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Firm entry and exit during a crisis period: Evidence from Russian regions

Ichiro Iwasaki[a,*], Mathilde Maurel[b,c,d], Bogdan Meunier[b]

[a] Institute of Economic Research, Hitotsubashi University, Tokyo, Japan
[b] Centre d'Économie de la Sorbonne, Université Paris 1 Panthéon Sorbonne, Paris, France
[c] Centre National de la Recherche Scientifique, Paris, France
[d] Fondation pour les Études et Recherches sur le Développement International, Paris, France

Abstract

In this paper, we aim to empirically analyze the determinants of firm entry and exit in Russia using a regional-level panel data for the years of 2008–2014, with special emphasis on institutional failures and the politico-economic impact of external crises. We found that these two elements exhibit statistically significant and economically meaningful effects both on the creation and destruction of Russian firms, controlling for potentially explanatory factors. Our empirical results also suggest that the process of firm entry and exit is manifold across Russian regions due to their heterogeneity. Nevertheless, a surprisingly robust estimate of the world oil price (irrespective of the difference in target regions) suggests a possible high exposure of each Russian region to a global crisis. This comes from the importance of oil trade with the world and, accordingly, the ongoing crisis may bring a harmful influence to regeneration of Russian businesses.

JEL classification: D22, F15, G01, P31, P33
Keywords: firm entry, firm exit, institutions, economic integration, crisis, Russia.

1. Introduction

One generation after the launch of the perestroika, two features characterize Russian business relative to many other transition countries: first, barriers to entry are considerably more pronounced and second, as a result, the extremely low

* Corresponding author, *E-mail address*: iiwasaki@ier.hit-u.ac.jp.
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level of firm entry in Russia by international standards. The Amadeus dataset, which is restricted to firms with more than 50 employees, provides a record of formal entry and shows gross entry rates from 1999 at below one percent. Entry rates are significantly lower in Russia than in other former socialist economies, and even these are (negative) outliers by developed economy standards (Aidis and Estrin, 2006; Aidis and Adachi, 2007; Aidis et al., 2008). For comparison, in Brazil the gross entry rates are up to 14% and net entry rates in China and India of over 6% pa and 3–4% pa, respectively. The picture that emerges is a blessing curse, as growth is fueled by oil exports, while other economically important areas, such as small and medium enterprises (SMEs), are underdeveloped.

The reinforcement of SMEs is key for the emergence of values and norms attached to the market economy. In terms of purely formal constraints, Russia performs relatively well; but enforcement is poor. The rule of law is also weak, creating uncertainty and non-consistency, which is damaging to the firms' prosperity. The absence of confidence in investing at home is reflected by the net private capital outflows, which stood in 2014 at $150 billion, equivalent to 8% of GDP. One of the main problems faced by Russian business owners is illegal practices such as bribing and corruption, as repetitively reflected in the Russian firms' survey by the World Bank. The fatality of being involved in corruption activities constitutes the main pervasive and self-reinforcing entry barrier.

The World Bank doing business indicators provide useful information for assessing the quality of the business environment across a large set of countries: ease of doing business, starting a business (licenses), getting electricity, registering property, getting credit, protecting minority investors, enforcing contracts, resolving insolvency. As reported by Doing Business, Russia ranks 13th out of 25, its worst position being registered under the *protection of minority investors*, *trading across borders*, and *dealing with construction permits* items. Two out of those three indicators correspond to our research questions: *Trading across borders* records the time and cost associated with the logistical process of exporting and importing goods. More precisely, it measures the time and cost (excluding tariffs) associated with three sets of procedures — documentary compliance, border compliance and domestic transport — within the overall process of exporting or importing a shipment of goods. This indicator describes the logistical obstacles towards a deeper integration of Russian enterprises into the world economy. *Protection of minority rights* measures the strength of minority shareholder's protection against misuse of corporate assets by directors for their personal gain, as well as shareholder rights, governance safeguards and corporate transparency requirements that reduce the risk of abuse. One interesting component in the building of the protection of minority rights is the ease of shareholder suit index, which is one of our variables of interest.

Another pernicious feature of the Russian economic performance over the recent decades is the continuous fall of non-energy goods and services in total exports, echoing the weaknesses of SMEs in the manufacturing and service sectors, while oil represents the lion's share of total trade. In fact, in recent years, the concentration of Russia's economy in the oil and gas sector has steadily increased over time. In addition, Russia's non-energy sector has become less competitive in world markets. While the volume of the nation's non-energy merchandise exports grew at an annual rate of 11% in 2010, they grew by only 7.6%