

BUS854

Managing Cultural Diversity in Business

Case Study analysis:

**Contemporary challenges within
the Russian business environment**

Individual Assignment

by

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The Case: The reluctant briber

(adpoted from: *The reluctant briber* 2006, p 79)

A year in the life of an ordinary Russian entrepreneur (who, strangely enough, would rather not be named).

Call him Ivan. When The Economist met him, on a flight from Moscow to Ukraine, Ivan was perplexed. Before the "orange revolution" of 2004, he said, "I knew who, when and how much" to bribe, on behalf of the small minerals company he co-owned in Ukraine. All the new talk of wiping out corruption was making business impossible.

Ivan mostly works in Russia, his homeland. He is just the sort of small entrepreneur that the country needs to flourish, if its economy is to rely less on oil and gas, and its society to be stabilised by the growth of a middle class. Ivan has the strong stomach and dark sense of humour needed to survive the everyday perils of doing business in Russia. As he proved in a series of meetings over the last year, he is also enlighteningly candid.

Like many successful Russian businessmen, Ivan, who is in his 50s, had a scientific training, which meant he was not too exposed to Soviet indoctrination. He owes the once unthinkable lifestyle he now enjoys--foreign holidays, overseas education for his children--mostly to his dealings as a commercial-property developer. When The Economist saw him next, he was finishing a profitable project near Moscow. It was profitable not only for him. "It's like the last days of Pompeii," he said of the bribe-taking that consumed roughly a tenth of his costs, the same proportion, he said, as criminals extorted in the 1990s.

Ivan's experience is typical: despite theoretical improvements to the registration and tax systems, President Vladimir Putin himself remarked last year that anyone who successfully registered a business in Russia deserved a medal. Vague and overlapping regulations can seem expressly designed to enrich predatory officials. Outright seizures of firms by criminal raiders, usually in cahoots with security or justice officers, are frequent. Ivan's project required dozens of licences, and every licence needed a bribe. Despite new rules that are supposed to restrict them, he faced a procession of bogus inspections by fire, health and other agencies. Mostly, he said, the bureaucrats don't demand cash explicitly; they just procrastinate until it appears.

Ivan's other big problem - labour - is also a money-spinner for corrupt officials. The old system of vocational training, he told The Economist six months ago, has collapsed with the Soviet Union; these days, economists are easier to find in Moscow than manual labourers. Today's Russians, he complained, are only interested in "easy money". Drunkenness is another worry for employers (a common lament, which a new "register of non-drinking men", set up by an entrepreneur, whose members will be vetted by the wives of alcoholics, is intended to address). There is no choice, Ivan says, but to use illegal immigrants and pay off the police. Polls suggest that Russian businessmen fear bureaucrats more than criminals, and dread the police most of all. They charged Ivan 500 roubles (\$19) per month for each of his illegal workers. Still, at least the kickback system is intelligible. Ivan once started a venture in America which ran up against local sanitation rules: "no-one would take a kopeck", and the project folded.

For a while Ivan believed things might be changing for the better at home. The system seemed to offer him discounts for repeat custom: working on a second development in the same town near Moscow, he found that the bribes were lower (though he was also being leaned on to contribute to local schools, a common form of soft extortion). He also thought he might be benefiting from a short-term anti-corruption push. The federal government, he speculated,

wanted to show that at least some parts of the country were functioning properly. He believed Mr Putin's regular vows to fight graft.

Meanwhile, the situation in Ukraine was still unpredictable. Ivan doubted that the "orange" government was any less corrupt than its predecessor: "they all say that", he said of the anti-corruption slogans. For the time being, a sort of paralysis had set in among local officials. Almost no bribes were being taken, except the odd bottle of vodka, and nothing was getting done.

By last week, Ivan had turned despondent about Russia too. New people had taken control of the town he was working in. They didn't care, he said, that he had helped to create hundreds of jobs there; they were squeezing him out of the development with exorbitant demands in favour of their pet firms. That disappointment tallies with recent surveys that suggest graft in Russia is actually worsening. Old bureaucrats have found ways around new rules. The periodic firings of disgraced officials have come to seem like the fallout of government infighting, rather than part of a genuine war on corruption. Mr Putin's promises, Ivan has now concluded, are "just paper and words".

Like everything else in Russia's economy, the small-business sector is hard to measure precisely. Though it seems to be growing, obstacles like those Ivan faces are helping to keep it much smaller as a share of employment and GDP than in Western countries. But Ivan, at least, is still optimistic about Russia in the long run. Crooked officials may be as old as Russian literature, but he sees today's rampant corruption as a specifically post-Soviet illness. The Soviet regime bred nihilism among government officials but, he says, the fear that once restrained the worst of it has gone. Pen pushers with small government salaries shamelessly "go to the Canary Islands" on expensive holidays. Yet that mentality will eventually die out as a new generation of people go into business, Ivan believes. He himself regards the methods he is obliged to use with a sort of wry disgust.

Meanwhile, although he no longer wants to do business in Russia, things are returning to normal in Ukraine. The team that ran the country before the revolution is back in power, and Ivan once again knows who, when and how much.

Case Summary

The Economist's case mentions a big problem business in both Russia and Ukraine is facing at the moment: corruption. The keen entrepreneur Ivan is trying to deal with the consequences evolving. But with increasingly high demands for bribes from the bureaucratic system and police and a hardly recruitable workforce it seems to be impossible for him to do business in Russia any longer.

On the other hand, he is so aligned to the system that a venture in America had to be given up, because no one was willing to take a bribe. Both, changes after the "Orange" revolution in Ukraine and Russian government action trying to fight corruption, caused further irritation for Ivan's business instead of relief. Whether there is a better solution to the problems than Ivan's strategy of just hoping for a change to the better, should be the discussion of the following analysis.

Problems Ivan is facing

Instability as the first problem is also the one with the biggest impact on Ivan's business. It is one of the most important deterrents when it comes to investment making decisions. Among other measurements, managers analyze and compare different investment options by their Return on Investment (ROI). An investment is only made, if ROI is higher than a minimal target figure, which is mainly influenced by market interest rates and the risk of the investment. Hence it could be concluded that businesses need to have a certain level of stability in their environment in the long run, in order to be willing to invest and secure long term growth.

The reasons for the instability and uncertainty in Ivan's business environment seem to be closely related to the rampant corruption in Russia and in the member states of the Commonwealth of Independent States (CIS). Corruption is "the sale of government property for personal gain" (Shleifer & Vishny 1993). Figure 1 shows the Corruption Perceptions Index (CPI) for more than 150 countries, as determined by expert assessments and opinion surveys (Transparency International 2007). As a low CPI states a high level of perceived corruption, it is remarkable that no member of the CIS gets a CPI higher than 3.

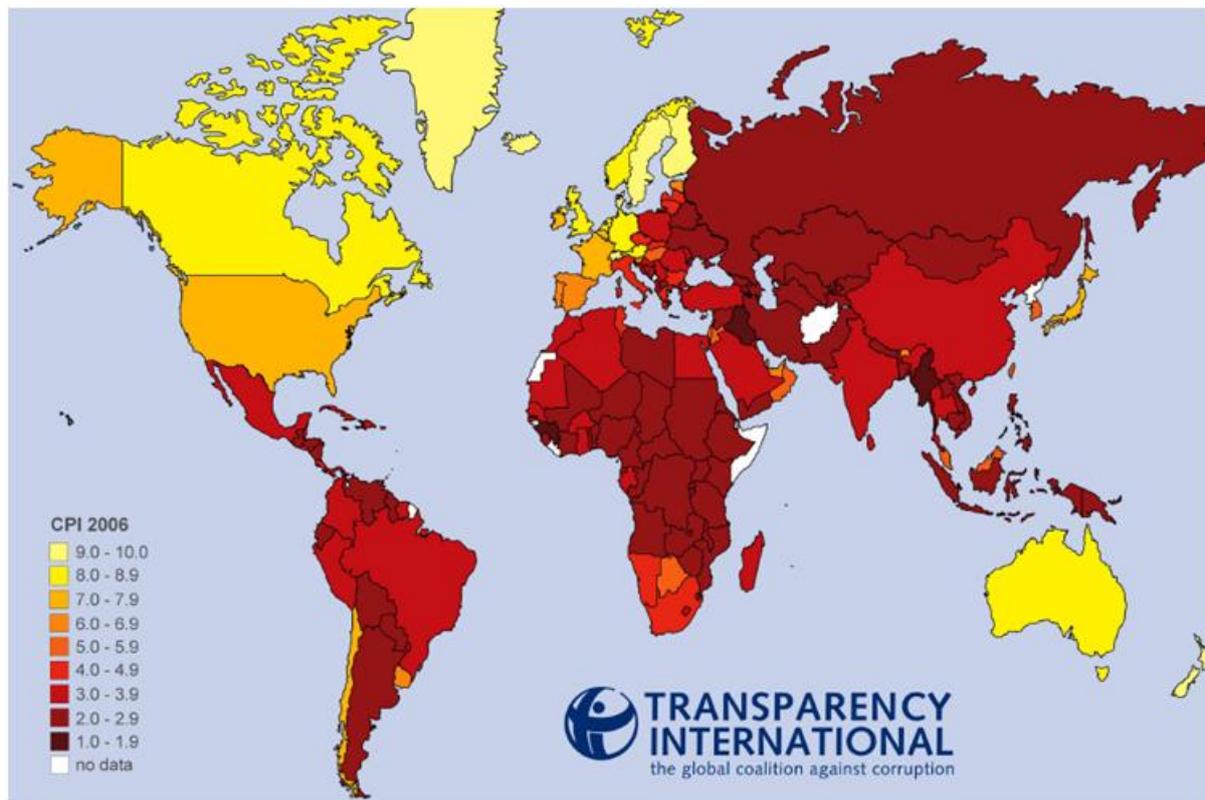


Figure 1: Illustration of the Corruption Perceptions Index for most countries in the world (Transparency International 2006).

Why is corruption more common in Russia and the former Soviet Union than, say in Australia? Hofstede (1980) suggests four dimensions on how to differentiate national cultures: Individualism vs. collectivism (IDV), power distance (PDI), uncertainty avoidance (UAI) and masculinity (MAS). Later on, a fifth dimension was added: time orientation (LTO). A comparison between Australia being a country with low corruption and Russia, might lead to assumptions, why bribes are more common in Russia (see figure 2).

The high power distance index shows that inequality is rather accepted among the Russian people. Since power is unequally distributed, it might be perfectly in order for officials to abuse their power by taking grafts. A low score in the individualism index might lead to the conclusion that bureaucrats expect business people to be loyal to the existing system by paying bribes and receive security to conduct business uninterrupted in return. People in countries with a high uncertainty avoidance index tend to have more formal rules and less tolerance for unusual ideas, thus leading to a bureaucratic system of government administration. Since decisions in such a system take long and once taken are not easy to overrule, it is the perfect environment for corruption. Since there is no clear link to corruption in the masculinity index and no data for long term orientation in Russia exists, those dimensions are not considered further.

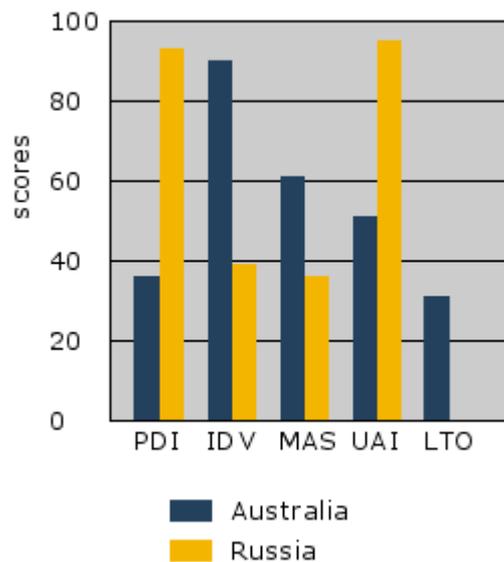


Figure 2: Comparison of Hofstede's dimensions between Australia (low corruption) and Russia (high corruption) (adopted from: ITIM 2007).

Discussion in literature about the effects of corruption on an economy as a whole and on each business within that economy is controversial. Leff and Huntington (cited in Mauro 1995) state that on the one hand, corrupt practices would enable individuals to avoid bureaucratic delay and that employees who are allowed to take bribes would work harder. Ivan has experienced both. License applications that are not accompanied with bribes are just not getting processed in Russia for an instance. In Ukraine anti-corruption slogans have caused a paralysis and “almost nothing was getting done”.

On the other hand Shleifer and Vishny (1993) argue that corruption tends to lower economic growth. The main reason for that is an inefficient allocation of resources. Highly skilled people like Ivan are allocated to rent-seeking activities instead of creating direct value for their business and economy. On top of that, with corruption leading to uncertainty as described in the case, Ivan is obviously not able to do all the investments he would like to do.

The second problem discussed in the case is that a skilled manual labor force is almost impossible to recruit. It is not only the breakdown of the vocational training system after the collapse of the former Soviet Union. It is also drunkenness that has to be held accountable for this development. Ivan tries to cope with that problem by employing illegal immigrants. However corruption plays a major role here, too. If Ivan was not willing to bribe the police, they would shut down his operations for employing them. Considering this, corruption seems to be solving problems.

The third problem Ivan has to deal with is that a once started venture project in America had to be given up. Ivan was so used to his local habits that he tried to apply them to the American system. With the business violating local sanitation rules and with no one willing to take a bribe, Ivan had no further concept on how to do the business another way.

Bribes seem to be Ivan's problem on the one hand, but also solve problems on the other. This creates a vicious circle and imposes clear threats for the way of doing business in those countries. The next paragraph introduces alternatives for Ivan on how to deal with his situation.

Possible solutions to Ivan's problems

To find solutions to the three identified problems, namely instability of the business environment, the lack of skilled workers and a possible international expansion, several alternatives have to be developed.

Firstly, Ivan suggests a solution to his problems on his own: Time will tell and solve the problems. He regards the corruption problem as a "specifically post-Soviet illness". In his believe the mentality of taking bribes as a normal way of conducting business will dissolve with a new generation of people going into business. Thus he takes a long term approach and hopes that in the meantime he could stay in business by keeping to the old system. Grafts therefore will bring relief from the short term instability and lets him employ illegal immigrants. An international expansion is not considered.

Secondly, a viable option could be to pay no bribes at all. This is what is suggested by Fisher et al (2006). According to them, bribing imposes three forms of risks for a company's reputation. First, most people in a country do not consider corruption as acceptable and normal. Second, they state once the bribing has begun it would never stop again. Increasing amounts of money needed to bribe an official are the result. Third, multinational companies using bribes abroad put their domestic reputation at risk. Their conclusion is that "viable companies can say no" (Fisher et al. 2006, p.255) by simply putting up a corporate code for employees, managers, customers and suppliers that does not allow any kind of bribery. Embedding this thinking in the Corporate Culture could establish a competitive advantage for the company. With breaking free from the vicious circle, Ivan would be able to bring stability into the system. Learning how to do business without bribes in an ethical way, Ivan would be able to set up new subsidiaries abroad and could recruit legal immigrants.

Thirdly, a pro-active stance could be the best way to deal with Ivan's problems. To avoid instability, it is necessary that Ivan starts to invest the money he has, instead of using it to bribe officials. He has to be able to provide a future perspective for the business and its stakeholders. He could achieve that by the following. First, he has to invest into a labor training program and abandon alcohol from the workplace. Joining and supporting the other entrepreneur's initiative of a "register of non-drinking men" as mentioned in the text benefits all. Those actions would provide Ivan with the workforce he needs, not leaving him any longer dealing with problems constituted by illegal immigrants. Second, he could join political forces against corruption, involve international organizations like Transparency International and support local media to fight corruption in the long run. Third, he has to support the government by making sure he pays all his taxes so that bureaucrats get better salaries, undermining the need for them to take bribes. Forth, in order to stay in business in the short run, Ivan has to diversify his business. He cannot concentrate on just one project. In order to be more independent from changes in the local bureaucratic system he has to keep a portfolio of different projects. By investing in foreign countries with partners that know local

customs, and being willing to learn on how they do business without bribing, he will be better off in the future.

Which of the three alternatives would be the best one to choose? To decide that, it is important to derive key decision criteria as it is done in the following section.

Key Decision Criteria

Ivan would certainly take a decision from an entrepreneurial, business point of view. Ethics would only play a minor role as he is also willing to apply his current policies in the future.

His major concern is hence on how to stay in business. To achieve this goal, three key decision criteria could be identified. Firstly, he needs to reduce the instability and uncertainty of his business environment to ensure long term success. Secondly, since an increase in profitability is key to future growth and therefore vital to stay in business, Ivan has to cut costs, namely to reduce bribe payments and rent-seeking opportunity costs. Thirdly, Ivan needs also to address short term issues. Only if the selected alternative provides profitability in the short and medium run he can continue his operations.

Which of the alternative solutions Ivan should take to stay in business in the short, medium as well as in the long run will be assessed in the following.

Alternative analysis

The assessment of the alternatives will take place by evaluating each according to the derived key decision criteria.

Ivan's proposed solution that in the long run his problems will be solved without taking action seems to have some substance. As mentioned at the end of the case, the return to "normal" in Ukraine seems to prove him correct. Since he was able to stay in business for the last couple of years despite all problems occurring he might be able to do so in the future as well. Nevertheless this alternative does not avoid uncertainty and does not stabilize Ivan's business environment, thus making further investment very unlikely. The second key decision criterion is also not met. Expenditure for bribes has been rising during the last years and so have the rent-seeking costs. However his solution could secure short term business since no change and adoption period to a new business philosophy is needed.

Not paying any bribes is the second alternative. However this solution seems to be only applicable to big companies and not to entrepreneurs like Ivan, since their bargaining power is much bigger. For them reputation does play a much larger role than it does for Ivan. Not participating in the vicious circle of corruption any longer would definitely lead to a reduction of uncertainty and to lower costs, thus meeting the first two criterions. On the other hand it is very likely that Ivan could not stay in business any longer in the short term as well as in the long run. Taking this alternative would imply that Ivan has to go abroad to conduct business.

The pro-active stance could be the best solution for Ivan. With investing in human capital and actively fighting instability and uncertainty he provides a clear perspective for all stakeholders. National and international diversification of business leads to reduced

interdependencies. In the long run when he has successfully adopted the new business model, payments for bribes will be significantly reduced. So the evaluation for the long term criteria is clearly positive. But this alternative imposes clear threats for the short run. Since the application of the new business model takes time, Ivan has to stick to his current policies in order to stay in business in the next years. Since Ivan seems capable of dealing with the current situation he might be able to bridge the gap until the new philosophy pays back.

Conclusion and Recommendations

The pro-active stance seems to suit Ivan's demands best. Solution three provides clear answers to the identified problems, namely instability of the business environment, the lack of skilled workers and a possible international expansion.

Acting instead of reacting gives Ivan the tools he needs to secure his business operations in the long run. Allowing the evolution of a better business model instead of abrupt changes, it pays tribute to local habits and culture. Avoiding the shock for his business it secures long term growth by fighting the underlying causes for Ivan's problems instead of its symptoms.

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