* 20 (1): 46-82.
64. Hendley, Kathryn, Peter Murrell and Randi Ryterman. 2000. Law, Relationships and

- Private Enforcement: Transactional Strategies of Russian Enterprises. *Europe-Asia Studies* 33:627-656.
65. Hendley, Kathryn, Barry W. Ickes, and Peter Murrell. 1997. Observations on the Use of Law by Russian Enterprises. *Post-Soviet Affairs* 13:19-41.
  66. Humphrey, Caroline. 2002. *The Unmaking of Soviet Life: Everyday Economies After Socialism*. Cornell University Press Ithaca & London.
  67. Jaffe, James. 2000. Industrial Arbitration, Equity, and Authority in England, 1800-1850. *Law and History Review* 18 (3)  
<http://www.historycooperative.org/journals/lhr/18.3/jaffe.html> (accessed on February 15, 2005).
  68. Johnson, Simon and John McMillan. 2002. Courts and Relational Contracts. *Journal of Law, Economics and Organization*, Oxford University Press 18 (1): 221-277.
  69. Kahkonen, Satu and Patrick Meagher. 1998. Contract Enforcement and Economic Performance. African Economic Policy Discussion Paper Number 1.
  70. Kalleberg, Arne L. and Arne Mastekaasa. 1998. Organizational Size, Layoffs, and Quits in Norway. *Social Forces* 76 (4):1243-1273.
  71. Kihlgren, Alessandro. 2001. Small Business Policy in St.Petersburg and the Development of this Sector in the 1990s. *Post-Communist Economies* 13 (4): 459-484.
  72. \_\_\_\_\_. 2004. The Methodology Used by Russian Statistical Bodies to Analyze Small Business. *Post-Communist Economies* 16 (3): 363-377.
  73. Klebnikov, Paul. 2000. *Godfather of the Kremlin : Boris Berezovsky and the looting of Russia*. New York : Harcourt.
  74. Kliamkin I.M. and L.M. Timofeev. 2002. The Shadow Life: A Sociological Self-Portrait of Post-Soviet Society. *Russian Social Science Review* 43 (1): 4-47.
  75. Kljuchevskii, Vladimir. 1990. *Istoricheskie Portrety* [Historical Portraits]. Moscow.
  76. Kochanowicz, Jacek. 1994. Reforming Weak States and Deficient Bureaucracies. In *Intricate Links: Democratization and Market Reforms in Latin America and Eastern Europe*, ed. J. Nelson et al., 195-226. Transaction Publishers.
  77. Komitet ekonomicheskogo razvitiia. 2004a. Osnovnyie itogi sotsial'no-ekonomicheskogo razvitiia Sankt-Peterburga v 2003 godu. <http://www.cedipt.spb.ru:9002/> (accessed in May, 2004).
  78. \_\_\_\_\_. 2004b. Malyi biznes. <http://www.cedipt.spb.ru:9002/manage/page?tid=745800137> (accessed in May, 2004).
  79. Konstantinov, Andrei. 1997. *Banditskii Peterburg*. St.Petersburg: Folio-Press.
  80. Kuznetsov, Yevgeny. 1998. Learning in Networks: Enterprise Behavior in the Former Soviet Union and Contemporary Russia. In *Transforming Post-Communist Political*

- Economies*, ed. J.Nelson, Ch.Tilly, and L.Walker, 156-176. National Academy Press: Washington, DC.
81. Ledeneva, Alena. 1998. *Russia's Economy of Favors: Blat, Networking and Informal Exchange*. Cambridge University Press.
  82. Leitzel, James. 1997. Rule Evasion in Transitional Russia. In *Transforming Post-Communist Political Economies*, ed. J.Nelson, Ch.Tilly, and L.Walker, 118-130. National Academy Press: Washington, DC.
  83. Levin, Mark and Georgy Satarov. 2000. Corruption and Institutions in Russia. *European Journal of Political Economy* 16 (2000): 113-132.
  84. Macaulay, Stewart. 1963. Non-Contractual Relations in Business: A Preliminary Study. *American Sociological Review* 28 (1):55-67.
  85. March, James and Johan Oslen. 1989. *Rediscovering Institutions: The Organizational Basis of Politics*. New York: The Free Press.
  86. Marsh, Christofer. 2000. Social Capital and Democracy in Russia. *Communist and Post-Communist Studies* 33: 183-199.
  87. McCauley, Martin. 2001. *Bandits, Gangsters and the Mafia: Russia, the Baltic States and the CIS since 1992*. Longman, Pearson Education.
  88. McFaul, Michael. 1997. When Capitalism and Democracy Collide in Transition: Russia's 'Weak' State as an Impediment to Democratic Consolidation. Program on New Approaches to Russian Security, working paper. <http://www.csis.org/ruseura/ponars/workingpapers/001.PDF> (accessed on February 15, 2005).
  89. Meyer, John W. and Brian Rowan. 1977. Institutionalized Organizations: Formal Structure as Myth and Ceremony. *American Journal of Sociology* 83 (2):340-363.
  90. Migdal, Joel S. 1988. *Strong Societies and Weak States: State-Society Relations and State Capabilities in the Third World*. Princeton University Press: Princeton, New Jersey.
  91. \_\_\_\_\_. 1997. Studying the State. In *Comparative Politics: Rationality, Culture, and Structure*, ed. M. I. Lichbach and A. S. Zuckerman, 208-235. Cambridge University Press.
  92. Moers, Luc. 2000. Determinants of Enterprise Restructuring in Transition: Description of a Survey in Russian Industry. World Bank Group. [http://lnweb18.worldbank.org/eca/eca.nsf/Attachments/The+Determinants+of+Enterprise+Restructuring+in+Transition/\\$File/14815.pdf](http://lnweb18.worldbank.org/eca/eca.nsf/Attachments/The+Determinants+of+Enterprise+Restructuring+in+Transition/$File/14815.pdf) (accessed on February 15, 2005).
  93. Morozov, Petr. 2002. Skol'ko stoit banditskaya "krysha"? [How much is a criminal "roof"?] In *Svoi biznes* 1 (1):79-81.
  94. Murrell, Peter. 1992. Evolution in Economics and in the Economic Reform of the Centrally Planned Economies. In *The Emergence of Market Economies in Eastern Europe*, ed. C. Clague and G. C. Rausser. Blackwell, Cambridge MA and Oxford UK.

- <http://www.bsos.umd.edu/econ/murrell/papers/czep.html> (accessed on February 15, 2005).
95. \_\_\_\_\_. 1996. How Far Has the Transition Progressed? *Journal of Economic Perspectives* 10:25-44.
  96. \_\_\_\_\_, ed. 2001. *Assessing the Value of Law in the Economic Transition from Socialism*. University of Michigan Press: Ann Arbor.
  97. Murrell Peter and Wang Yijiang. 1993. When Privatization Should Be Delayed: The Effect of Communist Legacies on Organizational and Institutional Reforms. *Journal of Comparative Economics* 17:385-406.
  98. National Institute of Systematic Research of Problems of Entrepreneurship, reports, <http://www.nisse.ru>.
  99. Nelson, Richard and Sidney Winter. 1982. *An Evolutionary Theory of Economic Change*. Cambridge, MA: Harvard University Press.
  100. \_\_\_\_\_ Nelson J., Ch. Tilly, and L. Walker, eds. 1998. *Transforming Post-Communist Political Economies*. National Academy Press: Washington, DC.
  101. \_\_\_\_\_ North, Douglass C. 1990. *Institutions, Institutional Change and Economic Performance*. Cambridge University Press.
  102. \_\_\_\_\_ . 1981. *Structure and Change in Economic History*. New York: Norton.
  103. \_\_\_\_\_ North, Douglass C. and Robert P. Thomas. 1973. *The rise of the Western World: a New Economic History*. Cambridge University Press.
  104. \_\_\_\_\_ Civic Forum. 2001. *On the Formation and the Development of Civil Society in Russia: A Statement by Russian Non-Governmental Organizations*, <http://gadfly.igc.org/russia/forum.htm> (accessed on February 15, 2005).
  105. \_\_\_\_\_ Podderzhka malogo i srednego biznesa v Peterburge. 2001. <http://www.smesupport.ru> (accessed in November, 2002).
  106. \_\_\_\_\_ Powell, Walter and Paul DiMaggio, eds. 1991. *The New Institutionalism in Organizational Analysis*. The University of Chicago Press.
  107. \_\_\_\_\_ Powell, Walter W. and Laurel Smith-Doerr. 1994. Networks and Economic Life. In *The Handbook of Economic Sociology*, ed. N. J. Smelser and R. Swedberg, 368-402. Russell Sage Foundation.
  108. \_\_\_\_\_ Radaev, Vadim. 1998. *Formation of New Russian Markets: Transaction Costs, Forms of Control and Business Ethic*. [in Russian.] Moscow.
  109. \_\_\_\_\_ . 2000. The Role of Violence in Russian Business Relations. *Russian Social Science Review* 41 (5): 39-66.
  110. \_\_\_\_\_ . 2001. Novyi institutsional'nyi podhkod I deformalizatsiya pravil v rossiiskoi ekonomike [New Institutional Approach and Deformalization of Rules in Russian Economy]. Working paper. Moscow State University.
  111. \_\_\_\_\_ Ragin, Charles. 1987. *The Comparative Method. Moving Beyond Qualitative and*

- Quantitative Strategies*. Berkeley/Los Angeles/London: University of California Press.
112. \_\_\_\_\_. 1994. *Constructing Social Research*. Pine Forge Press.
113. \_\_\_\_\_. 2000. *Fuzzy-Set Social Science*. The University of Chicago Press.
114. Ragin, Charles, and David Zaret. 1983. Theory and Method in Comparative Research: Two Strategies. *Social Forces* 61 (3): 731-754.
115. Randall, Linda. 2001. *Reluctant Capitalists: Russia's Journey Through Market Transition*. Routledge: New York, London.
116. Resursnyi Tsentr Malogo Predprinimatel'stva. 2000. Spravka o sostoianii malogo predprinimatel'stva v Sankt-Peterburge v 1992 – 1999 godahk. [Notes about the state of small entrepreneurship in St.Petersburg in 1992-1999]. <http://www.rcsme.ru> (accessed in November 2002).
117. \_\_\_\_\_. 2003. *Analiz roorganizacioni i mesta malorganizacionhk i srednihk predriiatii Rossii: Statisticheskaya spravka* [Analysis of the role and place of small and medium-size enterprises in Russia: Statistical reference]. Moscow. <http://www.rcsme.ru> (accessed May 11, 2004).
118. Rona-Tas, Akos. 1998. Persistence of Networks in the Post-Communist Transformation in Eastern Europe. IR/PS Research Report No. 98-04.
119. Rueschemeyer, Dietrich and Peter Evans. 1985. The State and Economic Transformation: Toward an Analysis of the Conditions Underlying Effective Intervention. In *Bringing the State Back In*, ed. P. B.Evans, D. Rueschemeyer and T. Skocpol, 44-77. Cambridge University Press.
120. Sachs, Jeffrey and Katarina Pistor, eds. 1997. *The Rule of Law and Economic Reform in Russia*. Boulder, CO: Westview Press.
121. Schönfelder, Bruno. 2001. Debt Collection, Foreclosure ad Bankruptcy in the Czech Republic: an Economic Analysis. *Post-Communist Economies* 13 (4).
122. \_\_\_\_\_. 2003. Debt Collection and Bankruptcies in Slovakia: A Study of Institutional Development. *Post-Communist Economies* 15 (2): 155-180.
123. Sergeyev, Victor. 1998. *The Wild East: Crime and Lawlessness in Post-Communist Russia*. M.E.Sharpe.
124. \_\_\_\_\_. 2001. Organized Crime and Social Instability in Russia: The Alternative State, Deviant Bureaucracy, and Social Black Holes. In *Russia in the New Century: Stability or Disorder?* Edited by V. Bonnell and G. W. Breslauer, 158-174. Westview Press.
125. Severo-Zapadnaya Konsaltingovaya Gruppa. 2003. Potentsial malogo i srednego biznesa v razvitii ekonomiki Severo-Zapadnogo Federal'nogo okruga. [Potential of small and medium-sized business in the economic development of North-Western Federal region]. <http://www.fbd.spb.ru/informational.resource/potential.of.sme.in.nwfo.russian.pdf> (accessed May 11, 2004).
126. Smelser, Neil and Richard Swedberg, eds. 1994. *The Handbook of Economic*

- Sociology*. Princeton University Press, N.J. Russell Sage Foundation, New York.
127. Solomon, Peter H. and Foglesong, Todd S. 2000. *Courts and Transition in Russia: The Challenge of Judicial Reform*. Westview Press.
  128. Stark, David. 1997. Organizing Diversity: Evolutionary Theory, Network Analysis and Postsocialism. *Regional Studies* 31:533-544.
  129. Stark, David and Laszlo Bruszt. 1998. *Postsocialist Pathways: Transforming Politics and Property in East Central Europe*. Cambridge: Cambridge University Press.
  130. Stiglitz, Joseph. 1999. Whither Reform? Ten years of the transition. World Bank: Annual Bank Conference on Development Economics. Keynote Address, <http://www.worldbank.org/research/abcde/pdfs/stiglitz.pdf> (accessed February 15, 2005).
  131. \_\_\_\_\_. 2000. Two Principles for the Next Round or, How to Bring Developing Countries in from the Cold. *The World Economy* 23 (4): 437-454.
  132. Swidler, Ann. 1986. Culture in Action. *American Sociological Review* 51 (2): 273-286.
  133. Taranovski, Theodore. 1994. The Russian Legal Tradition. In *Law in Russia, 7-17*. Papers from the legal symposium. The Henry M. Jackson School of International Studies University of Washington.
  134. Tatur, Melanie. 2000. The Moral Embeddedness of the Market – Conceptualizing Post-Socialist Transformations. In *Shaping the Economic Space in Russia: Decision Making Processes, Institutions and Adjustment to Change in the El'tsin Era*, ed. S. Harter and G. Easter. Ashgate.
  135. Tikhomirov Vladimir. 2000. The Second Collapse of the Soviet Economy: Myths and Realities of the Russian Reform. *Europe-Asia Studies* 52:207-236
  136. Tilly, Charles. 1986. War Making and State Making as Organized Crime. In *Bringing the State Back In*, ed. P. Evans, D. Rueschemeyer, and Th. Skocpol, 169-191. Cambridge: Cambridge University Press.
  137. \_\_\_\_\_. 1990. *Coercion, Capital, and European States, AD 990-1990*. New York: Basil Blackwell.
  138. Torgler, Benno. 2003. Tax Morale in Transition Countries. *Post-Communist Economies* 15 (3): 357-381.
  139. Transparency International, 2004. *The Corruption Perception Index*. <http://www.transparency.org/cpi/2004/cpi2004.en.html#cpi2004> (accessed May 2005).
  140. Uzzi, Brian. 1997. Social Structure and Competition in Interfirm Networks: The Paradox of Embeddedness. *Administrative Science Quarterly* 42: 35-67.
  141. Verdery, Katherine. 1991. Theorizing Socialism: A Prologue to the 'Transition'. *American Ethnologist* 18:419-439.
  142. \_\_\_\_\_. 1996. *What Was Socialism, And What Comes Next?* Princeton, NJ:

Princeton University Press.

143. Volkov, Vadim. 1999. Violent Entrepreneurship in Post-Communist Russia. *Europe-Asia Studies*, 51 (5):741-755.
144. \_\_\_\_\_. 2000. Between Economy and the State: Private Security and Rule Enforcement in Russia. *Politics and Society* 28 (4): 483-502.
145. Waller J. Michael. 1997. Police, Secret Police, and Civil Authority. In *The Rule of Law and Economic Reform in Russia*, ed. J. D. Sachs and K. Pistor, 95-122. Westview Press.
146. Weber, Max. 1978. *Economy and Society: An Outline of Interpretive Sociology*. Ed. G. Roth and C. Wittich. Berkeley: University of California Press.
147. \_\_\_\_\_. 1999. *Essays in Economic Sociology*, ed. R. Swedberg. Princeton University Press: Princeton, New Jersey.
148. Wedel, Janine R. 1998a. *Collision and Collusion: The Strange Case of Western Aid to Eastern Europe, 1989-1998*. St.Martin's Press, New York.
149. \_\_\_\_\_. 1998b. Informal Relations and Institutional Change: How Eastern European Cliques and States Mutually Respond. *Newsletter of the East European Anthropology Group* 16 (Spring).
150. Williamson, Oliver E. 1985. *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting*. New York: Free Press; London: Collier Macmillan.
151. Williamson, Oliver E. and Sidney G. Winter. 1991. *The Nature of the Firm: Origins, Evolution and Development*. New York: Oxford University Press.
152. Xin, Katherine R., and Jone L. Pearce. 1996. "Guanxi: Connections as Substitutes for Formal Institutional Support." *Academy of Management Journal* 39 (6): 1641-58.
153. Zorkaia, Natalia and Nadia M. Diuk. 2004. Values and Attitudes of Young Russians. *Russian Politics and Law* 42 (3): 67-90.
154. Zukin, Zharon, and Paul DiMaggion. 1990. *Structures of Capital: The Social Organization of the Economy*. New York: Cambridge University Press.