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THE IMPACT OF INSTITUTIONAL COLLAPSE ON THE FORMATION OF CULTURAL VALUES OF RUSSIAN MANAGERS AND ENTREPRENEURS

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Abstract

Modern Russia has been going through one of those rare historical stages in which both the cultural and economic foundations of the nation endure radical changes simultaneously. This puts particular pressure on the formation of the national pattern of entrepreneurial and business behaviour. Three major influences affecting entrepreneurial culture are identified in this contribution and their effects are evaluated. It is argued that the diffusion of new cultural patterns in business relations is going to be slow and idiosyncrasies will persist. As a result, a noticeable variance between national and international entrepreneurial culture is to remain a challenge to foreign firms doing business in Russia and a deterrent to the process of Russian marketisation in general.

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Market system presumes that there are private property and liberalization, but also organizations and the rules as well as proper understanding of these rules and market culture.

Grzegorz Kolodko

Research on cross-cultural competence has revealed the significance of national cultural values as factors affecting business organisation and management (Trompenaars 1993). Hence the importance of understanding the pattern of such values and trends in their development for the practice and theory of international management. Yet the question “what are the specific aspects of culture to which differences in entrepreneurship or management can be attributed?” has been identified in the literature as yet waiting for a sufficient theoretical treatment (Lachman *et al* 1995). This study seeks to tackle this question with a particular focus on Russia. The country has gained a reputation of being a difficult place for foreign firms to do business. This is often attributed to differences in business cultures and managerial attitudes which is based on the “ancestral suspicion [by Russians] of the West” (Holden 1999). We propose to analyse the business responses of Russian entrepreneurs and managers within the theoretical framework of the hypothesis that observed idiosyncrasies are the consequence, to a certain degree, of the internal strife between new and pre-transitional cultural values in the Russian society. Following this approach we look at major cultural influences to which Russian entrepreneurs and managers are subjected. Particular attention is paid to the economic environment and institution building. In Russia there is a clear discrepancy between the degree of the marketisation of the economy and the introduction of institutions supporting the market (Stiglitz 1999). Without institutional constraints self-interested behaviour produces responses which may contradict business norms accepted in mature market economies. This not only makes Russian entrepreneurs and managers difficult business partners but also undermines the image of capitalism as a fair and moral society.

The Interaction of Culture and Economy and the Challenge of Systemic Change

The Weberian analysis of capitalism demonstrated that the national economic character counts. This character is, on the one hand, the product of national history, culture, ideology, beliefs, tradition of government and other nation-specific factors. On the other hand, it reflects developments in the economic environment. National culture is instrumental in arranging professional values and attitudes and determines the forms in which some universal principles get incorporated into business practices and thus become generally acceptable, for the duration of a particular historical period, at a national level.

Societal culture puts constraints on the economy. They are informal but nonetheless, as noted by North (1990), very pervasive. As an inherent social institution, cultural values influence some “written rules” that enable and guide common interactions within societies. Culture also affects the progression in economic life. According to Arrow (1974), it asserts an additional set of variables expressing social demand through “internalised demand of conscience”, which has real, practical economic significance and increases the efficiency of the economic system. Changes in the economic foundations of the society cause changes in cultural norms and values. This in turn stipulates alterations in the “demands of conscience” in respect to the economic system. Clearly, contradictions between culture and the economic environment are inevitable. We may expect economic parameters to be capable of faster and more radical change than those attributed to culture. The latter as an aggregation of accepted social rules endorsed by tradition, long standing norms and role models secures the continuity of features constituting a national character and other nation specific features.

Post-communist transition has revealed itself as one of those rare historical events in which both the cultural and economic aspects of the life of a nation go through a period of a radical change *simultaneously*. As a result culture cannot play fully its role of an institutional safety net helping to structure economic relations according to the premise of the “demands of conscience” in periods of transition. The process of economic and social changes has taken a particularly dramatic form in countries that were formerly parts of the Soviet Union because there the central planning model had developed to its fullest extent, putting these countries, in

terms of social and economic experience, at odds with other countries at the similar level of development.

Such a situation is bound to put particular stress on the formation of the national pattern of entrepreneurial and managerial behaviour which counts reliance upon past experience and stereotyping among its important elements. This behaviour is built around a search for information about situations and options for the purpose of taking business decisions. Information is then processed and evaluated in the course of what is essentially selective filtering of input against certain criteria. If some of them become vague the efficiency of decision-making may suffer. Conventions associated with national cultural values occupy a prominent position among these criteria as they are related to both institutional and consciencial aspects of business. In their established form such conventions constitute a national business culture. They make it easier to decision-makers to choose routinely those responses to signals coming from the economic environment and the society that have a proven record of being adequate and successful.

In modern Russia the task of developing adequate attitudes in terms of business culture represents a formidable challenge. A radical transformation of the economic set-up urges economic agents to produce responses that are entirely new to them. Importantly, these responses have to be based on the set of values and the type of rationality which are different in comparison to those that was significant before and, due to social inertia, still constitute a notable part of the national cultural tradition. At the same time information coming from the economic environment is likely to be distorted, confusing and incomplete because transitional institutions are not sufficiently befitted for market signals to emerge or to be received and responded to effectively (Kuznetsov 1994). Entrepreneurs and managers have to operate in the situation of abnormally high uncertainty as formal market institutions are not yet fully operational and informal social institutions, including business culture, are in the state of flux. Equally, cultural values as an important element of culture to impact business are in the process of redefining. Therefore it is hardly possible to talk about a “system of cultural values” in Russia as something consistent and comprehensive. The coexistence of conflicting values adds uncertainty to information flows and decision making.

Under these circumstances the ability of entrepreneurs and managers to take decisions and develop long-term strategies is hampered. Academic literature suggests that economic agents should react by attempting to obtain greater knowledge or redefine their decision problem so that uncertainty is no longer critical (Cohen and Cyert 1965). Because decision-making in business has a cultural dimension (Nath 1988; Vertinski *et al* 1990), the accumulation of knowledge and problem setting will be affected by major cultural influences to which entrepreneurs and managers are exposed. In modern Russia three such influences may be identified:

- the national cultural tradition as carried over from the previous historical period;
- new cultural trends induced by changes in domestic business and economic environment;
- the example of business practices in countries with mature market economies.

To trace the three influences in the behaviour of economic agents is a considerable challenge. Yet this is a very important issue which may throw light on the future of Russian business culture as well as help to explain some unorthodox patterns of behaviour existing in transitional Russia. Furthermore, the emerging business culture is one of the constituting elements of the national culture and national character as a whole. This leads to an intriguing question of the wider cultural impact of the formation of the class of entrepreneurs and capitalists in the country.

Misrepresentation of Capitalist Values

The principles of free entrepreneurship contradict everything that the Soviet system stood for. Yet we cannot expect that modern Russian entrepreneurs would be able to liberate themselves entirely from any social experience gained under socialism. This is not only impossible but also impractical as long as common social experience provides the framework for a meaningful exchange of information without which no business activities are feasible. As pointed out by Hampden-Turner and Trompenaars (1996), cultures are neither wrong nor right. Hereditary cultural holdings provide orientations to issues “because there would be chaos unless they did so” (p.276). Accordingly, in modern Russia, there is a pronounced

tendency for informal rules, which previously existed as a continuation of now extinct formal rules, to remain in service as temporary substitutes for more formal arrangements. This is very much in line with the institutional theory that predicts that in the absence of a developed institutional infrastructure informal constraints including those rooted in a common cultural background become crucial in resolving basic exchange problems among economic agents (North 1990).

In the context of a transitional economy this solution brings about particular complications following a contradiction between the origins of informal constraints applied (a centrally planned economy) and the circumstances in which they are put to use (a proto-market economy). This implies a fair possibility of a conflict between informal rules in use and formal rules introduced in the course of reforms to facilitate transition to the market. Economic agents are likely to be forced to comply with informal constraints until a functional institutional framework is in place but by doing so they make the installation of such a framework more difficult and prolonged. Another aspect of this problem is that reliance on a transient set of rules brings to life a specific type of short-term oriented rationality which precludes businesses in Russia from strategic commitments which has a negative effect on economic growth in the country.

Understandably, the selection of norms of behaviour and experiences carried over from the past by managers and entrepreneurs in modern Russia reflects the realities of the present set-up. What makes this choice to bear important social and cultural consequences is that almost everything that was praised under the old system appears to be irrelevant or even counterproductive under current circumstances while behavioural patterns that were anathematised or seen as improper acquire importance. The shift in perspective puts the first generation of Russian entrepreneurs, in terms of culture, in a rather uneasy position of being at odds with historically endorsed cultural values. They are forced to challenge and contradict some of the values, which for millions of Russians are still synonymous to a socially responsible model of behaviour, for the sake of practices that were stigmatised during the lifetime of several generations. The paradox here is that new entrepreneurs act objectively as propagators of new cultural norms and values which, however, in the minds of many of their

compatriots bear a strong resemblance to something old and well known, something they grew accustomed to regard as vicious on moral grounds.

This contradiction is prone to create strife and tension in the relations between social strata. In modern Russia the circumstances under which the advancement of capitalism occurs contribute to the vilification of the image of the entrepreneur. This prejudice has its origins in the times when most forms of seeking economic self-interest were outlawed as antisocial and subversive as it was necessitated by the contemporary economic and political systems. In terms of culture this transferred into an attitude that regarded the activity of that kind as something low, indecent and shameful. Still nowadays opinion polls demonstrate that Russian public tends to deny entrepreneurs such virtues as morality, integrity, talent and hard work. Characteristically, Russians deem dishonesty and connections as the keys for business success in their country (based on the survey of 2000 Russians by the All-Russian Centre for Public Opinion. See: *Journal of Commerce* November 21 1997). The torrent of derogatory jokes about “new Russians” is another sign of the resistance that the traditional culture offers to the intrusion of new values.

The Trap of “Grey” Economy

The controversial character of the new set of entrepreneurial values and their antagonism with the previous social experience provides only a partial explanation of a negative attitude towards business people in the society. The realities of post-communist transition are at least as much responsible for the misrepresentation of these values. The Russian variant of capitalism is widely perceived as brutal and unfair. Consequently, free market values get a perverse interpretation within the Russian context. Public attitude is influenced not by the idealised concepts of new values but by the way they reveal themselves in the activities of the people who are popularly seen as the standard bearers of a new society. The latter, however, cannot inspire sympathy towards the values they allegedly represent (or rather misrepresent) because, as demonstrated by Nellis (1999), in the absence of institutional safeguards they are not encouraged to behave fairly.

The important point is that the morality of business people is not a function of propaganda or

ethical education “but is produced automatically by institutional arrangements” (Barry 1998, p.10). Without institutional constraints self-interested behaviour with its focus on cutting costs meets no limits. This pushes managers and entrepreneurs to adopt a “one shot” business strategy which entice them to defect from agreements and defy co-operation. The direct outcome of these ambiguous circumstances is that there is hardly any generally recognised and implemented set of behavioural rules to induce a collaborative conduct. The consequences are serious. Economically, this increases a risk premium and transaction costs restricting the possibility of economic growth. Socially, this undermines the image of capitalists as fair, moral and reliable members of the society.

Interestingly, the subjective value that Russian business people put on moral qualities is high. According to Radaev (1998, p.112) honesty and decency were mentioned by 79 percent of respondents to his survey as the most desirable features in business partners followed by trustworthiness and responsibility (29%). However, there is little evidence that this appreciation of high moral values has had any noticeable practical impact on business activities in the country. It is not uncommon for members of the business community to maintain that the current economic and institutional set-up in the country precludes honest ways of making money (Latynina 1999).

This situation contributes to the unpopular image of the entrepreneur and businessman. In contrast to other countries, in Russia there is a considerable degree of ambiguity regarding some most fundamental issues including ownership rights, the role of contract, the concept of legality, the notion of business ethics, etc. To use Mario Nuti's expression (Nuti 1992), Russia is currently in the stage of an "economic non-system", that is, a situation in which the old economic mechanisms have been demolished, but the new ones have not yet fully materialise. This leaves to the discretion of individuals many aspects of business, which under other conditions would be properly regulated by legal, professional, social and cultural conventions. Even the most meritorious of entrepreneurs find it difficult not to cross the line between legality and what is called sometimes “shadow” or “grey” economy. According to the Expert Institute of the Russian Union of Industrialists and Entrepreneurs (Yegiazorova 1997), up to 75 per cent of firms practice concealment of a considerable proportion

of income, placement of capital abroad and evasion of excise duty and smuggling as the most common forms of “shadow” activity. A report prepared by the Institute of Sociology of the Russian Academy of Science claims that nearly two thirds of the entrepreneurs would be ready to bribe an official and eight out of ten consider tax evasion and fraud a viable business tactic (Dushatski 1998, p.71). Direct criminalisation of business activities is an established feature. According to some sources, as many as 22,5% of Russian entrepreneurs have previous convictions for criminal offences and every fourth of them has connections in the world of crime (Rossiiskoi’e predprinimatelstvo 1994, p.5).

The credibility of new business values is threatened further by the fact that the entrepreneurship culture is seen by a considerable part of Russian population as the continuation and development of some dodgy and dishonest practices that existed in the Soviet days. This prevents private entrepreneurship from being regarded as a domain of goodness and disguises its new origins. The social profile of some typical entrepreneurs does not help the revaluation of entrepreneurship in the national cultural context either. Many of them (61 per cent according to some estimates (Santos 1995, p.145)) used to be associated with the bureaucratic apparatus of the Young Communist League, the Communist Party and local Soviets in the murky years prior to *perestroika*. During this period corruption and low moral of *nomenklatura* caused contempt and mistrust in the vast groups of the society which now is projected on new entrepreneurs. Post-communist transition allowed the members of *nomenklatura* to trade political power for wealth and gave them a head start as entrepreneurs, industrialists and bankers. As a result they infected the entrepreneurial culture with depravities, prejudices and idiosyncrasies characteristic of Soviet bureaucracy, including the subculture of intolerance, incompetence and corruption.

“Virtual” Economy versus Market Economy

The inadequacies of legal frameworks and the frequent changes in regulations (tax and bank regulations are especially notorious, being confusing and short-living) increase transaction and, sometimes, starting-up costs. Probably even more importantly, they contribute to the general atmosphere of low trust. As a result building up informal relations has grown in importance inasmuch as the bounding power even of the most explicit contractual agreements

may be inadequate.

In Russia, the tradition of relying on informal networks as an element of business arrangements has a long history. It emerged as a reaction to the rigidities of the official Soviet production system with its emphasis on technological determinism leaving very little space for the human factor. To compensate for this, informal hierarchies came into existence, cementing together suppliers and buyers, creditors and debtors. As a result the Soviet production system relied on informal arrangements and networks almost as much as on the formal ones (Popova and Sørensen 1996). In the period of transition, successful networking has become an even more significant factor as business people sought to compensate the poor performance of formal institutions with arrangements based on personal contacts. According to a recent study, 85 per cent of transactions by small businesses involve friends and relatives as business partners (Tambovtsev 1998, p.42). In the Russian context, though, networking does not mean getting better knowledge of business partners and their needs but rather it pursues the goal of conspiring against outsiders and avoiding legal control over financial and other transactions. Radayev (1998, p.133) reports on the growth of a “negative solidarity” which consolidates the entrepreneurs against “outsiders”, including the authorities. Business networks strive to resolve any “problems” internally which provides more flexibility and more chances to reach a mutually satisfactory solution than available formal methods but often at a considerable social cost, for example poor collection of taxes and price fixing.

Perepelkin (1995 p.38) claims that among Russian entrepreneurs the ability of "working the system" has more value than professional competence. Our own research confirms this conclusion. According to a former senior official of the Soviet Ministry of Finance whom we interviewed in Moscow, at some point of time, to be part of the system of important networks provided entrepreneurs with such a head-start that almost all leading members in his ministerial department had attempted to start a business venture, at least once, just on the strength on this factor alone. Not surprisingly, as a recent poll have shown, the western value of hard work and talent are not seen as credible recipes for success by Russians, rich and poor alike.

This tendency to substitute networking for the market is one of the features of the “virtual” economy developing in Russia, the other being the spread of barter in the place of monetary transactions. Emphasis on informal arrangement contradicts the idea of competition as the fundamental quality of an efficient market. The cultural aspect of this practice is also detrimental. It promotes exclusivity as a feature of business relations, which is of course counterproductive considering that the assumption of the equality of all economic agents is a major condition of an efficient market.

Uncertainty, which comes out as probably the most important single feature of the Russian business environment, has conflicting consequences for entrepreneurs. In a sense, some degree of uncertainty is good for entrepreneurship as it opens opportunities to those entrepreneurs who are prepared to create circumstances rather than accept them (Casson 1995). In the first years of transition in particular, the atmosphere was charged with the sensation of abounding opportunities for quick enrichment caused to a great extent by the fact that the dismantling of the socialist state had left ownership vacuum in respect to enormous amount of riches. This very incident, however, has given impetus to the criminalisation of the Russian economy. According to some sources, organised criminals are in control of nearly half the Russian economy (Shelley 1997). The consequences for honest entrepreneurs are damaging. The cultural stereotype of the entrepreneur was harmed as the strong interest of the Russian mafia in the economy has blurred the difference between crime and business in the eyes of ordinary Russians.

Is the Import of Culture Possible?

The influence of the example of business practices in countries with mature market economies on the development of Russia’s business is predictably limited, in particular as far as small and medium businesses are concerned. Russia remains a rather closed economy. Most producers cannot compete in the world market and have no resources to establish any form of business relations with foreign firms.

There is a number of ways in which entrepreneurs may be exposed to foreign influence. One

of them is professional education. Numerous business and management courses built around standard western programmes are available to Russians managers and business people. They are instrumental in shaping their outlook and thus affecting their professional values and attitudes which eventually will become part of their culture. Yet the experience that these authors have had with training projects in the former Soviet Union suggests that the impact of business education is less decisive than it could have been if the reality of the Russian business environment had had more resemblance to what is taught in classes. It does not help either that, as shown by Holden (1998), foreign educators (and not only they) are slow sometimes to do away with stereotypes in their perception of post-socialist economies and societies. Kolodko's (1998) irony is well justified when he writes: "some advisers still claim that there is a market economy in Russia only the people don't understand it. Yet as long as they do so, there is no market economy".

An actual business contact and direct collaboration with foreign firms may be seen as a particularly important form of exposure to modern market culture. However, while short-term episodic contacts are likely to have only moderate impact, the contribution of those foreign firms that look for serious and long-term success in the Russian market has its own limitations. Although there have been not so many examples of that kind, it is reasonable to predict that in such case foreign firms are likely to be keen to adjust to local conditions rather than change them. The adjustment may, in its extremes, either take the form of a foreign firm positioning itself as an enclave by minimising any contacts with domestic businesses or encourage it to accept or imitate local custom. Either way, the cultural "mission" of foreign entrepreneurship is going to be hampered.

On the whole, even under ideal conditions, the contribution of cultural "imports" cannot be decisive. Appearances may hold but the content of cultural norms has to be determined by the structure of incentives and the institutional set-up existing locally. Western methods and attitudes can be adopted by rational individuals only to such a degree or in such a form that does not contradict their realised self-interest. Literature on Russia reveals no apparent correlation between the grade of westernisation of business people and an increase in the "moral" component of their behaviour. There is evidence, however, that newly obtained skills

may be used fraudulently. Thus, sophisticated marketing ploys were employed by pyramid companies to persuade millions of Russians to invest their money. The vast majority of investors were to regret their gullibility when the pyramids had duly collapsed. Ironically, the most scandalous scheme involved the MMM investment fund, which even managed to impress *The Economist*, finding in MMM an rare example of a wholly Russian-owned company "able to devise an effective marketing campaign" (*The Economist* 1994).

Conclusions

It is now widely acknowledged that the market system in Russia has been slow to develop. Errors in economic reforms, slow and inadequate institutional changes, weak democracy are the factors blamed for this most often. The economic transformation in Russia follows very closely the "scenario" outlined by the prominent institutionalist D.North (1990, p.67) with regard to the countries with underdeveloped institutional framework: "With insecure property rights, poorly enforced laws, barriers to entry, and monopolistic restrictions, the profit-maximising firms will tend to have short time horizons and little fixed capital, and will tend to be small scale. The most profitable businesses may be in trade, redistributive activities, or the black market. Large firms with substantial fixed capital will exist only under the umbrella of government protection with subsidies, tariff protection, and payoffs to the polity – a mixture hardly conducive to productive efficiency".

In this article we tried to demonstrate that entrepreneurial and managerial culture as an important institutional component of the marketisation process, has been struggling to sprout. If changes in ownership are the substance of the process of marketisation, the development of market behaviour and culture determines its form. Deficiencies of the economic system are the major constraints affecting the development of new cultural values. First of all, the economic set-up being a "non-system," the business environment cannot but produce only very ambiguous signals as far as ethical and moral requirements for entrepreneurs are concerned. Second, inadequacy in the economic sphere affects the efficacy of two other sources of influences: the national cultural tradition and the example of imported business practices. Under these circumstances the diffusion of new cultural patterns in business relations is going to be slow.

A noticeable variance between national and international entrepreneurial culture is to remain a challenge to foreign firms doing business in Russia. This will also be a deterrent to the process of Russian marketisation in general. The culture of the economically dominant class eventually becomes the dominant culture of the society. Distortions in the cultural values and orientation of Russian entrepreneurs are the result of the chaotic nature of transition but, as soon as they crystallise, they become a factor that contributes to this chaos and prolongs its existence. There is no doubt that the shortcoming of informal rules may be overcome through reinforcing a formal institutional base, the process over which the society has considerable power. It is also quite evident that in Russian conditions this will not be an easy task.

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