



Ikea in Khimki, Moscow.

PHOTO: ANDREI RUDAKOV/BLOOMBERG

Business climate in Russia

Swedish investors' perspective

by Olga Golubeva

The notion of business climate is commonly used by international policy-makers, researchers and business people to address the set of location-specific factors shaping the opportunities and incentives for firms to do business in a particular country. The use of this concept is often more rhetorical than tangible as different parties include diverse factors in the definition. Nevertheless, business climate has been institutionalized as a concept that contributes to a country's economic growth and competitiveness. The poor business climate in Russia is, according to the OECD, "a glaring and persistent handicap for the Russian economy. Doing business in Russia is difficult and risky, due to the heavy administrative burden, widespread corruption and a weak rule of law."¹

Facing up to the problem, Russia's top leaders express their commitment to making improvements in the business climate. In October 2014, President Vladimir Putin assured the audience of the Russia Calling Investment Forum in Moscow: "We will continue system-wide work on improving the business climate in Russia".² Putin also cited the considerable changes to many laws in Russia and the optimization of administrative procedures which has taken place. In appreciation of such steps, the World Bank's Doing Business Ranking, one of the proxies for business climate, moved Russia from 120th place in 2012 up to 112th in 2013.³

Today, over 400 Swedish companies are present in the Russian market.⁴ Sweden is currently among the top ten foreign investors in Russia with 15.8 billion USD of accumulated investments.⁵ In 2013, Russia was Sweden's 13th biggest export market and 7th biggest import market.⁶ But why are Swedish and other foreign companies interested in Russia?

A large and potentially expanding consumer market, rich natural resources and sizable government investment

projects are cited as being central to Russia's competitiveness. It is, however, broadly recognized that Russia should establish a more balanced economy and diversify areas of growth. In order to improve the business climate in Russia, economic and political advisors often suggest that Russian government intensify its efforts to reduce administrative burdens, minimize bureaucracy and corruption, increase transparency, consolidate the rule of law, foster entrepreneurship and develop innovation capacity.⁷

While the importance of the business climate is emphasized by economists and policy-makers, there is still little guidance about what aspects of business climate in Russia are important and what specific reforms are needed. The influence of different variables in the business climate on Russia's attractiveness for foreign investors is an important issue that needs closer examination.

The purpose of this article is to analyze the business climate in Russia from the Swedish investors' perspective. The case presented is related to general theoretical discussions regarding

the concept of business climate and its definition in social science. The article also aims to present and analyze recent empirical survey data on the subject.

The paper summarizes the main theoretical frameworks that have been applied by previous research in business climate studies. Mainstream frameworks include institutional theory, macro-economic literature, micro-economic perspective (the theory of the firm) and the political process approach. Although a consensus definition of business climate may never be reached, the article attempts to systemize existing definitions and to highlight problems in the current usage of the term.

The article uses data from the Business Climate Survey conducted by Business Sweden⁸ during July–August

abstract

The article addresses the issue of the business climate in Russia from the Swedish investors' perspective and relates it to a general theoretical debate in the field. Statistical test suggests that the majority of variables relating to the business climate has deteriorated between 2012 and 2014. The findings support several mainstream theories regarding the business climate but also demonstrate some contradictions that would require further investigation. These include the reaction of Swedish business to the escalation of political tensions between Russia and the West and the factor of corruption, which is not viewed as serious enough to fully discourage foreign investors from staying in Russia.

KEY WORDS: Business climate, firm-level approach, business climate theories, survey analysis, T-test for paired samples, foreign (Swedish) investors, Russian market.

2014 in cooperation with Magnusson Law and Raiffeisen Bank.⁹ The survey presents the perception of the business climate in Russia among Swedish companies operating in the market. Experienced top executives, mainly Swedish nationals representing 82 companies, or 20% of all Swedish companies operating in Russia, participated in the survey in 2014. The survey was conducted using approximately 55 closed questions, while several questions allowed respondents to write comments and recommendations. Managers from small, medium-sized and large companies answered the questions; the proportions of service, production and trading companies across different industries is almost equal.

A similar survey was also conducted by Business Sweden in 2012. Since 2012, Russia's relations with EU and US have deteriorated. The annexation of the Crimea by Russia, the armed conflict in the eastern Ukraine, the introduction of sanctions against Russia by the EU and the US and the response by the Russian government with counter-sanctions have created challenges that were not on the agenda in 2012.

Although the current dynamics between Russia and the West do not yet constitute a new Cold War, Business Monitor International (BMI) expects a turbulent period to prevail for the next few years.¹⁰ Such a situation decreases the attractiveness of Russia for foreign investors. There is a serious concern as to whether Russia can continue to improve its business climate if it is in opposition to major parts of the global economy. The possible impact of an escalation of the conflict between Russia and the EU/US on the business climate in Russia, therefore, remains currently unknown.

The research paper compares the answers of top managers on different aspects of the business climate in Russia for 2012 and 2014. Does the managers' perception follow the global investors' current negative views on Russia? One might expect that the recent escalation of the conflict between Russia and the West would be reflected in the answers provided by top managers.

The study analyze whether business climate in Russia has deteriorated due to the recent escalation of turbulence between Russia and the West.

The research design combines qualitative and quantitative methods in order to address the research issue. Qualitative methods are a vital aid in identifying possible trends and developments as well as understanding which variables of the business climate are of major importance for foreign investors.

The methodology includes a quantitative T-test analysis for 20 selected business climate parameters.¹¹ The analysis starts with an estimation of a sample mean¹² for responses of managers during 2012 and 2014. Managers chose suggested alternatives ranging from 1 (low risk assessment or positive developments) to 5 (high risk assessment or negative developments). If the situation had deteriorated in 2014 compared to 2012, the scores provided by managers would be expected to rise to reflect higher risks associated with business climate in Russia. We assume that the answers have approximately normal distribution. T-test analysis was carried for paired samples of different business climate variables for 2012 and 2014.

The null hypothesis H_0 states that there is either an improvement of the mean for the 20 selected variables of the business climate in 2014 compared to 2012 or they are unchanged. The sample mean for 2012 (μ_{2012}) is assumed, therefore, to be equal or higher than the sample mean for 2014 (μ_{2014}).

The alternative hypothesis H_1 suggests that the sample mean for selected variables deteriorated in 2014 compared to 2012 reflecting higher (respectively, more negative) scores in the managers' replies. We can express the null and alternative hypothesis as follows:

$$H_0 : \mu_{2012} \geq \mu_{2014} \quad H_1 : \mu_{2012} < \mu_{2014}$$

H_1 hypothesizes that there has been deterioration in the assessment of different parameters of the business climate by managers in 2014, therefore a one-tailed T-test is performed. The level of significance of 5% is chosen ($\alpha = 0.05$).¹³ If the null hypothesis is rejected, then we have statistical support for the alternative hypothesis. If the evidence shows that the null hypothesis is false, we can conclude that the data supports the alternative hypothesis regarding a deterioration trend in selected variables of the business climate in 2014 compared to 2012.

The empirical data presentation combines qualitative analysis with an output from the T-test statistics.

Finally, topics regarding theoretical frameworks for and empirical investigations into business climate are suggested for future research.

Business climate, theoretical frameworks and definition

The concept of business climate has no significant body of shared views but is fragmented into different schools of thought. Various theoretical frameworks have been developed to study business climate.

The institutional theory takes as its point of departure that organizations are under pressure to adapt and be consistent with their institutional environment. Companies are assumed to aim for legitimacy and recognition, and they do so by adopting structures and practices defined as appropriate in their business environment. Pande and Udry conclude that long-run growth is faster in countries with a favorable business climate including higher quality contracting institutions, and higher levels of trust in such institutions.¹⁴ According to Yakovlev, the incompetence of public institutions in Russia imposes serious restrictions on the development of the business climate.¹⁵ A lack of institutions forces companies to search for their substitutes. The weak legitimacy of formal institutions in Russia, therefore, pressures firms to rely excessively on informal institutions, including personal networks.¹⁶

The macro-economic mainstream literature has generally used cross-country samples to explain GDP-based outcome variables with broad, country-level indicators of the business climate such as institutional quality, the policy environment and infrastructure. The majority of such analyses have found that these business climate variables have significant effects on eco-

conomic performance.¹⁷ The macro-analyses obviously generated useful insights, among others about the central role of secure property rights and good governance for the business climate.

The findings of the macro-econometric literature are often questioned due to concern about the robustness of the results. The explanatory variables at country level obscure variations across different regions within a country, across different types of firms (by firm size, age, ownership type, etc.), or both. The precise channels through which business climate variables affect economic growth are still not fully understood, and recent studies have been more cautious in their interpretation of the evidence.¹⁸ Other econometric problems, such as the failure to account for model uncertainty in cross-section studies, persist.¹⁹ Banerjee and Duflo, for example, stressed that macro-economic models can hardly account for the behavior of firms in a world full of different constraints and uncertainties.²⁰ The impact of constraints such as infrastructure limitations, lack of access to finance, or political issues on individual firms' decisions can be better analyzed at company level with the help of non-aggregative methodology.

In an effort to break through these limitations of macro-economic models, recent research attempts to search for micro-level evidence on the business climate and for ways to trace the climate's impact on company decisions and performance. While policy-makers and researchers often have very specific objectives regarding business climate, the firm is more likely to appreciate the holistic view of the business climate rather than any one specific goal.

One of the new frontiers of economics is, therefore, the analysis of business climate from a micro-economic perspective. Company theory puts the focus on a company as the core element, instead of the broad aggregate numbers in macro-economic analysis.²¹ Dethier et al. use enterprise surveys to provide an overview of literature with the focus on the impact of the business climate on productivity and growth in developing countries.²²

The crucial prerequisite for finding more disaggregated evidence is the availability of raw disaggregated data. Before the 1990s, standardized firm-level business surveys spanning multiple countries were practically nonexistent. The key development of the early 2000s was a push for greater standardization in order to build up a single, centralized database of comparable business climate surveys from around the world. The World Bank's World Development Report (2005) was the first to bring together insights from two World Bank initiatives, namely the Investment Climate Surveys and the Doing Business Project.²³ The EBRD-World Bank Business Environment and Enterprise Performance Survey (BEEPS)²⁴ is another initiative aiming to capture indicators of the business environment and track changes in the business environment over time.

There have been considerable discussions about the possible weaknesses of subjective, perception-based surveys compared to objective, quantitative data.²⁵ Carlin et al.²⁶ highlight the ease with which a subjective ranking of constraints is used for comparisons. Exploring such concerns, Gelb et al. examine subjective data yielded by the core Enterprise Survey perception questions. They conclude that while perceptions of business climate constraints may not always correspond fully to 'objective' reality, firms do not complain indiscriminately, and response patterns correlate reasonably well with several other country-

level indicators related to the business climate.²⁷ Examination of data surveys provides evidence that a good business climate favors growth by encouraging investment and higher productivity. Various infrastructure, finance, security, competition, and regulation variables have been shown to have a significant impact on enterprise performance.²⁸

Because business climate is obviously affected by political factors, some researchers suggest a political process approach as a theoretical framework for analysis. Curmudgeon analyses the business climate as a cumulative aggrega-

tion of policy decisions across departments, policy areas, and time periods, which are based on the decision-makers' belief.²⁹ Bittlingmayer et al. stress an explosion in the use of the business climate concept during last ten-fifteen years, among other things as a tool to affect public opinion and policy change.³⁰

Several researchers have demonstrated the great relevance of the political process approach to studying the business climate in Russia. Frye, for example, admits that ideally one would like to make investment decisions primarily on economic grounds where political power matters less than economic efficiency, but this is far from the case in Russia.³¹ Rochlitz provides some empirical support for the view that political motivation to acquire electoral votes by the federal government in Russia had an impact on the business climate of a particular region.³²

There is no way to prove which of these (or any other) theoretical approaches is more appropriate to analyze the business climate. Currently, no single approach can fully accommodate the concept of business climate and explain its nature. Neither of these approaches in isolation can give guidance on policy recommendations on how to improve business climate in different countries and regions. There might be room, therefore, for the co-existence of different academic approaches as they address different aspects and issues of business climate. Instead of deciding on which approach is the most suitable for analyzing the business climate, the current challenge might lie in systematizing the contributions of different theoretical schools and understanding their added value for different business environments.

But what is business climate? Business climate is often de-

“BECAUSE BUSINESS CLIMATE IS OBVIOUSLY AFFECTED BY POLITICAL FACTORS, SOME RESEARCHERS SUGGEST A POLITICAL PROCESS APPROACH AS A THEORETICAL FRAMEWORK FOR ANALYSIS.”

defined as an environment that surrounds firms within a given geographic area, where conditions and circumstances have a profound effect upon the success or failure of businesses.³³ It is also commonly stressed that differences in business climate are a reason why some countries are economically more successful than others.³⁴

Eathington, Todd and Swenson distinguish three major meanings in the concept of business climate: (1) an overall measure of growth or business health in a region; (2) a set of factors believed to contribute to regional economic growth; and (3) an intangible asset in the form of a regional reputation for business friendliness and receptiveness to growth.³⁵

The definition of business climate as an intangible asset is supported by the importance of sending a pro-growth, pro-business message to the international and local business community. Countries are, in that case, booking the business climate onto their balance sheets in the hope it will yield future 'earnings' from other businesses attracted to the region. Business climate in that context becomes a message, not a measure. This conceptual definition of business climate is perhaps the most problematical one for sound policy development. In the name of improving the region's reputation for business friendliness, countries and regions may commit significant public resources. In any case, the notion of business climate as a regional asset deserves the additional attention of researchers.

It is also possible that business climates may have their most crucial impact variables outside existing frontier definitions. Bittlingmayer et al. claimed that the business climate indexes with the best outcome explained only 5% of the total variation of performance.³⁶ A tentative conclusion might be that business climate ratings do not capture the concept of business climate in the right way.

Literature on the importance of different aspects of business climate for foreign investors is characterized by a certain inconsistency in conclusions between the studies.

Dollar et al. reach conclusions about the importance of the investment climate (including physical and financial infrastructure variables) for attracting foreign investors into eight Latin American and Asian countries.³⁷ Kinda shows that physical infrastructure problems, financing constraints, and institutional problems discourage foreign investors, particularly for Sub-Saharan African countries. The study supports the thesis that introducing additional explanatory variables of the investment climate can enhance understanding of the issue.³⁸ Mottaleb and Kalirajan argue that socio-economic and political variables such as regulatory frameworks, bureaucratic hurdles and red tape, regulations relating to setting up a new business, judicial transparency and the extent of corruption in the host country may impact foreign investors.³⁹

Several researchers question whether a conventional set of business climate variables is really important for foreign investors. The empirical results of the study by Goswami and Haider suggest that the host government policy has little impact on foreign investors.⁴⁰ Rather, cultural conflict and the attitude of the foreign investor country towards the host country are found

to be mostly significant variables. Empirical results by Blonigen et al. also reflect little support for the view that government policies are an important indicator.⁴¹ Researchers found no robust evidence in the analysis that business climate policy variables controlled by the host country (such as multilateral trade openness, business costs, infrastructure, and political institutions) have an effect on foreign investors.

It can be concluded that the importance of different business climate variables for foreign investors remains an ambiguous and open-ended issue in the literature. The reason behind such uncertainty might be our limited understanding of the concept of business climate and its theoretical framework. Another explanation might be the complexity of the phenomenon itself. We obviously face a challenge: researchers, policy-makers and the business community should pool their resources in order to reach consensus, even on a partial basis. There are many ways to describe business climate and plenty of variables that might be included in the definition. In the face of such uncertainty, the right approach might be to search for factors identified by the business climate concept that can enhance economic growth and competitiveness and attract foreign investors.

Business climate from the point of view of Swedish companies

The BCS data was collected for both 2012 and 2014, while for newly introduced questions, the empirical response is available only for 2014. Besides this, several responses are more of a qualitative nature and do not suit T-test methodology. However, they provide a valuable insight into different aspects of business climate from the point of view of Swedish companies operating in Russia. Therefore, statistical conclusions are complemented by a qualitative analysis.

The empirical data presentation and analysis is carried in two steps. First, we address strategic issues related to Swedish companies' establishment in Russia, including the perception of the Swedish brand in Russia, the profitability of business, establishment of local contacts in Russia and future plans of Swedish companies. Secondly, we summarize the empirical data for 20 selected variables regarding business climate in Russia. This data was used to carry a statistical paired samples T-test. Findings from the statistical T-test are complemented by the qualitative empirical data acquired from managers.

Strategic issues for companies' business establishment

An encouraging starting point for our empirical data presentation is that Sweden is perceived as a brand that is welcome in Russia. In 2012, for example, 79% of respondents emphasized that they were positively treated as Swedish business people in Russia, the figure being raised to 90% for 2014. According to the data, the escalation of conflict between Russia and the West was not directly reflected in the reception of Swedish companies by Russian society. On the contrary, Swedish brands were more appreciated in Russia in 2014 compared to 2012. This topic deserves further analysis, especially from the point of view of policy and government structures aiming to enhance co-operation between



The opening of a new H&M shop in Moscow, 2009.

Sweden and Russia in different areas. Evidently, certain measures promoting the image of Sweden in Russia contributed to offsetting the negative effects caused by political disturbances.

On the negative side, the empirical data suggests that it is hard for foreign companies to find the right business contacts in Russia. Many foreign advisors stress the importance of investing time in building up relationships with local partners: Russians do business with people, not with companies.⁴² According to the analysis, only 15% of respondents believe that it is easy to find reliable business partners in Russia; the figure is almost unchanged between 2012 and 2014. The amount of respondents that found very difficult to find a reliable partner in Russia rose from 3% in 2012 to 21% in 2014. The data indicates, therefore, that more efforts and promotion actions are required to assist foreign companies in establishing business contacts with local firms in Russia.

The analysis suggests that Russia offers a high potential return in combination with a high growth rate. Good profitability was reported by 72% of respondents in 2014, down from 82% in 2012. Good growth potential in 2014 was reported by 82% of respondents, compared to 95% in 2012. Although appreciation of return and growth potential by Swedish investors is high, the trend seems to be negative for both indicators. An interesting observation is that 10% of managers in 2014 expressed uncertainty about profitability of Russian business, compared to none in 2012.

The survey demonstrated that in 2014, 55% of goods or services produced by Swedish companies in Russia are sold on the local domestic market against only 8% on the international market. The analysis supports the view that that Russia's large, expanding consumer market continues to be one of its most attractive features for foreign companies. A large population, ris-

ing disposable income and a burgeoning middle class are drawing the attention of foreign investors.

A question about Swedish companies' expansion plans in Russia for the next three years deserves special attention. Surprisingly, in 2014, as many as 65% of managers did have expansion plans in Russia. Business executives remain upbeat about Russia's growth prospects in the medium term. Although in 2012 this figure was 82%, the current level of expansion plans in Russia seems to be at a high level in view of the recent deterioration in the relationship with the US and EU. We do not seem to have a good explanation regarding how the conflict escalation impacts particular firms operating in Russia. Foreign investors that are already established in the Russian economy might be more optimistic about the country's future than those who do not have practical experience and knowledge and form their judgments based, for example, upon mass media articles.

In summary, the consensus view on strategic issues related to Swedish companies' business establishment in Russia remains rather positive. Foreign investors appreciate the good profitability and growth possibilities, including the sizable domestic consumer market. Several potential pitfalls include the difficulty of finding reliable business partners as well as some signs of slow-down in potential growth possibilities. More analysis is, however, needed in order to understand the potential impact of an escalation of conflict between Russia and the US/EU, in particular on foreign investors and their plans for Russia.

Selected variables regarding business climate

The empirical data for the paired samples T-test for selected variables regarding the business climate is summarized in Table 1.

From statistical tables for T-distributions, we can determine

Table 1: Summary of the empirical data for paired samples T-test for selected variables regarding business climate in Russia

		Paired Differences					T-values	Df ⁴³	Sig. (one-tailed)
		Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
1	Political risk 2012–2014	-.97561	.64742	.07150	-1.11786	-.83336	-13.646	81	.000
2	Currency risk 2012–2014	-.84146	.36749	.04058	-.92221	-.76072	-20.735	81	.000
3	Counterparty risk 2012–2014	-.10976	.38510	.04253	-.19437	-.02514	-2.581	81	.006
4	Inflation risk 2012–2014	-.69512	.46319	.05115	-.79690	-.59335	-13.590	81	.000
5	Company registration 2012–2014	.09756	.51183	.05652	-.01490	.21002	1.726	81	.044
6	Getting information 2012–2014	-.26829	.44580	.04923	-.36625	-.17034	-5.450	81	.000
7	Availability of statistics 2012–2014	-.32927	.64893	.07166	-.47185	-.18668	-4.595	81	.000
8	Russian law 2012–2014	.40244	.49341	.05449	.29403	.51085	7.386	81	.000
9	Corporate taxation 2012–2014	.02439	.60809	.06715	-.10922	.15800	.363	81	.358
10	Customs procedures 2012–2014	-.31707	.58538	.06464	-.44569	-.18845	-4.905	81	.000
11	VAT refunds 2012–2014	.04878	.38176	.04216	-.03510	.13266	1.157	81	.125
12	Payment discipline 2012–2014	-.09756	.43347	.04787	-.19280	-.00232	-2.038	81	.022
13	Banking short-term 2012–2014	.26829	.44580	.04923	.17034	.36625	5.450	81	.000
14	Banking long term 2012–2014	.06098	.50547	.05582	-.05009	.17204	1.092	81	.139
15	Postal infrastructure 2012–2014	-.41463	.62758	.06930	-.55253	-.27674	-5.983	81	.000
16	IT infrastructure 2012–2014	-.37805	.71389	.07884	-.53491	-.22119	-4.795	81	.000
17	Managers availability 2012–2014	-.04878	.49447	.05461	-.15743	.05987	-.893	81	.187
18	Employees fraud risk 2012–2014	.08537	.45000	.04969	-.01351	.18424	1.718	81	.045
19	English proficiency 2012–2014	.50000	.61363	.06776	.36517	.63483	7.379	81	.000
20	Corruption 2012–2014	-.76829	.47917	.05291	-.87358	-.66301	-14.519	81	.000

the critical value, which should be used for comparison with a computed T-value.⁴⁴

The null hypothesis states that there is no worsening of the mean for selected variables of the business climate in 2014 compared to 2012. Based upon calculated T-values, the for the following 11 variables of the business climate can be rejected: *political risk*, *currency risk*, *counterparty risk*, *inflation risk*, *getting information*, *availability of statistics*, *customs procedures*, *payment discipline*, *postal infrastructure*, *IT infrastructure*, and *corruption*. For these variables, we have statistical evidence that situation deteriorated in 2014 compared to 2012.

How confident are we in rejecting the null hypothesis? P-value is the probability (assuming that the null hypothesis is true) of getting a value of the test statistic at least as extreme as the value actually obtained. If the p-value is smaller than the significance level (in our case 0.05), H_0 is rejected. P-values for a one-tailed T-test are presented in the last column of the Table 1.

We rejected H_0 hypothesis for 11 variables of the business climate. For all these variables, the p-value is far beyond 0.05, which gives us additional support to the strength of the decision to reject the null hypothesis.

Furthermore, very low p-values have been observed for 3 other variables: *Russian law*, *short-term banking*, and *English proficiency*. A p-value is a way to express the likelihood that H_0 is false. While the p-value for these 3 variables is as low as 0.000..., the conclusion about the rejection of the null hypothesis is statistically supported.

The statistical test, therefore, supports the alternative hypothesis regarding a deterioration trend in 14 (of 20) variables of business climate in 2014 compared to 2012.

In economic literature, the term 'political risk' usually applies to a country as whole, being associated with nationalization or expropriation, possible changes in regulation, trade agreements and general instability. The same approach is also valid for currency and inflation risks. However, there have been few attempts to analyze these risks as company-specific factors.⁴⁵ In our study, managers emphasized the importance of political, currency, inflation and counterparty risks for their business in Russia.

Our analysis suggests that political risk in Russia increased between 2012 and 2014 from the point of view of foreign investors. Currency, inflation and counterparty risks have also increased between these two years, which is in line with the deterioration

in the current economic and political situation in Russia.

In 2014, a new question was posed inquiring about managers' views regarding the impact of the recent escalation of conflict between Russia and the US / EU. The response is rather mixed and hard to interpret. About 39% of respondents claimed that they were seriously affected by such relationship crises, while 42% found very little impact from the conflict on their business activities in Russia.

While it is hard to generalize from one survey, there is an obvious need to deepen our understanding of how major political and economic risks as well as escalation of international conflicts impact particular companies. It seems rather confusing that more than 40% of managers indicate very little impact from a conflict escalation between Russia and the West on their business in Russia.

Several researchers stressed the importance of acquiring the basic knowledge about the factors that govern the Russian market. Such factors involve economic, political, cultural, and ethical barriers that companies need to manage when working with Russia.⁴⁶

Our analysis indicates that it is rather hard to obtain information from Russian authorities and difficult to find applicable Russian statistics. The situation worsened between 2012 and 2014. One suggestion could be a proposal to improve the distribution of information and relevant statistics from the Russian authorities to foreign investors. Many potential investments might fail at an early stage of the project cycle if the Russian government were unable to provide the necessary information support to foreign companies.

The data suggests that customer procedures do not work satisfactorily, and the trend is negative between 2012 and 2014. The Russian Federation has been a member of World Trade Organization (WTO) since August 22, 2012. There have been several achievements in Russia's incorporation into WTO; the mission is, however, far from being completed. The high level of tension remains with the on-going current disputes between Russia on one hand and the EU on the other.⁴⁷ In addition, Russia's customs organization is often accused of being corrupt and bureaucratic.

According to statistical analysis, payment discipline and short-term banking deteriorated between 2012 and 2014. Having been shut out of international financing due to sanctions imposed by the West, Russia's banks started to experience certain troubles with funding. A worsening of payment discipline could also be the result of the general slowdown of the Russian economy.

Different infrastructure variables, including government authorities, transportation, IT infrastructure, registration and start-up of the company, etc., are important for the presentation of the business climate. According to the analysis, investors expressed concerns about the availability of infrastructure. Respondents acknowledged that meaningful improvements on

many positions are not yet happening. *P*-values for postal services infrastructure and IT infrastructure indicated that there is a negative trend between 2012 and 2014. It is of vital importance to stop the negative trend and further develop infrastructure in Russia.

According to Transparency International, Russia occupies 127th place out of 177 countries, approximately the level of Togo and Uganda.⁴⁸ Our study suggests that corruption is still a problem in Russia that limits business climate potential. Empirical data also indicates that there has been an increase in corruption in Russia between 2012 and 2014. When deciding to establish their business in Russia, 45% of managers calculated with the risk of facing corruption in 2014, while 53% of managers estimated that the risk of becoming exposed to corruption in Russia is high.

About 82% of respondents confirmed that Swedish companies have developed a code of conduct or similar policy documents dealing with the topic of corruption in Russia. Establishment of a code of conduct by foreign companies operating in Russia plays an important role in shaping the future

of the business climate in the country. However, in 2014, only 6% of managers acknowledged that their companies were considering leaving Russia due to corruption while 64% were not evaluating such an option. A very tentative conclusion might be that although corruption plays a negative role in the business climate in Russia, the impact of corruption is not enough serious to fully discourage foreign investors from staying in Russia. Due to the fact that managers confirmed widespread corruption, the only explanation might be that the profit received by business is enough to accommodate the necessary payments, if required.

RUSSIA IS KNOWN to have conflicting, overlapping, and frequently changing laws, decrees and regulations, which complicate the business climate. Poor rule of law is often seen as one of the risks of doing business in Russia for foreign firms, as it was shown by the experience of the UK-based Hermitage Capital Management and Telenor of Norway.⁴⁹ A special term, *reiderstvo*, was introduced in the literature to describe the acquisition of business assets in Russia through manipulation and distortion of the law, albeit often with active involvement of law-enforcement officers and courts.

The study indicates a rather negative assessment of Russian law by foreign investors, and the situation deteriorated between 2012 and 2014. The government is trying to create a more balanced and business-oriented set of rules, which could regulate business relationships more flexibly and effectively protect their participants' rights and interests.⁵⁰ In line with achievements to improve Russian legislation, some managers acknowledged a few positive developments. These positive changes, however, have not yet resulted in changing the negative trend. It also ex-

“RUSSIA IS KNOWN TO HAVE CONFLICTING, OVERLAPPING, AND FREQUENTLY CHANGING LAWS, DECREES AND REGULATIONS, WHICH COMPLICATE THE BUSINESS CLIMATE.”

plains why Russian businesses continue to structure themselves under offshore holding companies in order not to fall under Russian law.

In 2014, a new question was introduced into the survey regarding arbitration court proceedings in Russia. Surprisingly, 53% of managers had no knowledge regarding arbitration courts while the remaining answers were almost equally split between different alternatives. The efficiency and reliability of Russian courts, especially arbitration courts, have been studied by several researchers. Timothy Frye demonstrated that in 2000, 76% of managers from the survey believed that the courts could protect their legal interests in a dispute with another firm, while this figure increased to 89% in 2008.⁵¹ In both surveys, however, managers were significantly less confident in their ability to use the courts against regional governments in Russia. Gans-Morse suggested that during the 2000s new threats emerged in Russia in the form of attacks on business by lower and higher-level state officials such as regulators and law enforcement agents themselves.⁵²

UNFORTUNATELY, IN THE empirical survey BCS, no distinction was made between protection by the courts against private firms and against the Russian government bodies. It can be strongly recommended, however, that future surveys should include this distinction. The issue of strengthening of property rights in Russia might have less to do with the capacity of the state to decide disputes between private firms in the arbitrage court than with the necessity of legal constraints on the power of corrupt state officials. Lucy Chernykh, for example, demonstrates that lack of trust between the authorities and private business is an important feature of the business environment in Russia.⁵³

It is not clear why such a large proportion of managers are not aware of the situation regarding arbitration in Russia. One possible explanation might be that they did not need to turn to the courts for commercial disputes. Another explanation is that there is a common practice of holding potential arbitration proceedings outside the Russian jurisdiction. Therefore, foreign managers do not possess information on the subject.

Managers also stressed that there are still few English speakers in Russia. According to Education First English Proficiency Index 2012, Russia displays a low proficiency for the English language: it ranks 36th (and the lowest) in Europe⁵⁴. In our analysis, English proficiency by Russian people deteriorated between 2012 and 2014. There is no good explanation of the reasons behind this deterioration. In any case, an increased availability of English proficiency is needed to match requirements of foreign investors.

According to *Table 1*, several variables have relatively high p -values. If the p -value is large, then it is likely that H_0 is true. Therefore, there is an indication that H_0 might be true for the following 4 variables of the business climate: *corporate taxation*, *VAT refunds*, *manager's availability*, and *long-term banking*.

There is some statistical evidence that these 4 variables of the business climate have improved in 2014 compared to 2012.

The analysis indicates that there is progress regarding developments in taxation issues in Russia from the point of view of foreign companies. Managers also provide rather a favorable assessment of the development of the VAT refund process.⁵⁵

According to the analysis, the availability of qualified staff in Russia has improved between 2012 and 2014. Availability of managers affects the economy, and lack of human capital can adversely affect the business climate. Respondents pointed that in

the Moscow region, for example, there is still competition for highly qualified personnel. Besides, although Russia's education system is well respected, it still needs to cover more material relevant to businesses. As a result, Western companies need to spend a considerable amount of time on attracting, training and retaining Russian talent. The trend for the availability

“AN INCREASED AVAILABILITY OF ENGLISH PROFICIENCY IS NEEDED TO MATCH REQUIREMENTS OF FOREIGN INVESTORS.”

of qualified managers, however, seems to be positive between 2012 and 2014. It seems that it has become easier to find qualified managers, which could perhaps be explained by the economic slowdown in Russia.

Surprisingly, the analysis suggests that long-term banking has improved between 2012 and 2014. This is in contradiction with previously received indication on the worsening of payment discipline and short-term banking. On the other hand, several managers explained that they observed certain improvements on how the banking system in Russia works in general and reflected these positive changes in their assessment of long-term banking. Current turbulences, on the other hand, were reflected under the assessment of short-term banking. Besides, many Swedish companies get long-term financing from their headquarters in Sweden, while they use short-term banking products locally. Therefore, possible disturbances of the Russian banking system might be more obvious in short-term banking.

A new question was introduced into the 2014 questionnaire regarding the impact on Swedish companies of the withdrawal of Nordic banks from Russia. Surprisingly, 70% of respondents were not affected by such a withdrawal and only 16% experienced some troubles. This can be explained by the fact that Russian banks and other foreign banks quickly took over the market share of Nordic banks. Possibly the quality of banking services offered by Russian banks to the foreign companies was high enough to off-set the withdrawal of Nordic banks from Russia.

For two variables of the business climate (*company registration* and *employees' fraud risk*), the p -value is slightly lower than the significance level of 0.05. Statistically, we can reject the null hypothesis, although with a small margin. These two variables, therefore, probably deteriorated between 2012 and 2014, i.e. it became harder to register a company and the level of employees' fraud increased.

It is interesting to note that several Swedish managers expressed concerns regarding the high risk of fraud from their own

employees. There is a severe problem with human resources as almost half of western managers do not trust their employees in Russia. Serious discussion is needed including topics of education as well as ethical norms of business behavior.

Conclusions

One of the central assertions of the 2005 World Development Report on the business climate is that a good business climate drives growth by encouraging investment and higher productivity. Despite the established importance of a positive local business climate, we have shown in the article that current knowledge regarding elements that constitute business climate remains broad, elusive and hard to define. The reader should not draw the conclusion that business climate as a strategy or concept is worthless and does not deserve our attention. On contrary, we believe that business climate plays an important role in economic development.

For this reason, it is important to study this concept, including uncertainties about the very scope of the term business climate. Instead of a one-dimensional concept, we might need to pay more attention to different aspects of business climate. This approach highlights not only the complex nature of how the business climate affects firms, but also emphasizes that a region can excel in some areas while lagging in others. It is necessary to further explore the definition of business climate to include: the role of government, demographic configuration, political culture, natural resources, settlement and immigration patterns, geographic location and population distribution among city, suburb, small town and rural environments. Characteristics such as history, geography, community values and attitudes can be also considered for the future research agenda.

Our study suggests that the following variables of business climate deteriorated between 2012 and 2014: Political risk, currency risk, counterparty risk, inflation risk, getting information, availability of statistics, customs procedures, payment discipline, postal infrastructure, IT infrastructure, corruption, Russian law, short-term banking, and English proficiency. Our observation is in line with the worsening current political and economic situation in Russia. When someone does business in Russia, they need to have a long-term commitment. This would be impossible if the investors' picture on different risks continues to deteriorate. In order to break the trend and make Russia more attractive for foreign investors, the Russian government needs to build a business climate based on transparent and predictable rules, reducing risks and uncertainty.

While corporate taxation, VAT refunds, manager's availability, and long-term banking continue to evolve and foreign investors still face various challenges in navigating the system, our analysis indicated that they have enjoyed positive developments between 2012 and 2014.

To improve its business climate, Russia needs to change the way that foreign investors, particularly potential ones, see the country. This concept – viewing business climate as an asset – could be relevant for Russian politicians and government officials. Russia needs to send a welcoming message to encourage new investors to enter the market and current investors to stay.

This is, however, impossible without radical reforms aiming to enhance the quality of the “business climate” itself. An intangible asset “business climate,” being booked on Russia's balance sheet, should provide the high quality features insuring long-term prospects for investors.

The findings provide support to several mainstream theoretical arguments regarding the business climate but also demonstrate some contradictions that require further investigation. These include the reaction of the Swedish business to the escalation of political tensions between Russia and the West and the corruption factor, which is not viewed as sufficiently serious to fully discourage foreign investors from staying in Russia.

The article does not identify any strong reasons for preferring one school of thought for analysis of business climate at the expense of another. This paper applied a micro-level analysis, and some results on company-based business climate work are encouraging. Company-level enterprise has proved a rich resource for research to explain firms' performance as a function of different aspects of the business climate.

For future research, a more disaggregated approach (company or industry level) is suggested as the relative importance of each component is likely to differ from business to business. The international research community is also well placed to develop more standardized measures of the business climate in order to make cross-country comparisons. When more survey analyses become available, proper data macro-economic regressions could test for the impact of changes in the business climate on productivity, investment returns, and growth. ✖

Olga Golubeva, PhD, senior lecturer, School of Social Sciences, Department of Business Administration, Södertörn University.

references

- 1 Angel Gurría, *Modernizing Russia in a Challenging Global Environment*, speech by OECD Secretary-General delivered at the Gaidar forum, Moscow, January 18, 2013. Accessed January 11, 2015, <http://www.oecd.org/russia/modernizingrussiainachallenginglobalenvironment.htm>.
- 2 “Putin pledges to improve business climate in Russia”, Russian News Agency TASS, (October 2, 2014). Accessed January 11, 2015, <http://itar-tass.com/en/economy/752423>.
- 3 *Smarter Regulations for Small and Medium-Size Enterprises. Comparing Business Regulations for Domestic Firms in 185 Economies* (Washington DC: International Bank for Reconstruction and Development, 2013).
- 4 *Economic relations between Sweden and Russia*, (Moscow: Embassy of Sweden in Moscow, 2015). Accessed January 11, 2015, <http://www.swedenabroad.com/en-GB/Embassies/Moscow/Business/Economic-relations-between-Sweden-and-Russia/>.
- 5 *Russian Federation: Inward Foreign Direct Investment Positions by Instruments and Geographical Allocation in 2009–2013*, Central Bank of Russia, 2015. Accessed January 11, 2015, http://www.cbr.ru/eng/statistics/print.aspx?file=credit_statistics/dir-inv_in-country_e.htm&pid=svs&sid=ITM_14544.
- 6 See “Statistics Sweden” for more information about Swedish foreign trade. Accessed January 11, 2015, <http://www.scb.se/en/Finding-statistics/Statistics-by-subject-area/Trade-in-goods-and-services/Foreign-trade/Foreign-trade---exports-and-imports-of-goods/Aktuell-Pong/7230/142265/>.
- 7 KPMG Advisory, “Investing in Russia. An Overview of the Current Investment Climate” in *Shaping Russia's future*, Ernst & Young's attractiveness survey of Russia, 2013.
- 8 Business Sweden, the Swedish Trade & Invest Council, was founded on January 1, 2013, to facilitate the growth of Swedish companies abroad and investment opportunities in Sweden.

- 9 The survey *Business Climate Survey – Russia 2014* is a public document prepared by Business Sweden, info@business-sweden.se
- 10 *Russia And The West: Not A New Cold War, But A Cooler Period*, Business Monitor International (BMI), A Fitch Group Company, November 11, 2014. Accessed January 11, 2015, <http://www.businessmonitor.com/news-and-views/russia-and-the-west-not-a-new-cold-war-but-a-cooler-period#sthash.V7JMieVj.dpuf>.
- 11 Paired T-test is calculated according to the formula: $T = (\bar{d}) / (s_d/\sqrt{n})$, where \bar{d} is the difference between observations in 2012 and 2014; s_d – the standard deviation of the differences; and n is the number of observations. Data collection strategy supports the assumption that the empirical samples are not totally independent, but are related to each other. Therefore, T-test for paired samples is applied.
- 12 The sample mean is calculated using the formula $\bar{X} = (\sum X)/n$ where X – represents particular values chosen by managers, ranging from 1 to 5, and n is the number of values in the sample.
- 13 The level of significance of 5% means that we have a 5% probability of rejecting the null hypothesis when it is true.
- 14 Rohini Pandle and Christopher Udry, *Institutions and Development: A View from Below*, Yale University Economic Growth Center, Discussion Paper No. 928 (2005).
- 15 Andrei Yakovlev, "The Evolution of Business: State Interaction in Russia: From State Capture to Business Capture?", *Europe-Asia Studies*, Vol. 58:7, (2006), 1033–1056.
- 16 Sheila M Puffer and Daniel J McCarthy, "Two Decades of Russian Business and Management Research: An Institutional Theory Perspective," *The Academy of Management Perspectives Journal*, Vol. 25:2, (2011), 21–36.
- 17 See Jean-Jacques Dethier, Maximilian Hirn and Stephene Straub, "Explaining Enterprise Performance in Developing Countries with Business Climate Survey Data", *The World Bank Research Observer*, Vol. 26:2 (2011), 258–309; Stephene Straub, "Infrastructure and Growth in Developing Countries: Recent Advances and Research Challenges", *Policy Research Working Paper 4460* (Washington DC: The World Bank, 2008).
- 18 Stephene Straub, Charles Vellutini and Jonathan Warlters, "Infrastructure and Economic Growth in East Asia" *Policy Research Working Paper 4589* (Washington DC: The World Bank, 2008)
- 19 Simon Comander and Jan Svejnar, Do Institutions, "Ownership, Exporting and Competition Explain Firm Performance? Evidence from 26 Transition Countries", *IZA Discussion Paper No. 2637* (Bonn: Institute for the Study of Labor, 2007).
- 20 Abhijit Banerjee and Esther Duflo, "Growth Theory through the Lens of Development Economics", in *Handbook of Economic Growth*, ed. A. Philippe and S. Durlauf (Amsterdam, Elsevier: 2005), 473–552.
- 21 Warrick Smith and Mary Hallward-Driemeier, "Understanding the Investment Climate", in *Finance & Development*, (March, 2005), 40–43
- 22 Jean-Jacques Dethier, Maximilian Hirn and Stephene Straub, "Explaining Enterprise Performance in Developing Countries with Business Climate Survey Data", *The World Bank Research Observer*, Vol. 26: 2 (2011), 258–309.
- 23 A Better Investment Climate for Everyone, *World Development Report* (Washington DC: The World Bank, 2005)
- 24 See <http://data.worldbank.org/data-catalog/BEEPS>. Accessed February, 8, 2015.
- 25 Reyes Aterido, Mary Hallward-Driemeier and Carmen Pagés, "Investment Climate and Employment Growth: The Impact of Access to Finance, Corruption and Regulations Across Firms", *IZA Discussion Paper No. 3138* (Washington DC: The World Bank, 2007).
- 26 Wendy Carlin, Mark Schaffer and Paul Seabright, "Where are the Real Bottlenecks? A Lagrangian Approach to Identifying Constraints on Growth from Subjective Survey Data", *Discussion Paper 2006/04* (Edinburgh: Centre for Economic Reform and Transformation, 2006).
- 27 Alan Gelb, Vijaya Ramachandran, Manju Kedia-Shah and Ginger Turner, "What Matters To African Firms? The Relevance of Perceptions Data", *Policy Research Working Paper 4446* (Washington DC: The World Bank, 2007).
- 28 On the issue, see, for example, Mary Hallward-Driemeier, Scott Wallsten and Lixin Colin Xu, "Ownership, Investment Climate and Firm Performance", *Economics of Transition*, Vol. 14: 4, (2006), 629–647.
- 29 Curmudgeon, "Business Climate and the Second War Between the States", *Journal of Applied Research in Economic Development*, Vol. 10, (2013). Accessed January 11, 2015, <http://journal.c2er.org/2013/02/business-climate-revisited/>.
- 30 George Bittlingmayer, A.P. Hall, Peter Orazem and Liesl Eathington, *Business Climate Indexes: Which Work, Which Don't, and What Can They Say About the Kansas Economy* (Kansas Inc. Publications, 2005).
- 31 Timothy Frye, "Corruption and Rule of Law", in *Russia after the Global Economic Crisis*, ed. Anders Åslund, Sergei Guriev and Andrew C. Kuchins (Washington DC: Petersen Institute for International Economics, 2010), 79–94.
- 32 Michael Rochlitz, "Corporate Raiding and the Role of the State in Russia", in *Post-Soviet Affairs*, Vol. 30 2–3 (2014), 89–114.
- 33 "Local Business Climate", *The NFFIB National Small Business Poll, NFFIB Research Foundation*, Vol. 6, Issue 2, (2006); Jean-Jacques Dethier, Maximilian Hirn and Stephene Straub, "Explaining Enterprise Performance in Developing Countries with Business Climate Survey Data," *The World Bank Research Observer*, Vol. 26: 2, (2011), 258–309
- 34 K Mark Weaver, Eric W Liguori and George S Vozikis, "Entrepreneur Business Climate Perceptions: Developing a Measure and Testing a Model", In *Journal of Applied Business and Economics*, Vol. 12 (2011), 95–104.
- 35 Liels Eathington, Aaron L Todd and Dave Swenson, "Weathering the Storm of Business Climate Rankings", Department of Economics, (paper presented at the 44th Annual Meeting of the Southern Regional Science Association, Arlington, Virginia, April 7–9, 2005), 5.
- 36 Bittlingmayer et al..
- 37 D. Dollar, M. Hallward-Driemeier and T. Mengistae "Investment Climate and Firm Performance in Developing Economies", *Economic Development and Cultural Change*, Vol. 54:1, (2006), 1–31.
- 38 T. Kinda "Investment Climate and FDI in Developing Countries: Firm-level Evidence", *World Development*, Vol. 38:4, (2010), 498–513.
- 39 K.A. Mottaleb and K. Kalirajan "Determinants of Foreign Direct Investment in Developing Countries: A Comparative Analysis," *The Journal of Applied Economic Research*, Vol. 4:4, (2010), 369–404.
- 40 G. Goswami and Samai Haider "Does Political Risk Deter FDI Inflow? An Analytical Approach Using Panel Data and Factor Analysis", *Journal of Economic Studies*, Vol. 41:2, (2014), 233–252.
- 41 B.A. Blonigen and J. Piger "Determinants of Foreign Direct Investments", National Bureau of Economic Research, *Working Paper 16704*, (2011).
- 42 KPMG Advisory, 2013.
- 43 df – number of degrees of freedom.
- 44 A one-tailed T-test with a degree of freedom $df=81$ and the significance level of 0.05 ($\alpha = 0.05$) has a critical value of 1.664. The decision rule is to reject the null hypothesis if the computed value of the T-test is lower than -1.664.
- 45 Alexei Gorjaev and Konstantin Sonin, "Is Political Risk Company-Specific? The Market Side of the Yukos Affair", *Working Paper, No. 772*, (University of Michigan: William Davidson Institute, 2005).
- 46 On the issue, see, for example, Peter Hultén, "Swedish SMEs' Establishment of Business in Russia: A Case Study", *Journal of East-West Business*, No. 15:1, (2014): 5–24; and Jordan Gans-Morse, "Threats to Property Rights in Russia: From Private Coercion to State Aggression", *Post-Soviet Affairs*, Vol. 28:3, (2012), 263–295.
- 47 See the WTO's web-side for the review of Russia's disputes within the WTO. Accessed June, 4, 2015 https://www.wto.org/english/thewto_e/countries_e/russia_e.htm.
- 48 Transparency International, "The 2013 Corruption Perception Index." Accessed January 11, 2015; <http://www.transparency.org/country#RUS>.
- 49 Philip Hanson, "Reiderstvo: Asset-Grabbing in Russia", *Russia and Eurasia PP*, No 3 (2014): 12.
- 50 For example, the presumption of acting in good faith has been replaced by an obligation to do so – in line with many European jurisdictions. There have been steps to recognize escrow accounts, and legislation regarding a host of financial and contractual activity was modernized.
- 51 Timothy Frye, "Corruption and Rule of Law", in *Russia after the Global Economic Crisis*, ed. Anders Åslund, Sergei Guriev and Andrew C. Kuchins (Washington DC: Petersen Institute for International Economics, 2010):86.
- 52 Jordan Gans-Morse, "Threats to Property Rights in Russia: From Private Coercion to State Aggression", *Post-Soviet Affairs*, Vol. 28:3, (2012), 263–295.
- 53 Lucy Chernykh, "Ultimate ownership and control in Russia", *Journal of Financial Economics*, No. 88, (2008), 169–192.
- 54 Education First, "EF English Proficiency Index 2014". Accessed January 11, 2015, http://media.ef.com/_/-/media/centralecom/epi/v4/downloads/full-reports/ef-epi-2014-english.pdf
- 55 Value-added tax (VAT), designed to be borne ultimately by consumers, is a key source of tax revenues for Russia. Exports are taxable at 0% rate, and therefore refundable.