

# "What Is To Be Done?"

Ron Pope

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**NOTE: A good deal has changed, much of it for the better, since this essay was originally written. But much of the commentary is still relevant today. –R. Pope, March 7, 2006**

*See the response from a Peace Corps representative at the end of this essay—and Dr. Pope's rejoinder.*

With apologies to Lenin--who ultimately got the answer to this question all wrong anyway....

If we are going to effectively help Russia, more emphasis--a lot more emphasis--needs to be put on what's working in Russia, and by implication, what can be done to help improve the situation.

Ignoring the problems would be foolish in the extreme. At the same time focusing only on the problems undermines efforts to improve the situation in at least three ways: 1) it encourages the view that "nothing can be done"--so why try, 2) it minimizes dissemination of information about what is working and what is worth trying, and 3) the constant emphasis on the negative scares off prospective investors.

A very strong argument can be made that hope for the Russian economy lies primarily with small and medium enterprises, not with the holdovers from the Soviet system. The large firms, for the most part, are too stuck in the past to be successfully "restructured." Both managers and workers want to cling to practices that simply can't be made to work effectively in even a semi-competitive economy. These practices include depending on state subsidies, "top down management," the "guaranteeing of jobs" no matter how poorly the work is done or how overstaffed the enterprise is, and lack of attention to efficiency and quality.

In addition, large-scale projects attract the mafia and greedy bureaucrats--which, admittedly, are frequently one and the same.

In contrast, small startup businesses have to be efficient simply to survive. They aren't going to get government subsidies, and no one is going to pay them for their products or services out of a sense of charity. They either deliver the goods or they fail. If they succeed, they provide employment, they pay wages on time (or lose their workers), and they pay at least some taxes. (Clearly, the one thing the central government can do is restructure the tax system to the benefit of small business.) Those that are the best run will grow. Also, successful firms will be copied. Further, some employees will leave and start their own businesses.

Small enterprises simply cannot "suck up" resources and then produce less than they receive. They have to make a net contribution to the economy to survive at all.

For example, in the spring of 1994 we started a remodeling business in Vladimir. We were the first firm to install suspended ceilings and imported wall paneling--which give

the interiors of Soviet-era offices an entirely new look. Admittedly some of the first work our crews did wasn't the best possible quality. But, thanks to the foreman, Andrei Koretsky, that soon changed. Andrei had spent some time in the U.S.--and he also helped build the American Home in Vladimir, which serves as a model and where our offices are located. Andrei wanted the quality of his work to match that in America. When one Russian builder tried to talk his way out of redoing some work with the argument that it was "good enough for Russia," Andrei replied that it wasn't good enough for our firm. Several workers were let go because they weren't willing or able to meet quality standards--and the "message" got through to those who stayed on: "Do it right or look for another job." Providing quality work was the only way our firm could attract clients.

Soon other firm's were copying what we were doing--because it was initially very profitable. Now a number of firms are doing very decent work--and profit margins are down considerably. Those that don't do decent work can't stay in business. This is clearly to the benefit of the community as a whole.

All the remodeling businesses in Vladimir, unfortunately, have to use primarily imported building materials and tools. Very little is being produced in Russia which can match the quality of the foreign products--and none of the clients wants to pay good money for poor quality. For example, Russian made drywall crumbles easily.

There are a number of building products that can and should be produced in Russia--which has the world's largest forest reserves. Start up costs for the manufacture of many of these products would not be great. Unfortunately, small projects generally lack "sex appeal"--for both Russian and Western bureaucrats. Further, financial institutions and large investors reason that it costs them just as much to check out projects costing less than one million dollars as it does to review multimillion dollar projects. Therefore, the larger projects are thought to be more "cost effective." Finally, foreign investors in particular who are willing to make small investments generally don't have the time or resources to "get started" in Russia. (Nothing good is going to get done "overnight" under Russian conditions of corruption, bureaucratic ineptitude, ridiculous tax laws, etc.)

However, small investments are frequently the best way to get started. This is true even for large Western firms interested in the Russian market. One of the keys to success is linking up with Russians who understand what needs to be done--or are truly willing and able to learn--and who are reliable. The only way to know for sure that you are dealing with such people is to work with them for a while. This is much easier--and less risky--to do with small scale projects.

Once you are sure you are working with reliable and capable people--and after you have gotten some experience in dealing with Russian culture--you can expand your operations.

For example, everyone knows that the Russian telecommunications system is in bad shape. In Vladimir, you can dial one number but get another, the quality of the connection is frequently poor, and the phones often don't work at all. Fortunately, it is possible to send and receive e-mail--because the computer keeps re-reading the information until it gets it right--but you can't send faxes over most phone lines. There is also a major shortage of capacity--more people would like to have a phone than the system can handle. This is an especially important bottleneck for many businesses.

A group of local engineers would like to set up a fixed wireless phone system in Vladimir, starting with one station. (This is different from a cellular phone system. Among other things, it is quite a bit less expensive. It is also less expensive per phone than laying new cable.) Although it may seem strange to say so, unfortunately, startup costs will probably be less than a half million dollars for this project. I've been repeatedly told that this is too small for international lending programs such as the EBRD and for most private investors--for the reasons noted above. However, if this first step works well--and if the Russians involved prove to be good to work with--then more base stations can be added in Vladimir (the demand is there), and the same system can be installed in other cities, relying on the now trained Russians to do most of the work, including dealing with the local bureaucrats, etc.

In other words, this initially small investment can grow into a large investment. And the resulting improvements in the telecommunications system will greatly benefit other businesses. They will be able to add the extra lines they frequently badly need, and they will be able to have much better access to international telecommunication services. Therefore, they will be able to more easily make international calls (with decent quality connections), and they will be able to access the Internet and send and receive faxed documents much more easily.

[Update: The "phone shortage" was solved by the rapid expansion of competing "mobile" (cell) phone companies.]

But how does a small business like this get started?

The U.S. government programs that I am familiar with which are designed to assist small businesses are in general not effective--and sometimes they are even counter productive. These include the Peace Corps manned American Business Centers and the Business for Russia Program. To begin with, neither of these programs has access to any significant investment funds. There is little the Business Centers can do when someone comes to them with a good idea beyond provide "advice." Further, the Peace Corps volunteers, for all of their truly admirable dedication, tend to either know very little about Russian culture or very little about business, especially business as it is conducted in Russia. By the time they learn enough to be helpful, their two year tours are up. Finally, the Peace Corps program in Russia seems to be much less well organized than other Peace Corps programs around the world. On more than one occasion I have been approached by new volunteers with a request for help in understanding Russia, including suggested reading lists, after their requests for information from Peace Corps headquarters have gone unanswered. Further, there seems to be little by way of effective support once they volunteers are in country. For example, they are not provided with lists of useful contacts--even though, thanks to the work of private information gathering organizations, these are readily available. (We had the only copy in Vladimir of the Center for Civil Society International's very helpful publication, "The Post-Soviet Handbook.")

The Business for Russia Program seems to be an excellent example of "bureaucracy at its best." The emphasis is on "numbers served" vs. "results achieved." Much more would be accomplished in Vladimir Oblast if they would select 5 truly promising individuals, carefully link them with people in the U.S. who can truly help them start or expand a small business, and then allow them to stay in the States as long as is necessary to learn what they need to know. Instead, this program sends groups of 50 Russians per region to

the U.S. for five weeks. I do not know of a single individual from the first group of 50 people from Vladimir who participated in this program who benefited to the extent intended. They all learned something--just not enough to make a real difference. Further, they all needed more time in the U.S. to build the links with their American hosts that could have led to some small but serious investments in joint ventures. Unfortunately, bureaucrats tend to focus on the superficial--in this case, "numbers served."

In contrast, over the past four years we have helped bring just six militia officers from Vladimir to the U.S. for a 16 week program. This includes 12 weeks at the University of Illinois Police Training Institute followed by 4 weeks spent with various police departments around the state. The participants are carefully selected and they spend enough time in the U.S. doing the right things to make it a very productive experience. This program has contributed to concrete changes in police training procedures throughout Russia.

Programs like VOCA, which provides advice to agricultural projects with the assistance of expert volunteer advisors, seem to be more effective than organizations run directly by government bureaucrats. But they also suffer from a lack of access to investment capital.

All these government-sponsored programs become counterproductive when, with their emphasis on the superficial and lack of effective follow-through, they give the impression that "capitalism doesn't work." For example, the American Business Centers have a general reputation for being a waste of time and resources. This doesn't help convince people that small business development is a good idea--or that the U.S. can be relied on to provide effective help.

Despite the failures of most of the programs which are supposedly intended to assist small business in Russia, many Russians are finding ways to get things done. They raise money from friends and relatives, they invest a great deal of "sweat equity," and they deal with the ridiculous tax situation by simply not paying all that they owe--if they pay anything at all. However, with the application of a little common sense, a great deal more can be accomplished.

Specific, small, doable projects need to be identified, along with capable people. (This means that you need to work with a small number of projects and people at any one time.) Then advisors need to stick with these projects and people until a "critical mass" has been achieved. Two week on site visits with very little follow up or short trips to the U.S. (again with no meaningful follow up) are simply not going to accomplish very much. What is needed are genuine business incubators--which in fact work well in the U.S. In turn, these incubators need to have access--to decent amounts of startup capital--which they can make available to even very small projects.

For example, there is to date no commercial janitorial service in Vladimir. It would not take much capital to get one started--but it would take a lot of time and effort to select, train, and monitor the staff. (You would have to make sure they didn't fall back into bad habits--like using dirty rags to "clean" everything in sight.) You would also have to convince prospective clients that they could trust the cleaning staff not to steal them blind. (Staff selection and supervision will be extremely important.)

For the record, more emphasis on cleanliness should spill over into other areas where "quality counts."

Some observers might argue that "Russian culture" will make it "impossible" for them to meet American standards of cleanliness. In this context, just about everyone I talked to when we were building the American Home in 1992, including most Russians, was convinced that Russian builders could never do Western quality work--at least not in this century. But this quickly proved to not be true. In one case, a joint venture partner returned for a visit after we had remodeled the Russian plant director's office. The foreign partner was very impressed with the new office, but assumed the work had been done by foreigners. The director took great pleasure in informing him that everything had been done by Russians.

Again, despite all the failures to take advantage of opportunities, a lot is being accomplished by small businesses.

What is needed is more help for startup businesses, including providing access to small loans on reasonable terms and providing more carefully focused assistance (e.g., 5 instead of 50 participants in exchange programs) with much better long term follow up.

In addition to setting up truly functional business incubators, one other way to do all of these things is to help foster more joint ventures. An investor will automatically help take care of the details and is guaranteed to provide all necessary "follow up." An American janitorial company--with sufficient patience and a willingness to learn about Russian culture--could accomplish a lot working with the right people in Vladimir. But how do you persuade them to take the risk? In other words, "What is to be done?"

For a start, providing low interest loans and OPIC political risk insurance for small projects would be a much more effective use of taxpayer dollars than most of the current programs. Further, more needs to be done to "advertise" the multitude of investment opportunities available in Russia, and more emphasis needs to be placed on effective strategies for dealing with the admittedly large number of problems that crowd the Russian landscape--rather than focusing only on the problems and leaving the impression that "nothing can be done." In short, what is needed is a realistic problem solving approach that focuses on getting meaningful results. It CAN be done!

## **A response by Steve Taylor, Peace Corps Country Director, Western Russia, to Dr. Ron Pope's essay**

I read with interest Ronald Pope's comments about the Peace Corps program in Vladimir. As the Country Director of the Peace Corps program in Western Russia, I'd like to add some factual information.

During 1993-94 the Peace Corps and the United States Agency for International Development helped to organize several business centers throughout Western Russia. Their goal was to provide technical assistance and advice for Russians in small and medium-size business development. In Vladimir Peace Corps Volunteers the Peace Corps teamed up with the Eurasia Foundation to begin the Vladimir Center-Foundation for Business Development.

Since that time some of the 12 original business centers have closed down their operations due to a lack of financial support from local sources, some have changed their

focus and some, now staffed and financed solely by Russians as was originally intended, have continued working.

As is mentioned above, the initial goal of the business centers was to provide technical assistance and advice for Russians (not money) by working together with them on the grass-root level and transferring to them business technical skills. Funding was provided only for a start-up period after which host organizations were supposed to finance the centers until they became self-sustainable.

The Peace Corps is not an investment fund, it is a humanitarian aid governmental agency and it does not have any intention of doing investment projects anywhere in the world. It's main function is education--both business and non-business. The Peace Corps provides their most valuable resource--highly educated professionals, many of whom have run their own businesses. In the case of Vladimir, Volunteers placed there over the last several years have included an attorney, a CPA and an experienced management consultant.

And, because our Volunteers live and work with Russians on a daily basis for two year periods, the Peace Corps is one of the very few agencies that can speak with authority about the real state of the Russian economy and its impact on the lives of ordinary Russians.

As anyone who has spent even a few weeks in Russia knows, the economy is in a constant state of flux. Russians themselves are often at a loss to explain the economic situation. It should therefore come as no surprise that Americans sometimes disagree. However, the very fact that Peace Corps Volunteers have been making a continuous impact in Vladimir--and in many other regional cities throughout Western Russia--for the past six years, at a time when the majority of other business development efforts, both in the public and private sectors, have come and gone, certainly indicates the value our Russian sponsors attribute to the Peace Corps program.

And apparently, not only Russians attribute value to our Volunteers and our program. The fact the Mr. Pope approached one of our Vladimir volunteers with a request to author a business plan for him, would certainly appear to be a recognition of professional competence. In addition, two of Mr. Pope's employees will participate in the Business for Russia Program. Our Volunteers were members of the panel that recommended sending the two to the United States for a five week internship where they will soon be learning much more about the practicalities of running a business in a market economy.

For the past thirty-five years the three goals of the Peace Corps have remained the same--to promote world peace and friendship through the following objectives:

- To help the people of interested countries and areas in meeting their need for trained manpower;
- To help promote a better understanding of Americans on the part of the peoples they serve; and,
- To help promote a better understanding of other peoples on the part of Americans.

I am very proud to be leading a program in Russia which is undoubtedly meeting each of these goals and, hopefully will continue to do so, into the future.

Steve Taylor Peace Corps Country Director, Western Russia

## **Ron Pope's response:**

I just recently returned from two weeks in Vladimir--and I had a number of things to catch up on before I could respond to Steven Taylor's comments on my "What Is to Be Done?" essay.

I welcome the exchange of opinions. Further, I in no way want to impugn the intentions of the Peace Corps in general or the skills and dedication of its volunteers. However, the main point of my argument, which I do not feel Mr. Taylor directly addresses, is that there has been a lack of adequate "targeting" and effective follow-through with the programs intended to assist small business development in Russia.

Simply providing "technical assistance and advice" has not proved to be enough in most instances that I am aware of. (I am not speaking of just the situation in Vladimir but throughout all of Russia.) As for investment funds, while I realize the Peace Corps itself is not in the investment business, someone clearly needs to do more to help line up prospective funding sources for small-scale projects. Without investment funds, the advice frequently is, at best, useless and often even counter productive. (Expectations are raised only to lead to serious disappointment. This makes the program--be it the Business Centers or Business for Russia--appear to be useless.) I think it can very reasonably be argued that, especially given the substantial and growing Russian skepticism about aid from the West, if a project cannot be adequately implemented, it is best not to initiate it to begin with.

I am afraid that, overall, both the Business Centers and the Business for Russia Program have to be counted as failures, that is, we have to recognize that they haven't provided either the U.S. taxpayer or the Russians with a decent return on the substantial investment that has been made in them. (There has been too much emphasis on "numbers served" vs. "concrete results achieved.")

One partial solution might be to go back to past participants in the Business for Russia Program (and clients of the Business Centers), identify those who still show some serious promise, and then actively seek ways to help them actually get something done. This can include linking them up with prospective funding sources and/or prospective investors/joint venture partners. Especially if these are very small-scale projects (e.g., a commercial cleaning service), the risks should be acceptable even in these trying times.

The emphasis NEEDS to be on doable projects that are adequately followed through on--not just on "projects initiated." Once again, I am confident that it CAN be done!

## **SETTING THE RECORD STRAIGHT:**

### **Business Plans**

I did not ask a Peace Corps Volunteer in Vladimir to assist my business. Rather, I put him in touch with a Russian businessman who needed help in preparing a business plan. After the introductions, we provided significant assistance to this project. To the best of my knowledge, this remains the most viable commercial project this Volunteer has worked

on to date. (It is viable because the Russian has the funds to cover expenses while the business plan is being prepared. A good many promising projects don't get off the ground for a lack of the necessary seed money.) It is not that this Volunteer would not be capable of assisting us. He definitely has a solid business background--and he is learning quickly about the ins and outs of Russian business and politics. (We have had several long discussions--and he has learned a great deal from practical experience.) However, he does suffer from the handicap of having to work through interpreters--and this does make a difference. He needs to be teamed with a Russian who knows English well and whom he can fully trust. This Russian also needs to understand business and politics. (I think he has finally managed to link up with such a Russian.)

Finally, this Volunteer's effectiveness is going to remain severely restricted as long as he and the Russians he is working with lack access to sources of seed money and venture capital.

### **Business for Russia Participants.**

I provided letters of reference for 3 applicants to the latest round of the Business for Russia Program. Only one of the two who were selected works directly with me. We are partners in a joint venture remodeling business. He has been to the U.S. before, and we have discussed in detail what he might be able to profitably do in the brief five weeks he will be in the States this time.

All of the participants in this program that I have talked to, including during my most recent trip, have agreed that five weeks is too short a period to accomplish anything substantial in most cases and that the program lacks effective follow through. (I still think that more American hosts would follow through on their own if they had a better chance to get to know the Russians--and if the participants arrived with concrete doable projects in mind. OPIC political risk insurance for small-scale projects would also help--especially in the wake of current events.)

I remain convinced that a great deal more can be accomplished in Russian than has been the case to date if the focus is switched from "numbers served" to "results achieved".....

Ron Pope