

13th WORLD CONGRESS OF THE RSAI



RANEPA
THE RUSSIAN PRESIDENTIAL ACADEMY
OF NATIONAL ECONOMY
AND PUBLIC ADMINISTRATION

Centre for Economic Geography and Regional Studies

Factors of small business development in Russia

Speaker:

Stepan Zemtsov
PhD, Director of the Centre

25.05.2021

Relevance and purpose of the study

Small and medium business (SME) is a significant sector of the Russian economy ($\approx 43\%$ of GDP of the business sector, 38% of employees), a potential source of employment, diversification and economic growth

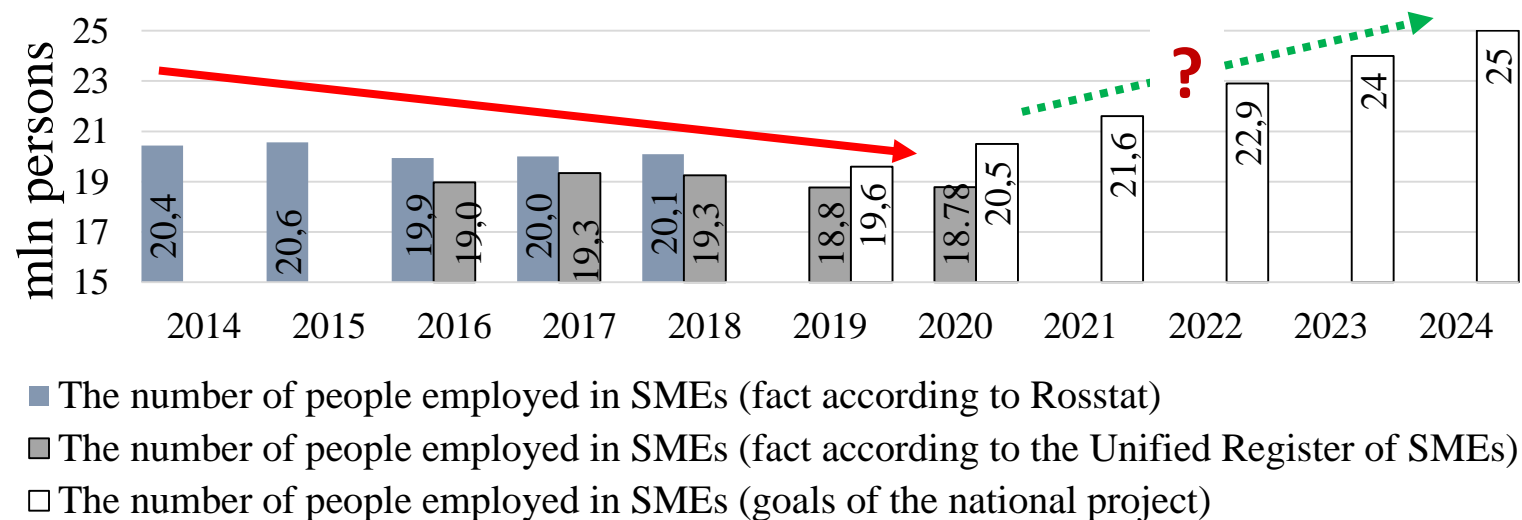
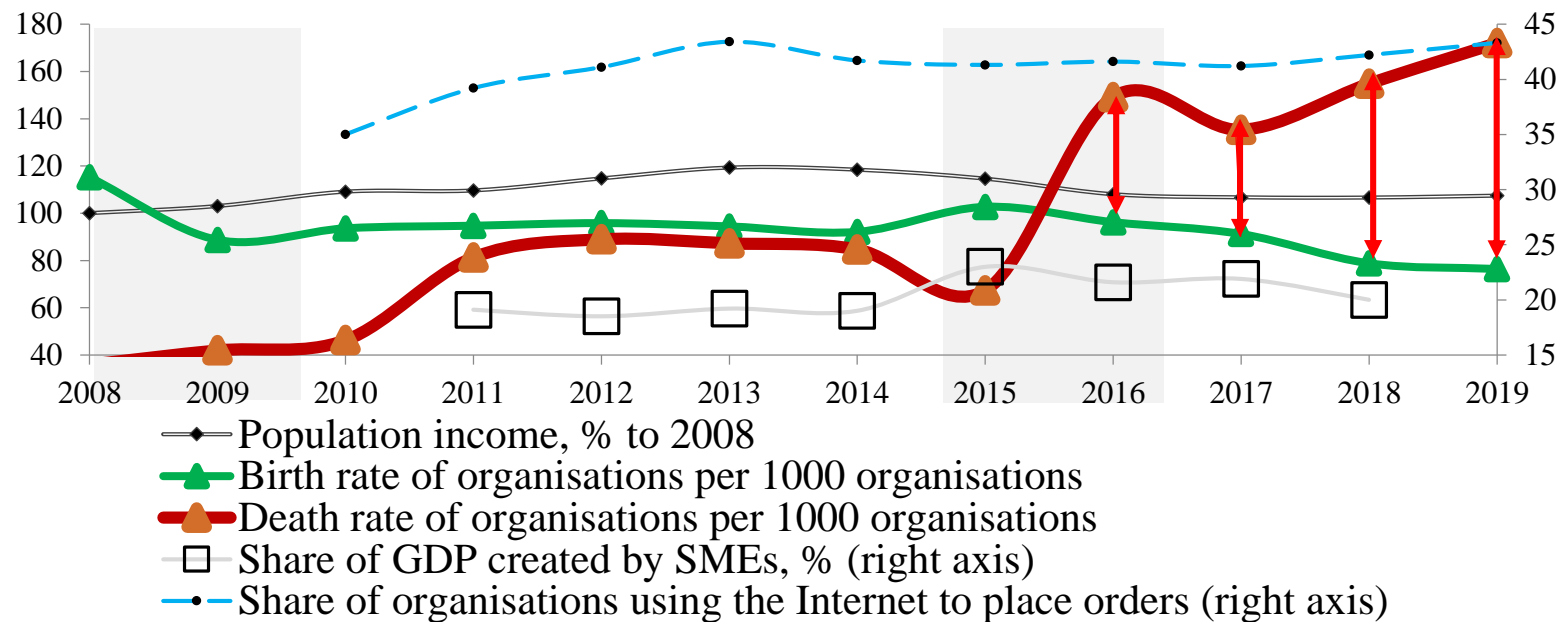
- pandemic and economic crisis → risks of rising *unemployment and necessity-driven entrepreneurship*
- increased risks of automation and digitalization → growth of the **role of entrepreneurship** as a creative process (*an entrepreneurs cannot be replaced by robots?*)
- falling prices for resources, increasing risks for commodity companies and the public sector in Russia → essential to form an **entrepreneurial economy**

The goal is to identify factors of SME development in the pre-crisis period to assess the adequacy of support measures during a pandemic

Is it possible to estimate the scale of the decline in the SME sector in 2020 based on forecasts of changes in the initial factors?

Contradictory dynamics of the SME sector until 2020

- SMEs declared as a **federal priority**: national project, SME strategy
- Many **new support initiatives** in 2010s (tax benefits, tax and other inspections reduction, special economic zones, regional tax incentives and tax holidays)
- Decrease in the share of SMEs in Russian GDP in 2018 to 20.2% from 22%, **increase of death rate** of organizations after 2016 (figure ►)
- Reduction in 2019: **-0.5 million SME employees** (figure ►), **- 100 thousand SMEs** due to a drop in personal incomes, online cash registers and an increase in VAT
- **Does Russian state support work?**



Different business environment and vulnerability of SMEs



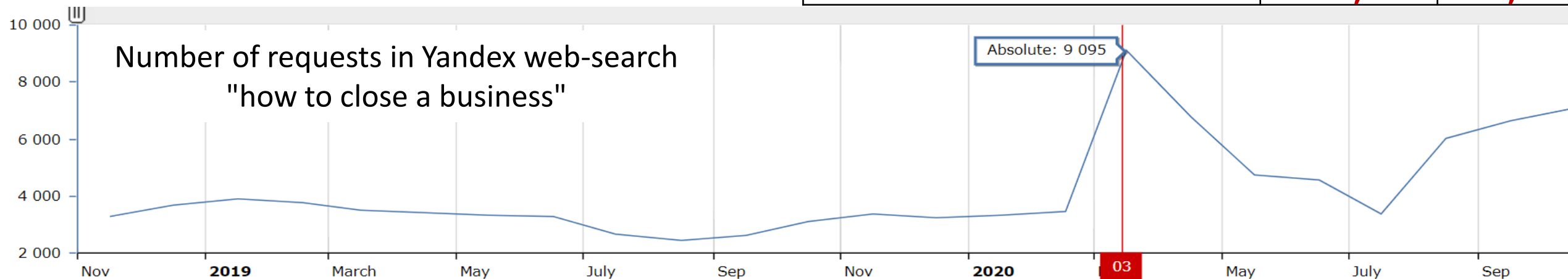
Types of regional entrepreneurial ecosystems in Russia

- High differences in geography and institutions
- **Best conditions:** largest metropolitan areas and coastal regions (market proximity)
- **Weak ecosystems:** the Arctic, the North Caucasus and the Far East: natural costs, remote markets, and poor institutions
- Weak ecosystems were **more vulnerable** during the previous crisis - the fall in 2015 was higher (!)

Downward trend of the SME sector in 2020

- COVID-19 affected about **75%** (4 mln) of all SMEs and **63%** of those employed in SMEs (12 mln persons) (figure ►)
- Number of web-requests "how to close a business" **has doubled** compared to last year (figure ▼)
- In the first half of 2020, the number of individual entrepreneurs ↓ **by -18.2 thousand** and firms ↓ **by -107.8 thousand**
- We will know the real scale of the fall only after 1-2 years (statistics)

Economic activity	SMEs employment, %	Number of SMEs, %
Total in the SME sector	100	100
<i>Most affected by COVID-19 industries</i>	5,5	11,2
hotels and restaurants	3,7	2,5
education	0,3	0,5
culture, sports, leisure and entertainment	0,6	3,9
provision of other types of services	0,8	4,2
<i>Industries that may be affected by the multiplier effect</i>	57,4	64,2
wholesale and retail trade; repairs	33,7	39,2
construction	9,5	8,7
real estate activities	6,5	6,7
transportation and storage	6,8	9,3
electrical energy, gas and steam	0,8	0,2
Total Affected	62,9	75,4

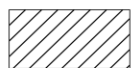


Geography and dynamics of the number of SMEs in 2020

- > 45% of SMEs - in 10 agglomerations
- The density of SMEs is higher, where there is demand (St. Petersburg, Moscow time, Novosibirsk), access to capital (+ Tatarstan, Tyumen) and market access (+ Kaliningrad, Primorsky, Krasnodar kr.)
- Sector ↓ after the pandemic in regions with vulnerable ecosystems (Ingushetia, Jewish region, Adygea, Komi, Tyva, Sakha, Crimea) but also in the largest agglomerations (Moscow, Perm, Samara Region) (!)



Number of micro and small firms per capita by 10.08.20



Number of micro and small firms decreased by more than 5% in 2020/2019

Research hypotheses and model

$$SBdensity_{it} = const + \alpha_1 * market_{it} + \alpha_2 * institutions_{it} + \alpha_3 * support_{it} + \alpha_4 * digital_{it} + \alpha_5 * controls + \varepsilon_{it},$$

i – a Russian region; t – year (2008-2018)

SBdensity – number of micro and small businesses per 1,000 economically active population, or workforce participants

market – availability of markets

institutions – institutional factors (legal environment, access to finance, administrative burden)

support – federal and regional support measures for SMEs (tax benefits, reduced tax rates, SEZs, tax holidays)

digital – percentage of individuals with access to the Internet

1. **Market access** (or size of potentially available markets) is a significant positive factor in determining the demand for small business services and products. It should be higher in the Russian regions near large metropolitan areas with higher population density and wealthier households, and in border and coastal regions near large countries with better export and import opportunities
2. **Unfavourable regional business environment**, that is a set of institutions, such as legal environment, access to finance or administrative burden, may significantly reduce small business density
3. **Proactive regional authorities** are able to affect entrepreneurial ecosystem development through various incentives, primarily related to lower taxes
4. The number of small businesses has been growing due to **digital economy expansion**, or digitalization. For instance, digital platforms provide access to any consumers in the world. A higher level of Internet access in a region provides more digital opportunities for small businesses and better access to new markets, as well as stimulates the development of new online services and start-ups.

Small business development factors in Russian regions

Dependent variable: Small business density – Number of micro and small businesses (with full-time employees up to 100) per 1,000 economically active (employed) population . Robust (HAC) standard errors. Fixed effects. All variables are log-transformed						
Variables/models	(1)	(2)	(3)	(4)	(5)	(6)
Average income per capita minus subsistence minimum	.296*** (.065)	.445*** (.064)	×	×	×	×
OR			.090	.340***	.251***	.259***
GRP per capita (t-1)			(.216)	(.122)	(.097)	(.1)
Unemployment (t-1)				-.042 (.049)	×	×
Market potential	.166*** (.038)	×	.229*** (.035)	×	×	×
OR		.000 (.000)		.0001*** (.000)	.0001** (.000)	.0001** (.000)
Population density						
Index of regional banking services availability	.266*** (.084)	.270*** (.094)	.301*** (.077)		.483*** (.089)	.476*** (.086)
Number of crimes per 100 000 inhabitants	-.259*** (.07)	-.236*** (.071)	-.317*** (.09)		-.148* (.083)	-.175** (.086)
Field tax inspection by FTS		-.031 (.025)				
Tax benefits per one organization	.015* (.008)	.014* (.008)	.020** (.008)		.017* (.010)	.018* (.010)
Tax holidays in a region in year t (0 if «No» and 1 if «Yes»)				.183*** (.024)	.110*** (.022)	.114*** (.022)
Regional tax incentives for USN payers (0 if «No» and 1 if «Yes»)				.221*** (.031)	.017 (.03)	×
Number of special economic zone in a region (0 if «No SEZ» and 1 or 2 or 3 if «SEZ exists»)				.096** (.041)	.059 (.045)	×
Percentage of individuals with access to the Internet			.092* (.046)		.164*** (.045)	.169*** (.043)
const	.575 (.662)	-.398 (.766)	2.714*** (.617)	1.788*** (.434)	2.010*** (.292)	2.062*** (.301)
Within R ²	.577	0.555	.580	.902	.862	.862
Between R ²	.160	0.236	.158	.415	.544	.542
SIC	-594.395	-542.622	-589.076	.152	.567	.555

Market

Institutions

Public support

Digitalization

CONCLUSIONS

- Household incomes, access to international and interregional markets, and capital availability can be the most significant factors.
- According to our model, with a reduction in world markets by **3%**, household income - by **5.5%**, the volume of banking services - by **5%**, it is possible the number of micro and small firms ↓ by **3.5-4%**, which is close to the data of the Federal Tax Service (about **4.3%**)
- We can expect a drop in the Russian GRP in 2020 by **0.22-0.67%** (for different regions) only from a decrease in the activity of small businesses (*Zemtsov, Smelov, 2018*)
- Small business density is lower in regions with a high crime rate because of greater investment risks
- **State support** in the form of all tax breaks and holidays can have a positive effect, but this impact is limited
- Regional tax incentives (USN), tax audits and special economic zones are insignificant if we consider the general institutional environment.
- Internet-access is also positively significant for SMEs development as it provides new market niches. Potential SMEs development is related to **digitalization** and knowledge-intensive sectors: delivery, online services, Internet banking, etc.

Thanks for your attention!

- Russian Economy in 2020. Trends and Outlooks. (Issue 42). M.: Gaidar Institute Publishers, 2021.
- *Zemtsov S.P., Chepurenko A.Y., Barinova V.A., Krasnoselskih A.N.* New entrepreneurship policy in Russia after the 2020 crisis. *Voprosy Ekonomiki*. 2020;(10):44-67. (In Russ.)
- *Zemtsov S.* Institutions, entrepreneurship, and regional development in Russia. *Journal of the New Economic Association*. 2020;46(2):168-80. (In Russ.)
- *Zemtsov S.* New technologies, potential unemployment and 'nescience economy' during and after the 2020 economic crisis // *Regional Science Policy & Practice*. 2020
- *Zemtsov S., Tsareva Y.* Development trends of small and medium-sized enterprises amid pandemic-induced crisis // *Monitoring of Russia's Economic Outlook. Trends and Challenges of Socio-economic Development*. Moscow. IEP. 2020. 17(9):16-26.
- Russian Economy in 2019. Trends and Outlooks. (Issue 41). M.: Gaidar Institute Publishers, 2020. 596 pp.
- *Zemtsov S., Baburin V.* COVID-19: Spatial Dynamics and Diffusion Factors across Russian Regions. *Regional Research of Russia*. 2020; 10(3): 273-90.
- *Zemtsov S., Baburin V.* Risks of morbidity and mortality during the COVID-19 pandemic in Russian regions. *Population and economics*. 2020. 6; 4:158.
- *Zemtsov S.P., Baburin V.L.* Entrepreneurial ecosystems in the Russian regions. *Regional'nyye issledovaniya*. 2019. 2. 4-14
- *Zemtsov SP, Tsareva YV.* Entrepreneurial activity in the Russian regions. *Journal of the New Economic Association*. 2018; 1(37): 118-34.
- *Zemtsov S, Smelov Y.* Factors of Regional Development in Russia: Geography, Human Capital and Regional Policies. *Journal of the New Economic Association*. 2018; 40(4): 84-108