

# Business Without Corruption: An Action Guide



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**ОПОРА РОССИИ**  
ОБЩЕРОССИЙСКАЯ ОБЩЕСТВЕННАЯ ОРГАНИЗАЦИЯ МАЛОГО И СРЕДНЕГО ПРЕДПРИНИМАТЕЛЬСТВА

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# Preface

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Set in the context of the Russian experience, this brochure is the result of a joint effort by two non-profit organizations that are well-known to entrepreneurs: the All-Russian Non-Governmental Organization of Small and Medium-Sized Enterprises (OPORA) and the Information Science for Democracy (INDEM) Foundation. OPORA is well-known as a business association not only for its research, but also for its extensive practical work to improve the business climate. The INDEM Foundation is known for its research on corruption. For the last three years it has been involved in projects to study small business.

The authors of this brochure faced a complex task: to give small business owners tools to resist corruption and strategies to survive and grow in an extremely aggressive environment. These strategies are not easy to use, because they are often in tension with your previous experience. They involve rejecting corrupt ways of doing business. Our suggestions are based on the results of research, an analysis of positive experience (however limited), and extensive interviews with representatives of small and medium-sized enterprises throughout the country. Our analysis of the situation and proposals are accompanied by specific examples and quotations from anonymous interviews with businesspeople.

We do not see this text as a final truth. On the contrary, we hope this brochure will be the starting point of a discussion with the active participation of its readers. This will help us correct mistakes and inaccuracies and gather additional information. With your help, we will then update the text with a new level of understanding.



# 1 Introduction

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Small business is the foundation of any efficient market economy. The successful growth of small business addresses three fundamental challenges. First, the socio-political challenge of creating a middle class, which stabilizes a democratic political system. The second challenge, creating a primary source of employment, is social. The third challenge is economic. Small business is a crucible of innovation, in which the industry of the future is born and without which real breakthroughs are impossible. The growth of small business led to the Ford automobile and the personal computer. Dynamic economic growth is possible only on the foundation of small business. These three challenges alone are enough to support a clear conclusion: where small business is suppressed, an efficient market economy cannot exist.

## 1.1 Assessment of the current situation

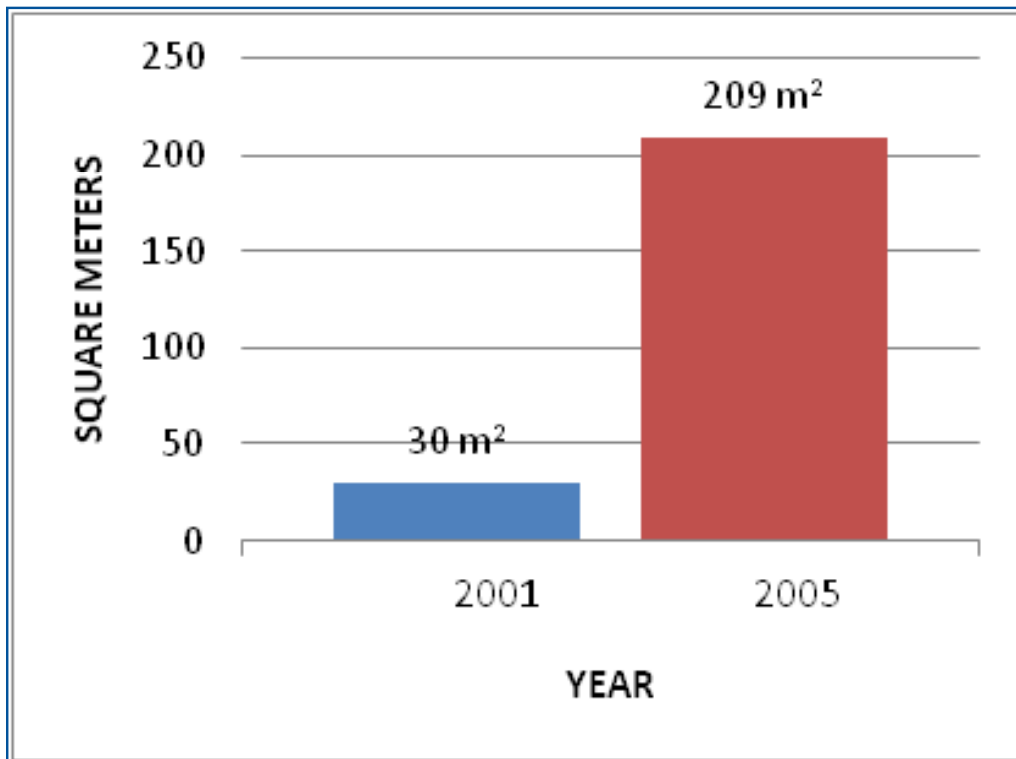
What is the situation in Russia? Statistics provide an incontrovertible verdict: Small business is declining. This is a sign of a serious failure to thrive. A clear manifestation of this failure to thrive is the rapid growth of corruption. In the period between two large-scale diagnostic studies of corruption in 2001 and 2005, the average amount of bribes paid by businesses increased precipitously, according to research by the INDEM Foundation and other groups. In the graph on the following page, this increase is measured in the number of square meters of apartment space that can be acquired on the primary housing market at average national prices for one average-sized bribe. We see a seven-fold increase in the relative figures, adjusted for inflation and price fluctuations. Both the INDEM Foundation's data and the results of surveys by

### DEFINITION:

Corrupt behavior is a type of opportunistic behavior by an agent in which the agent uses the resources of the principal not to accomplish the goals of the principal but for the agent's own purposes. In this situation the principal is defined as a person or organization owning property that such person or organization wishes to use in its interests. The agent is often a person hired to manage assets of the principal in order to advance the principal's goals more effectively. Corrupt behavior is the intentional betrayal of the principal's interests by the agent for the agent's own benefit.

OPORA yield a similar result: in 2005, bureaucrats' income from business corruption equaled approximately seven percent of the total (both legal and black-market) turnover of Russian firms, which, as businesspeople point out, are barely profitable in any case.

A representative survey of 1,600 Russian citizens in 128 cities in 46 regions of the country, conducted by Yuriy Levada's Analytical Center (the Levada Center) in June 2006, also revealed that about 50 percent of those surveyed see corruption as the main obstacle to economic growth in Russia.



*Apartment space that can be purchased for an amount equal to one average-sized bribe.*

According to studies by OPORA, high non-production costs of small businesses (administrative and corruption-related costs) grew from 8.5 percent of annual turnover in 2005 to 9.6 percent in 2006 (for comparison, in Germany these costs are 3.5 percent of net profit).

Many businesspeople say that the “reliability of corruption services” has changed. Today, a bribe is less likely to ensure the resolution of an issue. In other words, lower-quality corruption services are being provided for a higher price. For example, very often giving a bribe to a municipal government employee at a “single-window” to expedite processing land documents does not guarantee that these documents will be prepared without mistakes. The businessperson must then pay to correct errors and defects caused by the careless bribe-taker.

The second trend is a reduction in “services” as a proportion of total corruption and an increase in the share of extortion and direct confiscation. For example, where previously one could actually register a legal entity in less than the maximum allowable time by giving a bribe to expedite the process, now the same amount of money might, in the best case, only ensure that the established deadline is met. New types of corrupt payments have also appeared, which might be described as “bribes for the right to operate.” A very common example of such a bribe is a bribe to renew a lease agreement that the tenant already has a contractual right to renew. But without a bribe additional complications and unexpected problems could arise.

The growth of corruption is directly linked to the growth of the shadow economy. As businesspeople often describe it in interviews, a bribe is a sort of tax on shadow turnover. Thus, the growth in corruption is evidence of growth in the shadow economy. The INDEM Foundation estimates that the shadow economy is now at least 80 percent as large as the legal economy. However, that is on average. Deviations from the average may be very significant from one economic sector to another. For example, the share of the shadow economy on the consumer market is much higher; black-market turnover often far exceeds legal turnover — and this is the sector in which most small businesses operate. Finally, operating partially in the shadows makes business more vulnerable and dependent.

Small business itself has a general tendency to focus on short-term business strategies, which is an entirely natural tendency in such an aggressive and unpredictable environment. The strategic consequence of this is that small business is unable to perform its innovative function. This has a negative impact on the entire economy, its dynamism, and its potential for growth.

## **1.2 Origin of the problem**

The set of problems that make life difficult for Russian business may be divided into two unequal subsets. The larger subset has to do with the authorities, and the smaller one concerns business itself. Any transitional period in a society involves an increased level of legal chaos. The old system of legal norms and traditions collapses more rapidly than a new system is created. A sort of legal void forms. It is not surprising that in these conditions, bureaucrats and businesspeople alike take advantage of the situation. Business tends toward short-term strategies, which typically combine a desire for fast commercial success with indifference to legal purity, especially since strict legal compliance is so difficult in a transitional period. The bureaucracy sees new opportunities to extract income through corruption by trading on its power and the exercise of such power.

In a certain sense, corruption is convenient for both sides in resolving problems during the early stages of the transitional period. Yet this convenience becomes a trap in which corruption flourishes. The businessperson then realizes that the legal gaps in his business generate losses and great vulnerability and he begins to understand that it is in his interest to be “clean,” but it is too late for that now. Unrestrained by the authorities or by the public, corruption grows. Bureaucrats’ appetites increase. They no longer want “apples” (bribes); now they want “apple trees” (the business itself or total control over it). As a result, both legal regulation and the actions of the authorities push business into the shadow economy.

Bearing in mind this general picture of the growth of corruption typical in transitional countries, we focus now on the main causes of problems for business. This list is based on interviews that experts from the INDEM Foundation and OPORA conducted with small businesspeople in 2004-2006. In their view, the list of primary problems contains the following:

- Mistrust of government.
- Constant changes in rules and laws.
- Ineffective government regulation.
- The tax burden.
- Black-market transactions.
- Expensive credit.
- Problems with commercial real estate and control by the authorities over the real estate market.
- Low quality of municipal services involving maintenance of leased properties.
- Enforcement and fiscal pressure.
- Corrupt exactions.
- Poor performance by courts and the law-enforcement system.
- Participation in business by the authorities.

Problems that businesspeople cause for themselves include:

- Residual tendency to follow short-term strategies.
- Insufficient knowledge of the law and methods of legal protection.
- Mistrust of collective action.

#### **EXAMPLE:**

Interference by the authorities in the affairs of business is readily apparent in the tender process. The authorities form municipal enterprises whose main function is to conduct tenders. Initially, these enterprises arrange tenders on terms previously agreed upon with “favored” bidders. Then they take full control of this area of business, awarding contracts only to “their own” companies while pushing competitors out of the market.

### 1.3 The “pros” and “cons” of non-corrupt behavior

In their attitudes toward corrupt behavior, business owners may be divided into three groups. The first and largest group comprises those who follow a strategy of passive non-resistance: “Well, if there’s no other way, I suppose I’ll have to. Everyone else is doing it.” The most common example of this behavior is entering into a contract for urban redevelopment. It is illegal, but it serves a noble purpose in principle. Therefore, many businesspeople choose the well-known tactic, since violence is inevitable.

Another group, about 10 percent of Russia’s business community, does not hesitate to use corruption as an active strategy to gain a competitive advantage. Consequently, the larger the business, the more such “activists” there are. There are unlimited possibilities for agreements to cooperate with local authorities on various projects, with the corresponding expenditures for the right to implement the project.

A much smaller proportion of businesspeople choose what is currently the most difficult strategy: to do business without corruption. They strive to avoid virtually all corruption and to comply with all laws, no matter how difficult this is. Some are unsuccessful and go out of business. Others manage to survive, and many of them achieve real independence. Bureaucrats simply get tired of tormenting them because it becomes unprofitable to do so.

The question naturally arises: what discourages people from choosing this exotic strategy, and what would encourage them? Businesspeople themselves cite these obstacles to choosing non-corrupt behavior:

- Low level of legal sophistication among businesspeople.
- Low level of legal literacy among businesspeople.
- Absence of a strong and just government.
- Inability to turn to law enforcement agencies for help and protection.
- Shortage of non-corrupt methods to resolve problems.
- Inconsistency and unenforceability of laws.
- Punitive approach of enforcement agencies.

#### **CASE STUDY:**

After losing five lawsuits in a case against a businessperson in Novorossiysk, a bureaucrat in the tax service finally left him alone. Of course, the businessperson spent a lot of time and money, but that was a small price to pay to achieve increased independence and security, and to maintain a sense of dignity. Soon after, this businessperson became the leader of a grassroots group to protect small business.

Many businesspeople perceive corrupt practices as effective. Here is a typical response from an interview:

“The most effective companies are forced to pay a very large amount of money in order to eliminate obstacles to their growth. We are an ineffective company, because we may spend a year, or two, or three, in an attempt to resolve an issue legally, while others may take care of the problem in a month.”

Perhaps the short-term effectiveness of corrupt practices (which is precisely the issue here) is the best argument in their favor. But the usual result is that in the medium and long term, corrupt practices return like a boomerang and strike a blow against business. Violating the law always places the businessperson in a position of dependency on government bureaucrats, who can apply the law as they see fit and for their own purposes.

## **1.4 Scope of our recommendations**

In light of what we have written above, our call to choose non-corrupt strategies for doing business and our recommendations to implement these strategies may sound highly naive and impractical, coming from idealists who do not understand how the world really works. We assure you this is not the case. On the contrary, although each businessperson knows his particular situation best and we have only a superficial understanding of individual cases, we are quite familiar with the lives of a large number of business owners in every part of the country. We understand how difficult it is to decide to change one's strategy, how life experience and the actions of the Russian authorities can be discouraging. Therefore, we propose a system of simple criteria that can be used to decide whether it makes sense this brochure can be helpful and applicable to individual businessnes:

1. *Long-term strategy.* You can focus on a short-term strategy of making money, or you can take a more long-term view. A business owner who chooses the latter course must be prepared to face difficulties and losses for a certain amount of time in order to enjoy stable and reliable revenues in the future. The choice of a short-term or long-term strategy may be dictated by the type of business, its history, and ultimately the businessperson's temperament. If a long-term strategy is chosen, despite the difficulties of the transition to non-corrupt behavior, it is possible to prepare for losses in this period by making long-term “investments in the future.” Our recommendations may be helpful here.

2. *“The Task of the Augean Stables.”* The vast majority of businesspeople have some sort of *“skeletons in their closet.”* The legal uncertainties of the transition period, the many obstacles to doing business, and simply the search for easy solutions have all led to the accumulation of unlawful baggage. As a rule, most of it gradually becomes insignificant or can be cleaned up with a certain amount of effort. If you are prepared to do this and your “stables” can be cleaned, then you should do it, because that will make it much easier to follow our recommendations.
3. *Need for collective action.* Business owners are often devoted individualists. They want to and can take responsibility for themselves. As they see it, other people often get in their way. They usually believe that “No one is going to help me except myself.” If you cannot overcome this mindset, it will be difficult for you to take our recommendations. A significant number of them involve collective action, for which you must learn to trust others.

That is about it. Now decide for yourself.



# 2

## How to avoid problems when dealing with bureaucrats

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### 2.1 The nature of the environment

In order to choose the correct strategy, it is important to understand that regulation of business activity, administrative procedures, and biased rulemaking is the “business” of bureaucrats. They actively use their powers to maintain their earning power in their markets. The following are the three main areas of the bureaucrat’s “business,” each of which has its own unique features:

- Audits. Violations of the law in the conduct of your business may be identified (or “not noticed”) by a bureaucrat, and negative measures may be taken (or not taken) against your business as a result.
- Administrative procedures (permitting, licenses, approvals, etc.). Overcoming administrative obstacles to the continued operation of your business may be helped (or hindered) by a particular official, several officials, or an entire agency.
- Rulemaking (the adoption of regulatory acts and any official directives or decisions expressing the “political will”) transforms existing markets in the interests of certain groups or categories of business, or in the interests of bureaucrats acting within their discretion on behalf of themselves or companies affiliated with them.

#### CASE STUDY:

In one region, a bureaucrat who was the head of the regional office of Gosstroy (the State Construction Committee) also ran a private firm that performed expert analysis of license applications. The two doors, with the same person’s name on each, were across the hallway from each other. No application could get through without going through this set procedure. After a long period of time and with significant effort, local business associations were finally able to break this vicious cycle. The attorney for a business association gave a legal opinion on the practice, and requests were sent to higher authorities at the regional and federal levels. Ultimately, the public outcry over this conflict of interest forced the bureaucrat to resign from his position as head of the Gosstroy office.

## 1.

A bureaucrat sitting at the “trough” is not committed to making you comply with all the requirements of the law. In fact, if you have no violations, he may be rather annoyed. Considering the fact that no one gets a place at the “trough” for free, the need to “recoup” his investment often creates an incentive for the bureaucrat to act illegally. For example, extra requirements may be imposed on your business, laws that have been repealed may be applied to you, or non-existent procedures may be invented.

### LAWYER’S COMMENTARY

*What gets businesspeople into trouble? As an example, the typical small errors that occur in a grocery store include these:*

- *The sticker containing required information becomes detached from a liquor bottle*
- *The Rules of Sale “fall off the wall”*
- *There is no seal on the posted copy of the license*

*These and other trivial violations are punishable by a fine of up to 30,000 rubles.*

### CASE STUDY:

A company in the cosmetics industry was accused of violating applicable licensing requirements. The stated fine for the violations was 70,000 rubles. A bureaucrat told the company he would not refer the case to court if the company gave him a notebook computer as a “present.” The company manager correctly concluded that good arguments could be made against most of the claims in court, and that it was a bad idea to create a precedent for the bureaucrat to continually “eat at the company table.” As a result of the litigation, only one of the five original allegations remained. The fine was reduced to 30,000 rubles. And in the process, the company gained valuable experience in organizing its affairs. It no longer fears auditors, because absolutely everything is above board. The manager acknowledged that 30,000 rubles was a fair price for this knowledge, and the situation would have been much worse if the matter had ended with a banal bribe.

*Experience in the courts show that the punishment specified by article 2.9 of the CAM RF<sup>1</sup> - a verbal warning - is applied very rarely. The government, acting through its bureaucrats, deprives businesspeople of the right to make a mistake. Even for trivial errors that cause no harm whatsoever, the maximum penalty is imposed.*

*Businesspeople should remember that arguments that you do not feel well, that you are poor, or that you were simply inattentive to the requirements carry no weight in court. Unfortunately, insufficient legal and psychological preparation can bring unfavorable results. Only a sense of responsibility for yourself and your business, continual efforts to improve your legal literacy, and an attentive and exacting attitude to your work can protect you from errors.*

In order to do business in such an aggressive environment, you must clearly understand all the nuances of the laws regulating business and calculate in advance the

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<sup>1</sup>CAM RF – Code of Administrative Violations of the Russian Federation, dated December 30, 2001, No. 195-FZ.

risks and consequences of noncompliance (or the objective impossibility of compliance) with the requirements of the law.

The bureaucrat also clearly understands all the nuances of his “business” and knows all the legal “traps” into which businesspeople unintentionally fall. In this situation it is important to make the correct decision: either accept the lawful punishment once and get out of the trap, or become beholden to a bureaucrat who must be continually “fed.” This bureaucrat wants to reel you in on his hook and never let you get away. Any unresolved violations you have provide him with a constant source of income.

At first, these payoffs may seem negligible and cheaper than the cost of paying fines or correcting violations. However, in the long run these expenses become a major burden for several reasons:

- The bureaucrat’s appetite grows (“the cost of living is going up”);
- If you decide to terminate the corrupt relationship, you will face the harshest punishments, involving attacks by other agencies under the principle of group solidarity; and
- Gradually, the bureaucrat will begin to see your business as his own and may attempt to take it from you (many raiders take over businesses on orders from bureaucrats).

It is important to recognize that you can never predict how far people engaged in criminal activity will go.

## 2.

The most common method used by those who actually want to enter into a corrupt relationship with a bureaucrat is to use the services of legal intermediary firms. This is “outsourced” corruption. Many Western companies operate this way in highly corrupt markets in developing countries, because it allows them to claim that they never pay bribes. Indeed they do not pay bribes. Rather, they pay other companies to prepare their documents, handle administrative procedures, etc. And how exactly the result is achieved is up to the other entity. These intermediary firms are usually affiliated with officials in the relevant agencies.

There is a fine line between administrative barriers and outsourced corruption. Generally speaking, an administrative procedure is considered an administrative barrier when a government or municipal agency charges a fee for its services. In this case it is assumed that the profit does not go directly into the pockets of the officials, but is spent

### **CASE STUDY:**

The majority of firms providing real estate brokerage services and services involving such activities as registration of legal entities and real property, preparation of land and zoning documents, foreign trade, and customs law operate with corrupt methods.

in a lawful manner (although what happens with the revenues of state and city-owned corporations and similar entities is a closely guarded secret). However in the situation when a company mysteriously obtains all necessary documents in a very short time, it is hard to imagine that no compensation was paid to officials. The use of intermediary firms, which is so conducive to corruption, exists everywhere, in various agencies, but it is not yet legally regulated. Paying an intermediary firm for these services is more expensive than making simple cash payments, because some of the money goes toward overhead, taxes, and converting money into cash. However, a customer who pays for these services based on signed contracts and non-cash payments enjoys a significant level of protection.

Another common method of overcoming administrative barriers involves the services of black-market intermediaries. In this case, a significant portion of the money paid ends up in their pockets. Moreover, black-market intermediaries may refuse to return the money in *force majeure* circumstances or simply extort the money.

Without getting into the details of the more subtle forms of compensating officials, we will discuss the cheapest, riskiest, and most common form of making payoffs: putting cash in the official's hand. We must recognize that this is a criminal act, and both parties can fall victim to an unexpected anti-corruption campaign initiated by the other party. Sometimes these situations are staged by agreement between the bureaucrat and officials of law enforcement agencies in order to force the businessperson to make a much higher payoff.

### 3.

In one popular method, the authorities make decisions that restrict or eliminate businesses in a certain category, industry, or geographic area. This is particularly common among regional and local authorities due to the ease of implementing such decisions.

These decisions are generally adopted behind the scenes, without prior debate within the business community, or they are inserted at the last minute into the text of an otherwise uncontroversial document just before it is adopted or signed. There are many examples of this, but here are just a few, involving the most competitive retail markets:

#### ARTICLE 290 OF THE CRIMINAL CODE OF THE RUSSIAN FEDERATION

**Receiving a bribe.** Punishable, depending on the severity and elements of the offense, by a fine of up to 500,000 rubles or imprisonment for up to 10 years. Imprisonment for up to 12 years for a major bribe. The threshold for a major bribe is only 150,000 rubles.

#### ARTICLE 291 OF THE CRIMINAL CODE OF THE RUSSIAN FEDERATION

**Giving a bribe.** Punishment, depending on the severity and elements of the offense, by a fine of up to 500 rubles or imprisonment for up to eight years.

- Increasing the minimum floor space of pharmacies (to 60 square meters).
- Prohibiting sole proprietors from selling alcoholic beverages and increasing the minimum equity capital required for a company to apply for a license to sell alcoholic beverages at retail to one million rubles (or lower, at the discretion of regional authorities).
- Deciding to close mobile retail trade locations within 25 meters of metro stations.
- “Imposing order” by selectively closing small retail outlets (in Moscow and St. Petersburg).
- Closing all flea markets and wholesale markets in order to modernize them, while also changing the ownership of the markets or using the land for other purposes.

Decisions like these are usually adopted at the initiative of specific persons (“lobbyists,” as that term is understood in Russian), and the effect of the decision is to alter the market, often for the benefit of the largest players on the market, or to change the ownership of business entities. The risks of being “sequestered” in this manner grow in proportion to the growth of corruption as a means of successfully competing in the market. This is the unfortunate result of the past few years, and the situation is only exacerbated as markets become saturated. Unscrupulous bureaucrats are the main players in this dishonest competition.

These phenomena can be resisted only through collective action, by joining together along industry or geographic lines, or by acting through large, authoritative business organizations.

Among other things, these organizations can obtain expert analysis of an official directive to determine whether it has its origins in corruption. This becomes relevant in light of Russia’s ratification of the UN Convention Against Corruption.

#### LAWYER’S COMMENTARY

*In the Krasnodar region, an experiment is being conducted for the purpose of improving the operation of chambers of commerce and industry. The governor of the region issued a directive, No. 1088-r, dated November 23, 2006, requiring the local authorities to involve representatives of chambers of commerce and industry in the drafting of laws and other regulatory acts concerning business and foreign trade in the region. Chambers of commerce and industry are working with city and district administrations to find ways to implement this directive. For example, the following arrangement could be recommended for involving chambers of commerce and industry in expert analysis of municipal regulatory acts.*

#### EXAMPLE:

Another typical example of an unfounded decision made behind the scenes was the adoption of a corrective coefficient (K2) by certain local authorities. Business associations objected, and a representative of the city council was invited to a meeting of the regional chamber of commerce and industry. He explained that the K2 coefficient was not adopted on the basis of any sound calculation. They simply decided to extract the maximum amount under the theory that they might “get away with it.” They did not. But this approach to such a serious issue demonstrates not only the weakness and incompetence of the authorities, but also the absolute necessity for businesspeople and business associations to participate in the legislative process.

- *Develop a mechanism to deliver draft legal and regulatory acts for expert analysis, appoint persons responsible for conducting the analysis, and set deadlines to complete the analysis.*
- *Deliver draft legal and regulatory acts to the chamber of commerce and industry in a timely manner for expert analysis and receive the chamber's opinion based on its analysis.*
- *Analyze the chamber's suggestions and comments on the draft legal and regulatory acts and convey them to the appropriate office and departments within the administration for revision of the drafts.*
- *Attach the chamber's opinion to the draft legal or regulatory act as a separate opinion if the administration disagrees with the chamber's comments and suggestions in whole or in part.*

*These provisions should be enacted in a directive or resolution issued by the head of the municipal government and specified in detail in an Agreement on Cooperation or in rules adopted by both parties.*

When choosing a strategy, it is important to be flexible and to understand that in some circumstances, the only way to avoid becoming a victim of administrative extortion is to close the business. However, if you are already in a corrupt relationship, then the more successful your business becomes, the more likely it is that you will eventually lose it altogether. At some point, the bureaucrat will no longer be satisfied with receiving only a portion of your income. He will want all of it. Or your competitor will offer him more favorable terms in exchange for eliminating your business from the market. When the bureaucrat knows your weaknesses, it is easy for him to exploit them to achieve the desired result. Therefore, your task is to minimize corrupt relationships, eventually rejecting them entirely, at least the most risky and overt corrupt actions.

## **2.2 Method of self-defense**

In an environment when a businessperson can be squeezed in a bureaucratic vice between debilitating corruption and the threat of simply losing the business due to bureaucratic opposition, the choice of the correct individual approach is extremely important.

In this section we will describe some of the most important and commonly used methods of resisting a bureaucrat's corrupt intrusion into a business. These are effective, proven principles in the fight against corruption, as demonstrated by the experience of many businesspeople we interviewed at various times. Perhaps this experience will be helpful to you as well.

We will attempt to discover what a businessperson can do independently to reduce the costs of dealing with bureaucrats. First, it is very important to assess the situation accurately and to determine the level, influence, and connections of the bureaucrat. A tactic that might be effective against a low-level bureaucrat may not be useful to resist a higher-ranking official. It is also crucial to assess the extent to which a bureaucrat is interested in putting pressure on a particular businessperson. If you have been individually “targeted,” you must act accordingly. Moreover, the businessperson must assess the chances of success not only against a single bureaucrat, but against the government apparatus associated with him. Solidarity within the bureaucracy may be very strong, in which case the administrative resources directed against the businessperson can multiply.

We now divide our task into two parts and attempt to answer two questions: what to do if a problem already exists, and what a businessperson should do to prevent problems.

First, we will discuss what can be done in a situation in which a bureaucrat is already taking actions that have negative consequences for a businessperson or pressuring him to engage in corruption. The businessperson has a wide range of options for preventative action:

- *Legal analysis of complex or disputed issues.* It is important to prepare for the conversation carefully. You must be familiar with your case. Thoroughly study the documents you have and the legal provisions that are relevant to the specific issue. Being prepared demonstrates a professional approach and will help ensure a positive outcome.
- *Psychological preparation* for speaking with the bureaucrat, and using psychological tactics — they do it, why shouldn’t we? There is a lot of interesting and useful literature now about how to negotiate. Buy a book on the topic, and perhaps it will come in handy in a difficult moment. The most important thing in any negotiation is confidence in your position, and only competence can give you this confidence.
- *A few additional tips:*
  1. Bring a tape recorder and record the conversation.
  2. Talk beforehand with a bureaucrat you know (or another competent specialist) and get their support. The opinion of a professional concerning your problem could have a significant impact on the bureaucrat’s behavior, and this approach does not require you to resort to corruption.

3. Prepare and cite an example of a favorable resolution of an issue in a similar situation.
4. Put your request in writing, and file your letter with the agency regardless of how the negotiations go.
5. If a conflict arises, think of alternative, non-corrupt ways to resolve the problem and put them in writing. If your alternative solutions are beneficial to the public, (equipment for a children's playground, renovation of a school, etc.) it will be harder for the bureaucrat to ignore them.
6. You may wish to obtain letters of recommendation giving favorable comments about your business and requesting help in resolving your issue (for example, a request to renew your lease agreement in light of the extraordinary benefit provided by your business).
7. You may wish to come prepared with a draft letter of agreement on the problem. This makes things very easy for the bureaucrat, who only has to sign the document.

If a conflict has already arisen and the bureaucrat has made a decision that the businessperson disagrees with and believes to be inconsistent with the law, the businessperson can take certain actions to protect his interests, including:

- Appeal the decision through existing administrative procedures, by filing an appeal with the bureaucrat's immediate supervisor or with the next higher agency. Here you will also need the arguments you prepared for the unsuccessful negotiations.
- Appeal to the enforcement agencies or the prosecutor's office. Be careful: You must not make unfounded accusations; your complaint must be supported by specific evidence and references to violations of laws or regulations.
- File a lawsuit. At this stage, the level of legal literacy required of the plaintiff increases dramatically, therefore it is usually best to work with a professional attorney.

When a bureaucrat's decision does not technically violate the law but the businessperson suspects that the decision is based on discriminatory motives, formal legal or administrative procedures will not help. In these situations, the most effective action is to prepare in advance to respond when the decision is made using lawful methods of influencing the bureaucrat: Bringing public attention to the problem, getting business and public organizations involved in the issue, etc. We will cover these measures later, but for now let us concentrate on a few ways in which businesspeople can protect their interests on their own.

## 2.3 Legal remedies

When we interview businesspeople in the course of our sociological research, we often hear examples of legal methods to resist unlawful claims and informal (corrupt) encroachment by bureaucrats.

We have no precise statistics on the frequency and effectiveness of these methods (our data are by nature not quantitative), but we can say one thing with certainty: Legal methods of resisting administrative corruption are much more widespread than commonly believed. Moreover, legal countermeasures against corrupt forays by bureaucrats are successful much more often than we tend to think.

The problem here is in publicizing information. From the bureaucrats' perspective, information about successful efforts by businesspeople in this area is itself a recognition of the bureaucrats' errors, so they try not to advertise these cases. A businessperson who wins a case usually believes, quite reasonably, that his job is done, and he does not spend a lot of time and effort on publicizing his positive experience. Unfortunately, this means that the majority of businesspeople know very little about positive experiences of, for example, successful litigation against corruption. At the same time, unsuccessful efforts are publicized almost immediately, because this helps the bureaucrats strengthen their control over business. As a result, most businesspeople are well aware of the negative consequences of "going against the flow" and rarely see the favorable consequences and benefits.

### LAWYER'S COMMENTARY

*What does the term "legal remedies" include? It means the defense of one's rights and interests on the basis of the law. There can be different approaches to this defense, but the process should be handled by a professional attorney. What should you do if you are facing a specific act of extortion? Many business owners prefer to resolve the issue by other than legal means, by "making a deal," without realizing that this is not the easiest or least expensive route. Consult an attorney, even if you have no desire to get into litigation. You may get some sound advice that will help you diffuse the situation.*

*Where can you find information on legislative developments, federal and local government efforts to support small business, and positive examples of resolving conflicts between business owners and bureaucrats? Contact the nearest business organization. It might be a chamber of commerce and industry, an OPORA office, a business association, a small business support center, or just a law firm. Make a point of visiting these organizations at least once every quarter, just to catch up on the news. This will help you avoid potential problems and resolve existing problems more effectively.*

As a businessperson, a legal defense of your interests against claims by bureaucrats may be effective for several reasons.

First, bureaucrats frequently make demands of businesspeople that are utterly unfounded from legal standpoint. This is done intentionally, because the bureaucrat knows he is in violation of the law and is counting on the businessperson to “save” him. This bluff relies on psychological pressure on the businessperson and assumes that the businessperson is not well-informed about administrative procedures and his rights and duties. The only way to resist is to base your actions on a knowledge of the law, comply with it, and defend your lawful rights accordingly. Therefore, legal methods of defense may be effective, because they make it possible to expose the bureaucrat’s violation of the law immediately.

#### LAWYER’S COMMENTARY

*Business owners encounter corrupt behavior most often in the course of enforcement procedures. In one case, an auditor demonstratively “did not notice” an accounting book that was shown to him and stated in his report that the book was not produced.*

*If you encounter overtly unlawful actions by an official, you may:*

- 1. Suspend the audit until you find someone to be present and be a witness to the audit in your favor;*
- 2. Call and consult with an attorney or a small business support center;*
- 3. Ask for the telephone number of the auditor’s supervisor and call to report the “enforcer’s” unlawful behavior;*
- 4. Use a camera, video camera, or voice recorder to record every detail of the audit;*
- 5. Describe all violations that occur and attach your statement to the audit report, and include a reference to the statement within the report itself; or*
- 6. Make an inventory of all materials, documents, equipment, tools, etc., that are shown to the auditor and attach the list to the audit report.*

#### CASE STUDY:

A businessperson in the restaurant industry was in a difficult situation. A fairly high-ranking bureaucrat had gotten into the habit of coming in for a free lunch. After a while, since the businessperson tolerated this behavior in silence, the bureaucrat started to bring large parties in for dinner, calling it “charitable meals for the underprivileged.” After almost a year, the businessperson decided that he had fed all the underprivileged and bravely tried to protest. This brought a furious reaction from the bureaucrat, along with a flurry of unfounded claims and threats. Only then did the businessperson consult an attorney. A few properly worded letters to the appropriate authorities was all that was needed to stop the shakedown and put the bureaucrat in his place. Of course, there is no comparison between the amount of losses the business incurred during all that time and the cost of professional attorney’s services.

#### DEFINITELY:

- *Verify the authority of the auditor (check the audit order and the auditor's identification).*
- *Copy down all the information about the auditor.*
- *Make sure the auditor fills in all information in the Audit Record.*
- *Do not sign protocols and statements without reading them. Add your own comments if necessary.*
- *Do not sign blank pages if told "we'll write in the rest later." They will certainly write it in, but it will not be in your favor.*
- *Do not take the auditor's word. If he cites a provision of the law, get the exact citation and write it down.*

*This advice is simple, but it is often ignored.*

Second, bureaucrats themselves are frequently ill-informed about the legal details of their jobs. They make mistakes that they are ashamed to admit. Supervisors may also attempt to protect subordinates who are acting unlawfully. In these situations, the use of legal methods of defense immediately lets the bureaucrats know that the business owner is serious, will stand on principle, and intends to win vindication of his position. We have many examples of cases in which a business owner's claims were satisfied as soon as a lawsuit was filed. Quite often the case never even gets to court – when the bureaucrat realizes the legal vulnerability of his decisions, he corrects his position himself.

Third, we have observed a pattern in our discussions with businesspeople in various regions of Russia. Businesspeople who prepare in advance to use legal defense and do not hesitate to use it generally have fewer difficulties with bureaucrats; bureaucrats tend to avoid them. From the bureaucrat's perspective, a conflict with such a businessperson inevitably involves prolonged arguments, attorney fees, and possibly litigation. If the bureaucrat is not 100 percent confident of his position, there is no benefit to him in getting involved with the businessperson.

In order to fight back against a bureaucrat on a level legal playing field, a business owner should have an even better understanding of the law than the bureaucrat. This requires the businessperson either to continually monitor legal regulation of business or to have access to a knowledgeable specialist for consultation.

#### LAWYER'S COMMENTARY

*A professional should really help you understand all the laws. The businessperson's job is to make money. The most common misconceptions among businesspeople are: "A lawyer's services are too expensive, I have no time to meet with a lawyer, and the issue is not that complicated, I'll figure it out myself."*

## EXAMPLE:

In 2004, bureaucrats from the mayor's office in Perm required a fee on top of the price to purchase a license to engage in retail trade. With the support of a coalition of local businesses, a business owner challenged the requirement in court. The Arbitration Court for Perm Province held that:

(1) Local government officials do not have the authority to enforce the tax laws

(2) The absence of a license to engage in retail trade is not an impediment to (or prohibition against) engaging in retail trade (article 2, sections 3 and 4, and article 3 of the Tax Code of the Russian Federation)

(3) District authorities within the city and the administration of the city of Perm do not currently have jurisdiction over issues regulated by the laws on taxes and fees.

*Unfortunately, only those business owners who have had to defend their rights in court understand how much money they would have saved by consulting an attorney at the beginning.*

The first option requires significant costs in acquiring and maintaining knowledge about the laws regulating business. These costs include not only monetary expenditures to purchase legal databases and periodic updates, but also the time and energy required for systematic monitoring and analysis of the law. For small businesses, these costs may significantly outweigh the benefits. According to interviews conducted by the INDEM Foundation, only a small percentage of businesspeople do this work themselves. And those who do generally have a legal education. Typically, based on the examples we have seen, when such a small businessperson immerses himself in the details of the law in this area, he realizes it makes sense to reorient his business. Now he provides legal services to other businesspeople!

Another way is to pay for the services of a professional legal expert. However, the most economical option – paying for a one-time consultation – is not very suitable in this instance for the very reason that it is not systematic. As a result, businesspeople need to search for other options. One option is the legal services available from various business associations. Virtually every business association has either

one legal expert or a whole team of legal experts (depending on the scope of the association's activities) working to protect the business sector's rights, both through pre-judicial procedures and in the courts. Legal services are usually provided to the association's members on preferential terms, something that allows business owners to reduce their costs and is a key factor in attracting new members to such associations.

Conversations with business owners show that all the various legal means of resisting pressure from officials and protecting businesses can be categorized in chronological stages.

### **1. The protection of a business owner's legal interests *before* an official makes a final decision.**

- Contract a legal specialist (a business's own legal expert or a hired specialist) to take part in audits of the business's operations. The legal expert will be able to verify and offer a legal assessment of the auditors'

competence and of the legality of the auditors actions, make sure the results of the audit are properly documented, and put a stop to illegal actions, or document their illegality for the purpose of subsequently appealing them.

- The legal specialist can help draw up letters, statements, and other documents to support a business's activities, since preparing materials in the correct and proper way guarantees that the issues raised in them will be addressed.
- Secure the involvement of the legal affairs departments in the preliminary review of contracts and other documents imposing any obligations on a business.

## **2. The protection of a business owner's legal interests *after* an official has made a decision but within the framework of pre-judicial procedures:**

- After an audit finding has been drawn up or an official denial received from an administrative authority, but before any legal action has been taken, an attempt to appeal may be made to a superior organization. This option requires special expertise as well, since the arguments have to be based on the law. Only then can the action taken be rescinded or reconsidered.

## **3. Pre-judicial defense of a business owner's interests.**

Despite positive experience abroad using pre-judicial methods of resolving conflicts with government authorities, in Russia this option is still almost completely absent. Although, it will eventually play an important role in upholding citizens' legal rights. In the meantime, however, business owners have to focus their efforts on influencing officials during the decision-making process and on protecting their interests in the courts.

### **CASE STUDY:**

The accountant for a small business filed reports with the tax office, and a documentary audit revealed a technical error in the reporting documents. A fine of 13,000 rubles was imposed on the business. The business owner decided not to hire a lawyer, and represented himself in the appeal of the decision before the arbitration court. After a lengthy correspondence with the court, which returned the complaint several times for failure to meet the filing requirements, a hearing was set, at which the small business was shown to be completely unprepared legally. Moreover, the business failed to file its appeal in a timely fashion, so enforcement proceedings had already begun. Only then did the business hire an attorney, who was able to offer real assistance. However, the business's costs to prepare the documents and travel to the regional center for the hearing exceeded the amount in dispute, totaling 14,800 rubles. If the business owner had hired a lawyer before drafting the appeal, the costs would have been minimal.

#### 4. Protection of a business owner's legal interests in the courts.

- An example of the effective use of legal remedies is provided by the ruling of the Arbitration Court of the Republic of Kalmykia (in Elista) in Case No. A22-523/06/12-59 on August 3, 2006 (Bulletin No. 10 [167] of the Russian Federation Higher Court of Arbitration for October 2006), which granted the demands of several sole proprietors seeking the invalidation and non-enforcement of a resolution adopted by the Elista City Assembly to introduce a base profitability coefficient, known as K-2, in the amount of 0.1 for transporting passengers by taxi. The main evidence cited in support of the business owner's position was a precise economic calculation based on objective studies and qualitative indicators that demonstrated their de facto inability to pay taxes at the set rate and the lack of any economic justification for the amount of the K-2 coefficient, which ultimately prevented citizens, in this case business owner, from exercising his constitutional rights.

#### LAWYER'S COMMENTARY

*If the issue involves a change in legislation, do not try to settle the matter on your own. This is a job that takes time and serious preparation. For this reason, the only proper course of action in such instances is to contact a business organization that will represent your interests in a professional manner in the context of the interests of the group as a whole.*

As noted above, business leaders agree that a person who well-informed about his legal rights and obligations and about administrative procedures tends to have a powerful deterrent effect on officials. Over the past three years, the INDEM Foundation conducted a series of special in-depth interviews with business owners in Moscow, St. Petersburg, Saratov, Irkutsk, Smolensk, Volgograd, Velikii Novgorod, and Tver. Our experts also spoke with businesspeople in many other regions of Russia, and everywhere they found a number of individuals who had made successful use of this tactic in dealing with officials. Most importantly, over time these people were harassed less and less often. The strategy produced real results.

Needless to say, another question must be addressed. Was the particular attitude that the officials took towards these business owners prompted by the legal awareness they exhibited, or were the businesspeople merely exceptions to the rule for the officials, since they were an unfamiliar breed of opponent and therefore deemed too bothersome? It is hard to answer this question with any certainty, but in the final analysis, this is not the fundamental concern. The most important thing is the result that was achieved!

Judicial protection for violations of the interests of business owners is a logical continuation of their struggle to assert their rights. Unfortunately, the situation in this

regard, too, leaves something to be desired. There were instances in which business owners had won court cases against officials in all the regions where the INDEM Foundation conducted its surveys. In some cases, business owners had even won a whole series of victories against various government authorities! There was always a downside, however. The business owners usually turned to the courts only as a last resort. This was due to several factors. First, the case backlog means that court cases are heard very infrequently. Second, there are always significant costs associated with the preparation of legal cases. Legal advisers and attorneys are not cheap. Third, unscrupulous judges are often in league with government officials. In such circumstances, it is very difficult to win a case fairly. Fourth, in Russia a legal victory does not put an end to a conflict between a business owner and an official. There have been instances in which, after an official has been defeated in the courts, he has filed further claims, the business owner has appealed them and won, and yet more punitive administrative measures are taken against him.

#### LAWYER'S COMMENTARY

*It often happens that, after a businessperson has successfully appealed the findings of an audit, he becomes the focus of the most varied inspection and monitoring agencies and departments. The businessperson faces the choice of either going to court and putting his work aside, or trying to buy his way out of the situation. When this kind of heavy pressure is applied, the only viable solution is to get help from experts. Gather together your facts and documents, and contact a business association, a consulting service, or a support center. Your situation is not unique; there are ways and means to combat corruption, and they are being refined all the time. The problem cannot be solved unless you get involved.*

Nevertheless, seeking to uphold one's interests by legal means can be an effective tool in the arsenal of the small business owner if he makes proper preparations. First, he must either master the relevant field of law himself or enlist the services of a professional legal expert who specializes in the field. Second, he must combine the legal defense of his interests with effective efforts to uphold these interests in the course of his dealings with the official, and make use of pre-judicial means of resolving conflicts whenever possible. Then recourse to the courts will be just one potential outcome, and it will become possible to use other, less "extreme" ways of settling disagreements before going to court.

This system of legal means of protecting a business owner's interests would seem to be the most effective one. This is also proven by the findings of sociological surveys. For example, many respondents say that dealing with various officials calls for a very flexible approach. Only then is it possible to protect both a business owner's interests in a prompt and effective manner and to make sure the laws are observed.

An important role in enhancing the effectiveness of this system is played by two other areas of such "defensive" activity: Standing up for one's interests within the

framework of administrative procedures, and establishing the best possible interpersonal relationships with officials. These areas will be examined below.

## **2.4. Administrative procedures for the protection of a business owner's rights**

It is hard to say anything fundamentally new about administrative means of defending a business owner's interests. Nothing seems to have changed in this regard. If a businessperson is dissatisfied with a decision made by an official, he has the right to appeal the official's action to the latter's immediate superior.

Traditional policies and procedures remain in place. The process is still simple and readily understandable at first glance, and still relatively ineffective in practice. The main problem is that any appeal is heard within the framework of the same institution and inside the same system. As a result, there is too great a likelihood that upper management will act in the interest of defending the institution's good name and to uphold justice as a secondary concern.

Even so, our observations indicate that it is essential to use this tool all the same. Glaring mistakes by subordinates will always be corrected by their supervisors, and this will save time and money for businesses. The advantage of using this method is especially great in light of the fact that it can be used in the early stages of a conflict with an official and does not entail major outlays for attorneys.

If a business owner is unsuccessful with the official's immediate supervisor, he can go to the supervisor's superiors or to the agency that oversees the department with which the conflict arose. This step entails the most tension in relations with officials, but it also generates more resonance, which may be advantageous in certain situations.

For the most part, this technique can be fundamentally more effective for a business only in instances in which the supervising agency answers to some other authority. In the case of a prosecutor's office, for example, the provincial or federal prosecutor's office would be such an authority.

Our respondents have reported problems in this area. In Smolensk, for instance, the situation is such that all power in the region is highly concentrated and controlled. As a result, appeals to the prosecutor failed to have the desired effect; instead, cases were "quietly dropped." No results were achieved until the parties concerned were able to forward the cases to a higher level.

True, it must be acknowledged that officials at the very top (of the prosecutor's office, in this instance) are not very eager to get involved in such matters either. Very

often, cases are sent back for further investigation into the very “swamp” from which they were extracted with such difficulty. In these situations, *pro forma* letters will not get you anywhere. One has to continue storming the bastions of power. At some point your efforts will pay off.

## 2.5. Characteristics of interpersonal relationships

One distinctive characteristic of relationships between businesspeople and officials is the enormous impact of officials’ personal attitudes toward the businesspeople’s problems and concerns. For example, if an official is sympathetic to a businessperson, or at least not antagonistic or hostile toward him, obtaining a normal solution to the businessperson’s problems becomes wholly realistic.

In order to avoid additional problems in one’s relations with officials, it is essential to follow certain rules derived from experience.

First, a person should be very cautious and not provoke or annoy the official, not provoke a harsh reaction, avoid bravado, take a respectful and “understanding” approach, and show a readiness to work to correct any mistakes that may have been made.

For instance, in your dealings with officials, under no circumstances should you try to show that you are stronger, smarter, more resourceful, and so on and so forth. That is like waving a red cape in front of a bull. The officials will get all worked up and start trying their hardest to prove just the opposite – that they are relevant, irreplaceable, and all-powerful.

The best strategy seems to be to adopt a serious, principled, and respectful attitude based on a search for ways to solve the problem in keeping with the law. Then the official can more easily be persuaded to help, not hinder, the businessperson. In the final analysis, it is not a given that the person you are dealing with is corrupt. It may be that the official is simply eager to augment the city budget. After all, exceptions do exist.

### EXAMPLE:

Very often, business owners subjected to administrative liability by a tax inspectorate as a result of an audit will appeal the auditors’ actions to the superior tax authority. This is almost always completely unavailing. Very seldom does the tax service rescind decisions made by its subordinates. The case goes to court all the same, but time can be lost. If you are sure you are in the right, it is best to go straight to court.

### CASE STUDY:

A small business that produces honey was confronted with demands that it donate money to hold a ballroom dancing contest. After negotiation, a compromise acceptable to both sides was found. The company paid a far smaller amount but became an official sponsor of the event, during which it could display its name, promote its products free of charge and supply honey for a banquet.

One modern school of negotiation holds that in order to achieve a good outcome in a negotiation it is essential to adopt an orientation toward the parties' actual interests, not their fundamental positions. When the question is framed in these terms, the parties can jointly work out a mutually satisfactory solution to the problem. This principle can also be applied to our situation.

Without going into great detail, the simplest and most useful practical advice is as follows:

- Draw up a plan for the upcoming discussion;
- Select compelling arguments;
- Have the necessary documentation ready;
- Anticipate potential objections from the official and prepare responses to them;
- Decide which issues are ones you can yield on and which ones are matters of principle for you;
- Think about what you might offer in exchange, such as paving the square in front of your store, laying out a small public garden across from it, repairing the building's façade, and so on; and
- Find out beforehand what kind of person the official is, where he is from and what his interests are, so as to find common ground and a common language for discussion, to make a favorable impression on him, and to avoid unnecessary psychological problems in your dealings with him.

Needless to say, these techniques will not have any effect on an inveterate bribe-taker, but not all officials are that unapproachable.

Various methods of exerting a psychological influence on the official can be quite effective, such as:

- Pointedly switching on a tape recorder,
- Starting to videotape the encounter,
- Inviting witnesses to take part in an inspection or audit, or
- Displaying calm and self-confidence.

In the final analysis, if officials don't have any qualms about putting psychological pressure on businessmen, why not employ defensive countermeasures?

# 3

## Using civil society institutions to protect business

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Civil society institutions can be very effective in helping to defend business interests. To this end, such institutions have to command respect in government agencies and business circles alike. They have to be represented in discussion forums between business and government at the municipal level, in the region or at the federal level as legitimate representatives of the business community. The institutions may take the form of business councils attached to municipal administrations; various types of noncommercial organizations representing the interests of small business; trade unions; advocacy groups seeking to solve specific problems; business committees and commissions operating under chambers of commerce and industry; and other kinds of business associations. These organizations must have considerable expertise in order to identify problems in a professional manner and propose constructive ways of solving them, and be of interest to media as a source of information and competent expertise where business affairs are concerned.

Influential non-commercial organizations can protect business interests (or business association's interests) mainly by sending pertinent appeals to government authorities and calling attention to problems and potential solutions in various discussion forums operated by government agencies, as well as through the media. In some instances, such organizations sponsor mass events aimed at drawing public attention to a specific problem confronting businesses.

First and foremost, the involvement of civil society institutions in protecting a business owner's rights offers a means of depersonalizing the problem. The fact that a non-commercial organization can be more objective than a given commercial structure is especially important when the matter involves a violation of the rights of a specific business owner. Above all, this offers a way to protect a business owner as much as possible from attempts by the official who created his problems to settle scores with him. Moreover, some appeals from business owners themselves to government

### EXAMPLE:

One example is the involvement of noncommercial organizations around the country in the fight to lower the amount of the K-2 adjustment coefficient. In many regions, such opposition has been successful thanks to the solid professional efforts of specialists affiliated with business associations.

## CASE HISTORY:

The Krasnodar region issued a directive stating that, whenever a market is renovated, businesses must without fail be provided with retail space within the bounds of a municipal entity. The directive is a positive example of effective work by business associations.

institutions are aimed at promoting their own interests and often infringe to some extent on the rights of other participants in a given segment of the market. An appeal from a prestigious non-commercial organization, especially a regional or industry-based association of businesses or a nationwide organization (or regional division thereof) to the relevant government department carries much more weight and guarantees a measure of objectivity in assessing the problem. The more influential the organization, the greater the likelihood that effective steps will be taken to address the matter and that a detailed response will be received, as

opposed to a perfunctory reply that sends the appeal back to the official who already figures in it.

In many cases, however, problems are common to a whole category of business owners. For example, such problems might have to do with some regional issue that impedes continued business activity. They might also involve systematic violations of a business owner's rights by officials working in a specific department, such as action or inaction on their part that hurts business. In such instances, assistance can be provided to a particular business owner by resolving an issue that poses a problem for many of his colleagues.

The efficacy of a non-commercial organization's appeals to a government authority is contingent on many factors, mainly the influence that the organization wields in the region where the problem arose. The political will of local and regional authorities to foster a favorable business climate (or, on the contrary, to maintain a decidedly corrupt climate) is of great significance. In the Tomsk region, for example, the governor is very progressive and enlightened and works hard to battle administrative barriers and combat corruption. However, this example is sooner the exception. A list of regions in which the situation is just the opposite would be very impressive, and the question of exactly which regions would top the list is a challenging one.

Also important is how efficiently an organization goes to work in drafting letters to government agencies, and whether it cites sufficiently compelling arguments and selects the right recipients. To a considerable extent, this is a function of how effective the leader or group of leaders of the particular civic institution is, the resources at the institution's disposal, the leaders' understanding of the workings of such institutions, and the organization's personnel resources.

Adequate resources are one of the most important conditions for an effectively operating noncommercial organization. It is not imperative that these resources take the form of outright financial resources. They can also take the form of assets provided

by businesses (such as office space, office equipment and communications), personnel support (for example, the organization's personnel might be paid by a commercial structure, or a commercial structure might provide consultants), and information support (the creation and maintenance of Internet resources or the provision of airtime by commercial media outlets or space in commercial publications). It is not difficult to find various structures interested in fostering a favorable business climate; success depends on the degree of trust in those who initiate the process.

Extensive involvement by activist business owners in the operation of business associations can greatly enhance these business owner's social status, ensure that they will have civilized support in government structures, and help them gain a certain amount of publicity. All these things will help businesspeople protect their businesses against unscrupulous officials.

It is important that the activities of a non-commercial organization not boil down to serving the particular commercial interests of a specific group, because this will soon become evident and others will become wary of the organization's initiatives. Prestige, influence, and "political capital" are won through patient and persistent efforts to promote the social well-being of a broad range of representatives of the business community.

If a given region does not have any influential business organizations and the business environment is in need of substantial improvement, it makes sense for business owners to join together and create a new and active noncommercial organization. Such an organization can carry on its activities both independently or in partnership with a larger non-commercial business structure. For example, the organization can make tougher and more radical demands of the authorities with regard to some specific problem and stage mass protests, while asking the stronger and more influential organization (for example, OPORA, the Chamber of Commerce and Industry and others) to search for a compromise and settle the conflict.

### **CASE HISTORY:**

A city assembly decided to privatize some municipally owned properties that had been leased to businesses. It approved a privatization plan that included various facilities that had been leased for many years. The business owners had spent enormous amounts of money to renovate the facilities, most of which were abandoned basements, and had set up business operations in them and just begun to earn a profit on their investments. Then the properties were put up for sale at auction and bought by third parties. A conflict arose between the businesses and local administration officials. After negotiations involving the business owners, business associations, and the government officials, a compromise was found. A regulation was adopted spelling out procedures for reimbursing lessees for costs incurred in renovating facilities in the event the facilities were to be auctioned off.

## LAWYER'S COMMENTARY

*There are three main principles that business associations should observe:*

- *They should be organized according to the regional principle (for example, the Business Alliance of the Southern District of the City of \_\_\_\_\_);*
- *They should be organized by profession (for instance, the Union of Book Sellers); and*
- *They should be set up to deal with a specific task (for example, an advocacy group to work with the local administration in revising an adopted regulation, such as the aforementioned K-2 coefficient).*

*All methods of joining forces are good if they achieve their intended objective and help protect business interests.*

Another option is to join an existing organization or open a regional chapter of a national business association. By taking proper initiative and an active stance, business owners can significantly enhance the prestige of an existing noncommercial organization in a given area.

Being influential at the federal level does not automatically provide the same standing at the regional and local levels if a business association fails to do any effective work in those areas.

The activities of OPORA offer an example. OPORA is actually two organizations joined together under one brand:

- The OPORA Union of Business Associations (the members of which are associations, unions, guilds and other noncommercial business groups); and
- The OPORA of Russia, a national civic organization of small and medium-sized enterprises (consisting of individual members and with 80 regional chapters throughout Russia).

## EXAMPLE:

Business associations provide:

- legal experts familiar with practical issues;
- access to legal information;
- equipment and technical support;
- contacts with the public and news media outlets that can generate public resonance;
- opportunities to establish dialogue with the authorities;
- exchanges of ideas with other regions;
- authoritative opinions; and
- financial resources.

## CASE HISTORY:

To fight back against what was in effect legalized fund-raising for so-called "municipal needs," businesses established a City Assistance Fund and contributed money to it. Whenever the local administration asked one of the business owners to provide assistance to the city, the request was forwarded to the fund and reviewed by its board of trustees, which decided who would get how much money, and when and where the funds would be sent.

In just a few years, OPORA has become very influential at the federal level and participates in most public consultative bodies under the auspices of federal agencies. More recently, federal agencies have regularly sent various draft regulations and directives to OPORA for expert review. This makes it possible to exert influence on the adoption of critical decisions regulating business activity and to solve numerous problems.

The following is a list of successful OPORA initiatives:

- 2003: Significant amendments to the Law on the Police relating to inspections, which now require an inspection order and the presence of witnesses. The amendments also limit the powers of the officers of the Ministry of Internal Affairs officers to suspend business owner's activities.
- 2003-2004: The government adopted a decision declaring it inadvisable to set up special accounts for payments of value-added tax.
- 2004: OPORA played a role in formulating administrative reforms aimed at reducing redundant government functions, a result of which was the abolishment of the Russian Grain Inspectorate.
- 2005: Extrajudicial procedures for suspending business activities were rescinded (by amendments to the Code of Administrative Legal Offenses).
- 2005: The Prosecutor General's Office issued a directive establishing prosecutorial oversight of compliance with laws intended to protect the rights of business entities.
- 2006: OPORA's proposals were taken into account in the draft law on efforts to develop Russia's small and medium-sized enterprise sector.

For the time being, however, many decisions are still taken without any effort to get feedback from market participants, and the business community finds out about such decisions only after it is too late to organize any meaningful opposition against such ill-considered decisions. As a rule, such situations arise from lobbying efforts on behalf of the commercial interests of influential groups.

A recent example is changes in the laws regulating the sale of alcohol. The changes entailed a ban on the retail sale of alcohol by sole proprietors, a ban that benefited large companies and led to a decline in business for many smaller enterprises. The introduction of the unworkable Integrated National Automated Information System

### **EXAMPLE:**

The following is an example of the activities of the Realtors Union. All enterprises providing services in the real estate sector and belonging to the association may use a well-crafted package of documents that include standard service contracts. In addition, members of the union sign a code of conduct and a set of rules for providing realtor services. A staff legal specialist works to protect realtors' rights and interests. All of these measures are designed to provide guarantees of good faith and legality in business activities, and generated respect for and trust in the realtors on the part of both clients and government officials.

(INAIS) to track alcohol products and the need (in connection with that system) to re-label all wine and liquor triggered an extremely serious crisis in the alcohol market. Acquisition of the costly INAIS system, on the production of which, Atlas, a company with ties to the Federal Security Service, had a monopoly, became mandatory for all participants in the alcohol and perfume markets.

During this crisis, the government ultimately adopted a proposal put forward by an OPORA representative. It called for allowing businesses to provide the Federal Tax Service with manually-generated information about alcohol turnovers. Adoption of the proposal made it possible to restore operations of the alcohol market, at least partially, and to prevent the total paralysis of the market.

The changes also affected perfumes containing alcohol and led to a serious disruption of the perfume market. Thanks to the efforts of OPORA representatives, it only took four months to reverse the changes, making them no longer applicable to perfume. Unfortunately, the damage that was done will continue to take a toll on the sector for some time to come.

However, OPORA's prestige at the federal level has by no means translated into similar clout for its regional chapters, unless that prestige has been backed up with vigorous work in the regions. For their part, some regional leaders are not interested in working with OPORA representatives. Protectionism with respect to large monopolies and other companies affiliated with regional officials is incompatible with any civilized dialogue between business and government. High levels of corruption and the avoidance of personal responsibility make it impossible to resolve many issues at the regional level and force the business community to turn to federal authorities.

In such regions, a situation in which a business owner struggles to protect his rights on his own can result not only in the loss of his business and property, but also in incarceration. Sometimes it can even cost a business owner his life. Systemic corruption can be battled only by systemic methods, and authoritative and influential civil society institutions are major components of such a system. Support for these institutions on the part of business owner and their personal involvement in the organizations' activities are one of the most reliable means of protecting a business owner's rights.

# Conclusion

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Unfortunately, the ideas and recommendations proposed herein cannot be viewed as universal. In each individual situation, a business owner has to decide for himself which methods, and in which proportions, should be employed to achieve the best possible results in his dealings with officials. The principles cited above are basic guidelines for strengthening and defending the positions of business owners who are unwilling to take part in corruption in carrying out their businesses activities.

The only fundamental requirement is a consistent renunciation of corruption as a matter of principle. Practically speaking, it is impossible to battle corruption and, at the same time, use it to further one's own interests. Therefore, sooner or later business owners will be faced with the need to devise a strategy of action to combat corruption or an anti-corruption strategy that can be followed by business associations.

Assistance in this extraordinarily important and worthy cause can be provided by a framework anti-corruption strategy developed specifically for regional business associations. This strategy can be examined in the appendix to this brochure.

A "framework" strategy implies a strategy that describes general tools and areas of activity; the specific measures and actions to be taken must be devised by the business owners themselves. In the final analysis, no one has a better knowledge or sense of the situation in your region than you.



# Appendix: Anti-corruption strategies for business

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Efforts to solve many problems in dealings between businessmen and officials can be simplified considerably by employing the principles of an anti-corruption framework strategy.<sup>2</sup> This strategy makes it possible to design and systematically organize anti-corruption activities that can be carried out by individual business owners or business associations. It also sets forth guidelines for enhancing the effectiveness of these activities and for reducing the individual business owner's costs incurred from participation in anti-corruption efforts.

The overall set of proposed measures can be divided into three interrelated groups:

## 1. Guidelines for individual business practices

These guidelines are geared toward changing everyday interaction between individual business owner and officials of various government and municipal structures. For business owners, it is important that the following principles be observed in their work and dealings with officials:

1. Make every effort to comply with current regulations. This is the only way to deprive officials of any grounds for demanding bribes and to achieve independence from them.
2. Know the laws and other regulations governing your business and the oversight functions of government agencies. Very often, officials are not very well informed about the details of the legal regulations that apply to their own activities and the activities of businesses, and if a business owner's disagreement is well-reasoned and backed up with facts, they will "forget" about their original complaints.

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<sup>2</sup> This strategy was devised by the INDEM Foundation in 2004 within the framework of the project "Business and Corruption: Deterrence Issues in 2004" and with the support for Center for International Private Enterprise; it was refined and adjusted in light of the findings of subsequent studies conducted by the foundation.

3. Monitor changes in laws and other regulations. It often happens that officials cite business regulations that are no longer in effect. In such situations, this is an effective means of countering unjustified complaints.
4. Use “audit logs.” Some businesspeople say they provide a good way to keep track of the frequency of audits and inspections, and that the practice creates at least some barrier to unchecked and irregular audits and inspections.
5. Search for, and make use of, available experience involving effective individual interaction with officials.
6. Strive to pool your efforts with other business owners and search actively for common ground with them (other business owners do not necessarily need to be involved in the same kind of activity as you).

## **2. Guidelines for joint activities of business owners**

This set of guidelines is the most important element of an anti-corruption strategy and is geared foremost toward business organizations (associations, groups, etc.). Individual efforts to counter corruption in national or municipal governmental and administrative agencies are much more effective if they are pooled collectively. In contrast, the business owner who tries to implement an anti-corruption strategy by himself is the sole focal point for all the pressure and dissatisfaction of corrupt officials. As we know, officials at different levels almost always have at their disposal repressive mechanisms and means of suppressing discontent. At the same time, that individual business owner is working for the benefit of all businesses, since he is trying to replace the ineffective, corrupt practices of government officials with more effective, uncorrupt methods. He is therefore entitled to the support of other business owners.

Although there are many high priority measures that should be implemented as quickly as possible, the following can be singled out:

1. Help officials realize that thriving businesses benefit them. Give officials incentives to cooperate with business in anticorruption efforts. This is rather hard to do, but entirely realistic nonetheless.
2. Foster an environment of constant and comfortable corporate communication. This is very important in order to maintain regular information exchange among business owners.
3. Collect and disseminate experience involving positive examples of anti-corruption behavior. This will make it possible to greatly enhance a business owner’s resistance to outside pressure.

4. Develop, introduce, and monitor compliance with with ethical business norms and sanction entrepreneurs who violate them. Collective business organizations should work to raise business ethics in their regions and should exercise a certain amount of oversight over their members' compliance with such standards.
5. Set up an integrated service to monitor changes in the law and to communicate essential information to association members.
6. Develop "rapid legal response" services that can provide instantaneous legal counseling by phone or on site – a kind of "legal first aid service" – in situations involving violations of the rights and interests of business owners.
7. Realize the potential of business associations to collectively defend individual business owners in court and in administrative proceedings. To this end, it might be necessary to create organizations that can provide legal protection to business owners. Their services could be paid for both in a centralized manner (i.e., directly through an association) and on an individual basis (using preferred rates for the business association's members).
8. Organize seminars, roundtable discussions and advanced training sessions (in economics, legal matters, accounting and other aspects of business operations) for small business managers. Officials from relevant government agencies might be invited to practical seminars devoted to specific topics. Such seminars can be used to provide practical information and recommendations concerning the legal resolution of various issues. This will also make it possible to find out sooner about impending changes in the practices of such agencies and to better prepare for them.
9. Offer social-psychology training sessions for small business managers, with a focus on fostering the necessary climate within a team.
10. Collective business associations should offer information and consulting services to businesses on a wider scale. For example, they could seek out new fields of activity for small business and provide assistance in assimilating such activities. Many business owners look to collective business associations for consulting services in analyzing market conditions and other matters.

11. Business associations, foundations and individual businessmen should support the activities of non-governmental, non-commercial organizations working to protect various rights, such as helping citizens and businesses uphold their property rights. The sheer fact that social protection is available for private property rights will develop this economic institution, promote the solution of problems confronting business, inform and instruct citizens, and improve their attitudes toward business. Experience shows that such activities are carried out more effectively by non-commercial organizations, not by business associations per se.
12. Cooperate with government officials in improving and stabilizing national and municipal regulation and administration.
13. Communicate the negative effects of corrupt business strategies to business owners, and explain the factors that give rise to corruption and its negative consequences.
14. Exert a stronger influence on public opinion and officials through the news media, which is a major resource through which civil society can influence the government.

Plans should also be made for measures that will take a longer time to prepare:

1. Opposing “milking-cow” businesses set up by officials by staging collective boycotts (depriving them of revenue), offering alternative (competing) services provided by business associations, and pursuing criminal prosecution in court in instances that violations of the law come to light.
2. Centralizing charitable activities at the local level by financing festivals, providing public services and amenities, and so on through centralized foundations.
3. Putting pressure on government officials with a view toward ensuring transparency and information disclosure in the following matters: municipal and regional ownership of real estate, municipal and regional land ownership, land-related transactions, transfers of buildings from residential use to non-residential use, the provision of non-residential facilities for use, and bidding competitions and tenders for orders and purchases.
4. Setting up special expert councils of business owners under legislative and executive agencies to conduct assessments and expert reviews of decisions by these authorities that affect business. The degree of influence exerted by such expert councils will depend on the effectiveness, professionalism, and activism of business associations.

5. One area of activity for expert business councils is the conduct of regular anti-corruption expert assessments of all draft laws and regulations that are under consideration by government authorities and might affect the interests of business. This will have the effect of limiting government authorities' ability to adopt decisions that will encourage the development and expansion of corrupt practices from the outset.
6. Extending commercial loans to small businesses on preferential terms. The terms of these loans must not be beyond the means of the relevant categories of business owners and should complement the capabilities of administrations at various levels and the banking system to make actual loans to businesses. In the initial stages, projects of this kind will not be profitable, but over time they will be fully capable of making a profit for those who undertake them.
7. Such projects will have the additional anti-corruption effect of promoting swift and objective audits by the business community of businesses that apply for these loans. Even if non-bank lending to small business cannot be arranged, the practice of public audits is very important, since it can demonstrate or verify the honesty and transparency of firms belonging to business associations.
8. Steps can be taken jointly with government authorities to create "business incubators" – i.e., business centers in which a newly established or developing business can obtain comprehensive assistance in dealing with various organizational issues (such as registration, leasing, accounting, etc.). The purpose of these structures would be to simplify market entry for beginning business owners. Government officials could be encouraged to take an interest in such activities, which would be very useful to them as well. More business means more acclaim, more political dividends, more tax revenue, more jobs, more resources with which to tackle social problems, and so on.
9. Gathering information about, and prosecuting, officials who violate laws and the legal interests of business owners.
10. Organizing refresher training (at the regional level) for officials of agencies that are in constant contact with business, and also, as a subsequent step, training personnel for national and especially municipal administration.

In implementing collective measures under an anti-corruption strategy, business organizations are advised to use the "foot in the door" approach. First, they need to reach agreements of a general nature with officials, agreements that include a statement of intention to jointly tackle corruption, listing several areas of activity. Generating

the greatest possible publicity is key. The next step should be to inform the public of the newly created partnership. Then, before public interest wanes, put forward some sort of initial proposal. As the authorities begin to analyze that proposal and are focused on it, unveil another proposal. All of these measures should be carried out as publicly as possible, so the authorities have less of a chance to renege on their original commitments.

It is also very important to publicize individual membership in business associations. For example, a sign stating that a business is a member of an association can be posted in the business's office. Such signs make it possible to instantly identify a business who belongs to the association and provide additional symbolic protection against illegal encroachments.

### **3. Strategic political and administrative measures**

Systemic opposition to corruption at the regional level requires the adoption and implementation of many decisions at the federal level of government. Over the long term, the business sector should also consider the following fields of activity, which involve problems that have a considerable impact on the efficacy of anti-corruption policy in a given region:

1. Business associations should present valid arguments and lobby for redistributing taxes in their regions and at the municipal level.
2. Coordinated actions should be taken in privately owned media outlets against especially corrupt individuals.
3. Business associations should take part in elections in which they support anticorruption platforms and candidates working to combat corruption.
4. Alliances should be formed between grassroots business organizations and national parties with the aim of taking and holding on to power at the grassroots level.
5. Business associations and non-commercial associations should monitor expenditures of budget funds by national and municipal administrative authorities.



