



**Russian
Microfinance
Center**

**FINANCIAL SERVICES FOR
RUSSIAN SMALL BUSINESS:
MARKET SITUATION AND
PERSPECTIVES**

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Financial Services for Russian Small Business: Market Situation and Perspectives. – 33 pages.

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This paper describes the small business demand for financial product and mechanisms, in particular, assessment of the scale of the Russian SME sector, of the small business aggregate demand for financing, and of the sources of financing used by various enterprises' categories. It also contains the description of the supply of financial services to small business and key directions and instruments of development.

Vyacheslav Shironin, 2007

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The Russian sector of small and medium-sized enterprises (SME) amounts now to over 90% of the total number of businesses, and contributes approximately 30-50% of both overall employment and sales¹. There is widespread prejudice about it which depicts Russia as lagging far behind in terms of SME development. However the fact is that the SME sector is already playing a very important role, and is comparable in size, for example, the countries of Central and Eastern Europe. The business services sector is also on the rise; specifically the banking credit for small business has been very rapidly developing during the last 3-4 years, as have been microfinance programs. Still, small business demand cannot be entirely satisfied by the existing financing opportunities, be it ongoing enterprises operating in the traditional sectors and especially such enterprise categories as start-ups and innovative businesses.

Small Business Demand for Financial Product and Mechanisms

Assessing the scale of the Russian SME sector

The widely used abbreviation of SME most often has in Russia a far different meaning than abroad. And using this different – narrow – concept leads to ‘not noticing’ 80% of our SME sector.

- In the world, the SME category is considered to include any businesses with employment of up to 250 or sometimes 500 persons. In Russia according to the Federal Law №88 of June 14, 1995 *On the state support of small enterprise in the Russian Federation* a concept of a *subject of small enterprise* was introduced, falling into two categories: (1) individual entrepreneurs (sole traders) – not legal entities (Russian abbreviation PBOYuL), and (2) small enterprises – legal entities (that is, incorporated). An enterprise which is a legal entity is considered by this law a *small* one if its number of employed does not go beyond some threshold depending on industry (with the maximum of 100), and if the share of large/ noncommercial entities among its founders does not go beyond 25%.

¹ *Российское обозрение малых и средних предприятий*. – М.:2002

- The concept of medium-sized enterprise is in Russia lacking (both in law and in statistics), and the SME abbreviation is used just ‘automatically’ in line with the world tradition where indeed a category of small and *medium-sized* enterprises is specified. No data about medium-sized enterprises is included in any Russian SME statistics (with just a couple of exceptions). This leads to heavy underestimation of the SME employment and sales because half of the SME employment and at least one third of the SME sales are not reported.
- Besides, the concept of *small enterprise* is most often used in Russian publications in its legal, not economic meaning; because of this the individual entrepreneurs’ (sole traders’) contribution is also not included into SME statistics. This tells first of all on the reported number of businesses because 53,6% of the overall number of Russian businesses is not accounted for.

There are numerous means of assessing the size of the SME sector which may be not perfect but still provide good approximations.

- Putting together the data on both the small enterprises which are legal entities and the individual entrepreneurs (sole traders, or PBOYuL in Russian), and also getting resort to the existing *by-object* databases on medium-sized and large enterprises, one can obtain the following assessments:

The contribution of the Russian enterprises with employment of up to 250 persons (compared to the corresponding sum of contributions of *all* the Russia’s enterprises) is:

Share of the total number of enterprises	over 90%
Share of the total employment	over 45%
Share of the total volume of sales	over 40%

- The *Global Enterprise Monitor (GEM)*² approach deals with assessing the scale of people’s entrepreneurial behavior. These assessments get obtained by means of representative mass population surveys using questions like: *Have you done something recently which goes beyond your current responsibilities at your working place?*, or *Have you invested anything into an activity aimed at receiving profit?*, or *Did you help anybody starting a business?* etc. This survey (which to the best of our knowledge covered Russia only once in 2003) showed that our country is at approximately the world average level of entrepreneurial activity, immediately following the Netherlands and being followed by France.
- A survey conducted in the autumn of 2004 by Sergey Belanovsky resulted in lower estimates for the scale of the Russian SME sector³.

During this survey an interviewee was included into the ‘entrepreneur’ category based on his/her answer to the question: *Are you engaged in your own business or employed by other people?* Two versions were suggested as possible answers: *engaged in one’s own business* (entrepreneur); *employed* (based on a contract, a labor agreement).

² <http://www.gemconsortium.org/default.asp>

³ *Предпринимательский класс в России*. - Институт общественного проектирования, 2005.

According to the survey results, the share of entrepreneurs among the Russian population is not high; it comprises 2.7% of the polled adult interviewees which corresponds to 2% of the total population. To compare, a corresponding figure in the UK is 5%.

There may be several explanations of these smaller SME figures compared to other measurements. The difference between Belanovsky's estimates and the above *Global Enterprise Monitor* figures (which feature *birth* rates of businesses) looks understandable if we remember that Russia is characterized by a high level of business *turbulence*, i.e. simultaneously high levels of business births and *deaths*⁴:

	Births	Deaths	Growth
Individual entrepreneurs (PBOYuL)	20%	14%	6%
Small businesses – legal entities (incorporated)	8%	2-3%	5-6%

- One can assess the scale of the SME sector based on its share in the overall sum of tax contributions. We do not have reliable data of this kind, still many examples show that in many Russian cities and towns (which do not receive contributions from the extra-large oil, gas etc. enterprises) the small enterprises' tax contributions are no less than 20%, and usually 22-26%. These figures *do not* include the medium-sized businesses' taxes which most probably are no smaller.

Assessing Small Business Aggregate Demand for Financing

Unfortunately we are not aware of recent representative surveys and reliable assessments of SME demand for financing, which could have been used to understand the current market situation. Because of this we will suggest only expert estimates based on the available information.

- *Total* demand on the side of small businesses which are legal entities (including both working capital and investment requirements) can be estimated at the level of no less than 1 million rubles per enterprise (=approximately \$40 thousand). This figure consists of 80-90% demand for financing the working capital, and 10-20% to invest. The PBOYuL (non-legal entities) demand can be assessed at the level no lower than 0,1 million rubles (=\$4 thousand).
- *Unsatisfied* demand of small businesses can be assessed at approximately 0,5 million rubles per enterprise (=\$20 thousand), unsatisfied demand on the side of PBOYuL being 10-20 thousand rubles (=\$300-700). This includes 90% to finance working capital, and 10% for investment.
- Based on such calculations, the *overall unsatisfied demand* of the Russian small businesses (including both legal entities and the PBOYuL) can be assessed at the level of no less than \$10 billion.
- We should keep in mind that these calculations produce *very conservative estimates*. It can be demonstrated using the survey data of 1406 small legal entities and PBOYuL in the Republic of Tatarstan. According to these results, the aggregate demand for financing is 8 million rubles per enterprise (=\$320 thousand), the average unsatisfied demand being equal to 3,5 million rubles (=\$140 thousand). The Tatarstan economy being in many respects very similar to the Russian Federation average, republican SME statistics usually

⁴ *Российское обозрение ...*

is also very close to the national figures. Because of this there is much probability that the above data might be extrapolated to the whole of Russia.

Sources of Financing Used by Various Enterprises' Categories

- Russian SME's own earnings remain their key source of financing.
- The structure of SME sources of financing varies widely depending on their size (in terms of number of employed, turnover), industry, business lifecycle (innovation, start-up, expanding etc.). Unfortunately we are not aware of systematic research conducted along many of these 'coordinate axes'.
- The existing data regarding the structure of financing of smaller vs. larger enterprises shows that these variations reflect not only difficulties with, e.g., obtaining credit but also have to do with the entrepreneurs' values and preferences. Almost 35% of microenterprises do not see any necessity to apply for credit at all. On average, the smaller the enterprise, the more seldom it has debt and the more often it prefers to rely on its own earnings. As the enterprise grows larger, it becomes less inclined to use such sources of financing as its founders' private savings and/or money they earn by working for other companies; money borrowed from their friends and relatives; loans and/or consumer credit from other (non-financial) enterprises. At the same time for the larger enterprises investment from new owners (equity) and banks credit play larger role.
- By far the key factor which puts a limitation for an enterprise to apply for credit is its price, i.e. the interest level.
- The other factors' impact varies rather widely depending on the enterprise size. As the enterprise grows larger it becomes on average less constrained by such factors as the credit institutions' requirements concerning collateral and guarantee; unwillingness of credit institution to waste their time dealing with small-scale borrowers; and their own possible inability to return the borrowed money. At the same time the larger a Russian business the more often it is constrained by the shortage of credit with longer maturity.
- A most important factor very often hindering a business's access to external sources of financing is the shadow style of its operation, and the discrepancies between its official reporting and the real scale of its operation. Various attempts at measuring the total scale of shadow economy in Russia have been made which, naturally enough, produced large dispersion of quantitative estimates. However all the possible measurements show that as the enterprise grows larger the scale of its shadow activity dramatically declines.
- Cross-country comparisons of Russian vs. developed market economies show remarkable differences. Such sources of financing as equity and local banks are mentioned times more often in these countries than in Russia. On the contrary, the Russian SME much more often turn for financial support to their friends and relatives and/or use commercial credit by their input suppliers.
- The enterprises own earnings are leading as the most convenient source of financing. Such attitude results from a whole range of considerations, the key role playing the entrepreneurs' desire to maintain their independence. This source also remains the most easily accessible in Russia. It excludes the necessity to report your activity to the authorities. And, naturally enough, it excludes such problems as interest rates, collateral and paperwork connected with credit applications.

- The existing survey data show that all the other sources of financing are of less importance. Still, there exist the following differences in the business people's attitudes towards the outside sources: The banks credits look more attractive from the point of view of interest rates, their availability and maturity. Equity financing looks rather available, and it allows one to maintain one's independence and not to report to the authorities. Borrowing from friends and non-credit enterprises is convenient first of all because it does not put a strict limit on the repayment time.
- New surveys of entrepreneurs regarding what type of credit is most difficult to obtain support the 'shortage scale' established by the previous such surveys. As earlier, the most difficult thing to do is obtaining credit without collateral. Then, by decrease of shortage, come: sufficiently cheap credits; credits with longer maturity; comparatively large; quickly processed credits; and credits issued to smaller businesses.

Supply of Financial Services to Small Business

Russian Financial Market Dynamics

- The financial market of Russia currently shows very high growth rates and is considered (along with markets of Turkey and Ukraine) as one of the most attractive markets in the region of Central and Eastern Europe (CEE).
- In terms of aggregate credit growth rates Russia is currently by far the leading CEE country: according to the existing forecasts this rate will reach 40% annually for the period of 2000-2008 (in Euro). The key locomotive of the aggregate credit growth are consumer credits which have increased in volume 2-3 time during only the last year. Quick growth of banks deposits also takes place, the corresponding forecast for 2000-2008 being 30% per year. Another area where Russia is ahead of all the CEE countries is the level of profitability of the banking business.
- In spite of all this success, our country still lags behind many transition economies in terms of several key financial market indicators. The total volume of banks assets is in Russia only around 45% of the GDP while it is at the level of 60% of the GDP in the countries of South-Eastern Europe, 80% of the GDP in Central Europe, and over 200% of the GDP in the EC countries. The total volume of deposits reached in our country 25% GDP, as did the volume of issued credits, while these parameters are at the level of 38% and 33% in the CEE countries.
- The Russian financial market is simultaneously highly concentrated and fragmented. The five leading banks own nearly half the total banks assets. At the same time the financial market concentration index (aggregate market share of the five leading banks) совокупная доля рынка, принадлежащая пяти крупнейшим банкам) is in Russia comparatively low (Sberbank has approximately 26% of the market, then follow: Vneshtorgbank (6%) and Gazprombank (4%). Alfa-bank, Uralsib, Bank of Moscow and Rosbank have approximately 2% of market each.)

- Foreign banks penetration in our country goes very rapidly, however all of them still occupy only under 10% of the market, which is times less compared to any CEE country.
- Currently, the stable economic development of our country is to a considerable extent based on the high prices of oil and other natural resources. It means that potentially a drop in oil prices can produce serious negative impact on the Russian economy. In this connection the Center for Strategic Research and some other think tanks conducted research into the stability/vulnerability of the Russian banking sector under conditions of potential decrease of oil prices. The results they produced are confidential, however their general conclusion is as follows: even if a very sharp decrease in energy prices takes place this year, it will not lead to any serious consequences for the Russian financial system as a whole, nor for the majority of the key banks. However some of the leading banks might be hurt, which are heavily engaged in credit operations in the most risky sectors of Russian economy (construction, oil and gas etc.).
- Another factor of potential risk is connected with there existing a probability of an *infrastructural crises* in our country. This problem has been repeatedly mentioned by Anatly Chubais who first of all refers to the situation in the Russian electricity industry. The problem is, unexpectedly rapid growth of Russian economy resulted in corresponding increase of energy consumption and overburdening of the industry infrastructure. Similar problems are experienced by the transportation infrastructure (roads, pipelines), cities infrastructure etc. Potential manifestations of such crisis may come in the shape of physical shortages of energy supplies, traffic problems etc. which in turn may lead to breach of contract obligations and – along the chain of contractual relations – result in emergency phenomena of other kinds. This problem seems to be of real importance, however it has not got much attention, and we are not aware of quantitative assessments of the corresponding risks.
- A potential source of macroeconomic risks may be connected with the present *overheating of some Russian markets*, first of all, the real estate market. Given the insufficient development level of the Russian financial and stock markets, savings and investment tend to get concentrated on rather narrow market segments, especially on the real estate market. This tendency is contributed to by some government programs which are, inter alia, linked to the political lifecycle and are based on the electoral logic. At the same time our real estate and land ownership system still needs further development, and monopoly effects in the area of housing construction put barriers to expansion of supply. In this situation, a risk of financial pyramids and instability is rather real.

Consumer Credit: the Champion of Russian Financial Market

- Currently, some evidence of overheating the consumer credits market is also present. Our country is living through a boom of consumer credit, which has grown in volume several times during last year – year and a half, and has been maintained on a somewhat stable level only since last couple of months. The share of consumer credits in the whole credit volume in our country is still rather low, so there is much reason to expect continuation of this tendency. However one should take into account that currently the aggregate consumer credits volume is not adequately monitored nor controlled. Under the present reporting system, the banks' representative offices who issue credits directly to their clients, are not obliged to provide full information either to the regional nor to the financial nor statistical bodies. The climax of returns of the issued consumer credits is expected during the first half of 2007. If this climax is passed successfully, then most probably neither the Central

Bank of Russia nor any other regulating bodies will have any reason for hardening the regulation rules. Otherwise the conditions for obtaining consumer credits will become more tough, and its price higher.

- Currently, a substantial stabilization fund has been accumulated in our country. Its preservation and/or possible spending directions remain a subject of serious political and public debate with the final decisions which are by no means clearly predictable. If the fund is resorted to with the purpose of addressing the current needs, the country's financial system will inevitably experience a serious destabilizing blow. An opposite scenario is also possible, when the stabilization fund is used to compensate for some inequilibria.

Banks' Supply of Services to Small Business

- The contemporary Russian economy can be more or less accurately described as consisting of two key sectors. A comparatively independent priority sector exists which has its own financing flows. The borrowers who belong to this sector (including first of all large export-oriented enterprises) have opportunities of using international sources of financing and are all the more looking towards foreign banks. According to some estimates in 2005 about half the credit volume to the large enterprises was issued by foreign banks. Because of this, the smaller banks become all the more interested in looking for clients among the small and medium-sized businesses, and in providing services to individual customers.
- Large Russian banks expand their operation towards the provincial regions where they win markets by providing high quality services and their ability to issue big amounts of credit. At the same time it is easier for a not-so-large enterprise to apply and get credit from a local friendly bank than from a local subsidiary office of a Moscow financial institution. Russian local banks are firmly in the second place (after Sberbank) in attracting the individual deposits, and in small loans to individuals. Compared to the federal key banks, the local ones also show higher figures of credit to enterprises as proportion of their overall investment, because the big ones are more inclined to invest in shares.
- According to the *Expert Magazine*, the aggregate credit volume issued to Russian small enterprises in 2005 amounted to \$5 billion. Besides, small and especially microenterprises often receive financing in the form of individual consumer credits.
- Some foreign financial institutions who have tradition and extensive experience in this and similar areas (e.g. **Raiffeisenbank**) seem to be interested to enter the markets of credit to individual customers and small businesses. Their strategy also includes purchase of share in comparatively small banks, most often outside Moscow and St. Petersburg. This tendency leads towards a situation when the emerging market of credit services to small businesses will also get access to foreign financial resources. Because for such a system of relations the burden of Russian prudential regulation is currently less heavy, this tendency may lead to decreasing the price of credit paid by the borrowers.

Non-bank Financing for Small Business

- According to estimates published by the **Российского микрофинансового центра**, the aggregate supply of microfinancing services currently amounts in Russia to \$1 billion.

- The microfinancing industry in Russia has successfully passed the initial difficult part of the logistical curve and entered the stage of exponential growth. Practical technologies have been developed necessary for creation and successful operation of a microfinancing organization including: general organizational scheme of an institution, technique of dealing with the clients, personnel selection and training programs, software etc. Quite successful experience of replicating such technologies has been also accumulated.
- In some regions micrifinancing institutions (such as credit cooperatives, private and public funds) have become an indispensable element of business environment. At the same time they are completely lacking in some other regions, or play there only minor role. Such vacuum should be perhaps considered as potentially attractive niches which provide good opportunities of rapid expansion of the microfinancing market.
- Until recently, the market of non-bank microfinancing services has been developing not only without government support but also outside of its sphere of attention: initially it was based on support of international and foreign programs, and now it is driven by the initiative and enterprise of the microfinancing institutions themselves. Such lack of attention on the side of the government resulted in legal vacuum and all range of connected problems, but on the other hand, it provided much freedom and room for development. Today the microfinancing market is entering a stage when it has to be integrated into the general system of legal relations and should be subject to the country's rules of economic regulation. Because of this, it is crucially important that the idea of microfinancing occupies its own definite place in the public understanding, and it becomes a specific issue of professional discussion. The future legal and regulatory framework of microfinancing activity should reflect its own goals and possible problems (which are different e.g. from those of the banking sector).

Financing the Start-ups

- Traditionally in any country the start-up enterprises (who have no credit history) are financed from the private savings of their founders, or by informal borrowing (from their friends, relatives etc.), or by involving venture equity investments. In the latter case, reliability and operational viability of the created set of relations essentially depends on the efficiency of the country's legal system. Accordingly, at the level of macroeconomy and government policy, the new enterprises birth rates are directly influenced, first, by the incomes and savings levels of individuals and families, and second, by the staus of the legal system. At the societal level, the most important factors appear to be the type of family and kin relation as well as relations within small social groups (ethnicity included).
- Problems and risks connected with creating a business and the necessary capital may be quite small, especially for a micro business. Later on, this business goes on developing and accumulating its credit history which gradually becomes a basis for its borrowing. Hence the importance of not creating unnecessary obstacles for the start-ups and for the smallest businesses: the burden imposed on them (taxation, reporting, regulations, inspections) should be minimal or – ideally – equal to zero.

Venture Financing in Russia

- Venture financing is a special variety of start-up financing, usually dealing with high-tech business. A venture fund (or individual) usually invests in stock, the other share being owned by the initiators of the new company who invest their intellectual property.

- There are many success stories of Russian innovative companies; still on the average the innovative component of Russian small business is not impressive. However this picture looks absolutely different if all the new decisions which have never been introduced on the Russian market before are included in the category of innovation.
- It is more often not in Russia but abroad that Russian R&D results and inventions are transformed into sellable commodity, because there this process can be supported by a more favorable environment and special infrastructure. Then new owners re-sell it either in the form of intellectual property or as a start-up enterprise based on this property. Absence of supporting infrastructure results in Russia in a situation when an innovative entrepreneur can independently enter the market only with minor improvements of an already existing product. This is why the most successful approach to commercialization of Russian scientific products consists of servicing large international corporations' demand and hunting in Russia for the lacking technologies which are necessary for designing these corporations' new products. In other words, more successful turns out to be a demand-driven approach and not attempts to promote the existing stock of R&D results.
- Since mid-1990ies organizations and individuals ('business-angels') have been operating in Russia who call their activities venture financing. Recently this sector has been rapidly developing. However in fact the activities of many 'venture investors' is much closer to the area of 'private equity'. The majority of such institutions are 'later stages funds' whose key objects of investments are sufficiently mature companies having their own developed markets and looking for medium-term investments to expand. Such bias towards later-stages clients is caused by the continuing boom on the consumer market, which still has many free attractive niches.
- The development of innovative business and venture financing in Russia is hindered by the whole range of problems:
 - Closed regimes of the scientific institutions; lack of infrastructure to support search for R&D results
 - Researchers being not aware of the venture funds existence and modes of operation
 - Researchers being not aware how they should interact with other players in the chain of commercialization of their innovation; their professional and psychological unreadiness
 - Absence of mechanisms in Russia to adequately defend intellectual property and minority shareholders
 - Unfriendly taxation system
 - Absence of institutions involving the national long-term savings into the economy (pension funds, insurance)
 - Comparatively unfriendly investment climate, especially as regards long-term investment.
 - Shortage of professional innovation managers
 - Insufficient development of IPO mechanisms for innovative companies
- Innovative small businesses role is supplemented and to some extent replaced by the large corporations who invest into innovative projects aimed at development of their own production.

- The Ministry of Economic Development and Trade of the Russian Federation (MEDT) is currently creating several government-private venture funds on the scale of \$10-50 million each. They will be contribute 25% by the Federal budget, 25% by regional budget, and 50% by private investors. Based on their several characteristics, an opinion is expressed by some professional observers that these funds will also most probably behave as private equity, and not venture investors, because their composition does not correspond to the purpose of addressing the needs of start-up companies and/or high-tech business. At the same time these funds will most probably be able to supply finance to fast-growing companies. One can suppose that these funds' key function will consist of servicing the needs of member companies of the special economic zones.
- Another direction of the MEDT policy consists of creation technoparks in several Russian regions, including development of corresponding infrastructure and close cooperation with the research institutions. This may contribute to infrastructure development and to better mutual understanding among the researchers and the entrepreneurs.

Opportunities on the Stock Market

- Comparatively small and new companies usually have much more problem entering the stock market than larger and better-known businesses. Because of this, many stock exchanges provide special facilities for innovation and fast-growing companies (such as NASDAQ and AIM - Alternative Investment Market – of the London Stock Exchange). In 2006, such facilities were created at the two largest Russian stock exchanges **MMBB** and **PTC**. Companies of capitalization between 100 million and 5 billion rubles can trade their stock here if they meet some other conditions: belong to the category of innovative business and/or grow at a rate no lower 20% per year.
- According to some analysts' comments, creating in Russia opportunities for non-larhe companies' IPO may provide an alternative to various 'grey' investment schemes. Further developments will be connected, on the one hand, with necessity to develop a legal framework for trading stock of companies which would provide only a 'narrowed-down' package of information. On the other hand, such limited disclosure of information will inevitably increase investment risks, and if not-highly-transparent companies of low liquidity make IPO in mass, the other stock market actors will have problem assessing their investment potential. Anyway, such a massive IPO is not likely to happen soon.

The Government's Role

- Macro policy of SME development should not be narrowed down to *small business support*. Almost all decisions in the area of the economic policy produce some impact on the business climate. Traditionally in Russia, the key macroeconomic parameters (level of prices, their dynamics, currency exchange rates, interest rates etc.) are analyzed in terms of their interconnection and their impact on the macroeconomic results (GDP, aggregate employment, economic growth etc.). The fact of these parameters' influence on the entrepreneurial behavior is acknowledged but not much discussed. Meanwhile it might have been advisable to take into account the macro decisions' impact on such statistics as: number of created and liquidated businesses; enterprises' size profile; their financial profile; capitalization and many others. Unfortunately, such impacts are not considered by the Central Bank or Ministry of Finance of Russia.

- The present economic (as well as political, social etc.) situation in Russia is characterized by fragmentation when different sectors, industries and institutional mechanisms are weakly connected and operate under different rules of the game. Specifically, ‘official’ activities go separately from the ‘unofficial’, and there are many grades of ‘semi-official’ behavior. Thinking of government policies, we should perhaps allow that such fragmentation is inevitable in a transitory economy. Reforms and policies directed at the institutions of the ‘official’ economy should not harm the healthy processes which are underway in the ‘non-official’ economy. Second, intermediary institutions should be encouraged and/or created whose goal would consist of bridging the gaps which separate comparatively isolated institutions. Specifically such intermediaries may be very efficient in an economy where, on the one hand, there is surplus of money, and on the other hand, businesses still experience problems getting access to finance.
- The goal of integrating the fragmented (inter alia, into ‘formal’ and ‘informal’ relations) Russian financial system looks quite consistent with the concept of *inclusive financial system*. This concept has been developed based on the extensive many-years experience of the donor and microfinancing institutions, first of all in the developing countries. Its main idea is aimed at creation of financial system capable of integrating and incorporating all the strata of population, including the very poor. Much effort has been spent in order to elaborate on various issues connected with informal nature of employment and enterprise of the potential clients of such a system, lack of property suitable for collateral, their non-economic motivation etc. All these issues are very actual in the Russian situation, and they are relevant not only with the low income groups. Because of this it looks reasonable (at least for the Russian transitory economy) to generalize the concept of inclusive financial system so that it includes the whole array of issues to overcome the phenomenon of fragmentation.
- Given the insufficient level of development of both the Russian banking and non-banking financial sectors, the system of Federal, regional and local authorities becomes (at least potentially) an important channel of SME financing. There are ‘technical’ problems in this way, connected with legal regimes of providing budget money to private firms. The most important aspect of this issue however deals with the fact that all the decisions about SME development (and especially, financing) are taken (first of all, on a regional or local level) in a situation of severe conflict of interest. There are major contradictions between the authorities’ goals of developing business on their territory, lobbying for ‘upper-level budget’ subsidies, and the necessity to invest into local communal infrastructure. Besides, local officials usually personally take part in business, and they are not inclined to support independent or ‘stranger’ businesses on ‘their’ territory. One solution to this set of problems may go along the lines of the experience of the Tatarstan Republic where the goals of SME development are made a formal responsibility of the local officials, who have to demonstrate success measured by indicators.

Key Directions and Instruments of Development

We can see various directions where the Russian market of financial services for small business can improve its effectiveness and efficiency. These results can be achieved over short- medium- and long-term period:

Goals for Sort-term Period

- Replicating the successful experience. There has been extensive practical experience accumulated by now in the area of servicing the financial demand of small business. This experience can be rather easily disseminated and practically replicated using franchising schemes and/or government investment into creation of similar institutions.
- Improving the assessments of credit risks. Specific decisions by the banks and other financial agents as well as the Central Bank's policies (creation of reserves etc.) are based on the existing assessments of risks connected with providing credit to small business. There is much reason to believe that these risk assessments are overestimated. It might be reasonable therefore to re-assess them, and to develop a more adequate classification of the SME borrowers.
- Correcting the Central Bank's and other supervisory bodies' policies. Further to improving the informational data bases, analytical and PR work need to be done in order to influence the policies.
- Introducing friendly taxation regimes for innovative enterprises
- Encouraging partnerships to apply for credits Many small businesses operate in a 'grey' zone and are unable to provide a bank or another credit institution with 'official' information necessary to extend a credit. It might be reasonable in this situation to develop standard approaches (including legal formats and documentation) which would make it possible for such businesses to apply for credits as partners of more transparent firms.
- Providing guarantee. A similar role may play providing guarantee, e.g. by the local authorities.
- Increasing the efficiency of selling the collateral Developing infrastructure for easy selling of collateral if the credit is not repaid might also contribute to decreasing credit risks and expenses.
- Developing IPO mechanisms for innovative companies.

Goals for Medium-term Period

- Development of retail (small) credit institutions. Such institutions could resort to the whole toolkit of risks reduction based on their idiosyncratic knowledge of their client's business, their professional and social environment, collective responsibility etc. On the other hand, such credit institutions could be considered large and transparent enough to be good partners of banks.
- Reducing the cost of issuing credit through introduction of scoring
- Risk reduction through accumulation of credit histories. Besides *credit histories of non-financial companies* who are final borrowers, it seems worthwhile to develop credit histories also of retail (small) credit institutions. This would make possible for the retail institutions themselves to be very flexible in their choice of approaches to reduce credit risks, and not to rely heavily on their client enterprises official reporting.
- Risk reduction through insurance

- Using more cheap sources of refinancing, specifically through pooling together of retail (small) credit institutions in order to enter foreign financial markets.
- Encouraging development of a two-tier system of credit cooperatives.
- Developing a system for training innovation managers.

Goals for Long-term Period

Legal and Courts Reform, Pension Reform, Housing reform, Developing Stock Market, Personal Incomes/Property Reform