How Russian Enterprises Cope With Payments Problems
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Abstract: An American specialist on Russian economic law and managerial behavior examines the means by which enterprise directors cope with non-payments. Analysis is based primarily on evidence from six in-depth case studies of industrial enterprises in Moscow, Saratov, and Yekaterinburg. On-site observation of managerial routines complements intensive interviews with a range of managerial personnel and examination of sales contracts and other documentary records. The author identifies three basic patterns of adaptation to the threat of insolvency, the factors that explain the managers' behavioral choices, and the implications of these changes for the broader banking, inter-enterprise, and legal systems.

Russian industrial enterprises have proven remarkably tenacious. The past decade has brought many unexpected twists and turns in their road, to which they have responded with varying degrees of success. Some have flourished. Most have been left battered and bruised. What is striking is how they cling to life, even in the face of insolvency. Logic would seem to dictate that unprofitable firms would eventually be forced to exit from the market. But the seemingly perpetual existence of Russian enterprises appears to confound the logic of the market. In this article, I explore how these enterprises routinely go about cheating death. More specifically, I lay out several common coping mechanisms and identify the factors that influence the behavioral choices of enterprises. While the details of these tactics are of intrinsic interest, their consequences are more far-reaching.

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Enterprise debt, in its many forms, is hardly a new phenomenon in post-Soviet Russia. Industrial enterprises have been coping with high levels of debt since the onset of the transition. Much media attention has been paid to the inability of the central state to collect taxes. A significant percentage of the unpaid taxes are owed by industrial enterprises. In addition, many enterprises owe money to their trading partners. The disintegration of the planned economy brought greater autonomy to enterprise management. With autonomy came responsibilities. These only increased with privatization. No longer could enterprises blithely assume that the state would bail them out of difficulties. Inter-enterprise sales no longer amounted to moving money from one pocket of the state to another. Sellers actually expected buyers to provide value for these goods, in either monetary or in-kind form. In the post-Soviet period, there have been successive waves of inter-enterprise debt (see generally Woodruff, 1999; Ickes and Ryterman, 1992 and 1993).

Under normal circumstances, payment both to the state and to private creditors takes place through bank transfers. Contracts routinely include detailed information about the bank accounts of both parties, which should allow payments to be made in a way that minimizes transaction costs. In practice, however, the process has proven rather unwieldy. Most problematic has been the sluggish pace of processing payments thanks to the underdeveloped nature of the Russian commercial banking system. Although the number of days necessary to receive payment has declined in recent years, there is still a sense of uncertainty that pervades transactions. Further complicating matters is the growing tendency to require prepayment before shipping goods, particularly for unfamiliar customers. From the seller’s perspective, this requirement can be seen as a rational response to the epidemic of non-payments. But in a world where payments are processed slowly, it has the unintended consequence of decelerating sales transactions more generally.

2Since 1993, non-payment cases have comprised more than 40 percent of the caseload of the arbitrazh courts (Hendley, 1998). When considering that only a tiny fraction of non-payments are ever litigated, the total number of defaults is undoubtedly astronomical.
3For more on inter-enterprise debt, see Woodruff (1999) and Ickes and Ryterman (1992 and 1993).
4The dual monetary system inherited from the Soviet period made this necessary (Woodruff, 1999; Poser, 1998, pp. 164-165).
5Seventy-four percent of surveyed enterprises reported that their sales contracts include some form of prepayment (Hendley, Murrell, and Ryterman, 1999a).
6As part of the survey, we asked procurement directors how many days elapsed between the time they ordered their bank to pay a typical supplier and that supplier’s receipt of the payment. The mean number of days for each region is set forth parenthetically. The first number is for intra-oblast' transactions and the second number is for inter-oblast' transactions: Moscow (3.58 / 8.4); Novosibirsk (4.66 / 10.1); Yekaterinburg (4.85 / 8.67); Saratov (4.87 / 11.1); Voronezh (5.73 / 10.87); and Barnaul (8.3 / 14.45). Poser (1998, pp. 168-169) has a general discussion of the issues surrounding prepayment. For a more comprehensive analysis of regional variation in how enterprises do business with one another, see Hendley, Murrell and Ryterman, 1999b.
When payment is not forthcoming, sellers can pursue delinquent buyers in a variety of ways, ranging from informal negotiations to litigation (Hendley, Murrell, and Ryterman, 1998). If the seller opts to pursue legal action, it will likely emerge with a court judgment covering the amount of the debt. If payment is not forthcoming voluntarily, it can seek to collect the judgment directly from the buyer's bank with the assistance of a court order (ispolnitel'nyi list). If the funds contained therein are sufficient, then the amount of the judgment is transferred to the creditor. When debts exceed available funds, the bank keeps track of the unpaid bills in two separate files, or kartoteki. Amounts owed to the state are recorded in kartoteka 1, and amounts owed to private creditors are recorded in kartoteka 2. Once these kartoteki are established, any money that comes into the bank account is automatically transferred to the creditors, according to the priority established by law (Art. 855, GK). The bank has no discretion in this matter. The law requires that obligations to the state be satisfied before wages or private creditors are paid.\(^\text{10}\)

Private creditors may elect to be more proactive in seeking recovery after prevailing in litigation. They may seek the assistance of state agents charged with enforcing judgments (судебные приставы), who can force debtors to sell assets to satisfy a judgment. In 1997, the rules governing these судебные приставы were completely revamped with the goal of making it easier for courtroom victors to recover (Belousov and Martynova, 1999; Sklovskiy, 1999). Even so, the process remains cumbersome and expensive for creditors. None of the case study enterprises had resorted to the судебные приставы. Neither had they pushed their debtor-buyers into bankruptcy, though the law permits it.

Enterprises have adapted to the rules requiring banks to reallocate any funds that come into kartoteka-encumbered accounts by opting out. Once debt appears on the kartoteki of their bank accounts, they typically respond by ceasing to use these accounts. Their rationale for doing so is obvious since they lose all control over funds that come into accounts with kartoteki. More interesting are the specific tactics used by enterprises to survive in this business environment. Through the case studies, I have identified three distinct coping strategies. A careful analysis of the settings in which each behavioral pattern arises allows me to ferret out possible causal factors. Following that, I turn to a discussion of the consequences of these short-term solutions for the institutional landscape of post-Soviet Russia.

### DEALING WITH ENTERPRISE DEBT: THREE PATTERNS

#### Pattern 1: The Shell Game

Some enterprises respond to debt by funneling their operating funds through the bank account of a seemingly unrelated company. This company may be created specifically for this purpose or may have been created for another purpose. The only essential quality is that its bank account be debt free. A good example of this coping strategy is provided by a Moscow enterprise that produces consumer goods, Московская Бытающая Техника (MBT).\(^\text{11}\)

MBT began production in 1923, and its trophy cases are replete with awards bestowed during the Soviet era. It was privatized in February 1993\(^\text{12}\) and is presently an open joint stock company (Тikhomirov, 1996). Although insiders initially owned a majority of MBT stock, 85 percent of the stock is now held by outsiders, including a 42 percent stake owned by an American consumer goods company. The Moscow city government has retained a 15 percent equity interest. Both of these large stakeholders are represented on MBT's board of directors.\(^\text{13}\) The general director is in his early 40s and has spent most of his work life at MBT.\(^\text{14}\) His management team is mostly composed of long-time MBT employees, though his key vice president is a young business school graduate, full of ideas as to how MBT can regain its competitive edge.

MBT produces a variety of consumer goods. It does not sell directly to the public, but sells to retail outlets throughout Russia. It has a large and constantly changing group of customers that it seeks out at regional trade shows. It flourished financially during the late 1980s and early 1990s and even had dreams of developing its own chain of retail stores. To this end, it created a "trading house" (дистрибьютор) in 1991, known as Torgovoi Dom Bytovoi Tekhniki (TDDB), which was intended to serve as a central point of distribution. TDBB was never activated for this purpose. MBT fell on hard times once the Russian market was opened to foreign manufacturers. MBT proved incapable of competing on either price or quality. Since that time, 60 percent of the work force has been laid off.\(^\text{15}\) Delays in the payment of wages averaged three months during 1997.

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\(^\text{10}\)The original text of article 855 of the Civil Code gave top priority to wages. The Russian Constitutional Court declared this unconstitutional in December 1997 and mandated that obligations to the state be given preference over wages (Вестник Конституционного Суда Российской Федерации, no. 1, pp. 23–31, 1998). Presidential Decree No. 1212, dated August 18, 1996, as amended through October 30, 1998, also addresses this issue.

\(^\text{11}\)The names of the case-study enterprises (as well as affiliated enterprises) have been changed in order to preserve their anonymity.

\(^\text{12}\)MBT privatized via Option 2, which allowed enterprise employees to purchase 49 percent of the capital stock under advantageous terms. See Ashlund (1995) for a detailed description of the three options for the privatization of state enterprises.

\(^\text{13}\)MBT has less than one thousand shareholders. Consequently, its board is elected on the principle of one share, one vote (Об акционерных, 1996, Art. 66. Тихомиров, 261–265).

\(^\text{14}\)He began working at MBT in 1980 and, with the exception of a brief period in the early 1990s, has worked there continuously. He was a member of the Communist Party during the Soviet era.

\(^\text{15}\)In 1992, MBT had one thousand employees. By 1997, it had only 350.
Like many Russian producers, MBT has struggled for survival. MBT management has tried to minimize losses due to non-payment by customers, but has yet to find any foolproof tactic. Although the sales department requires new customers to provide documentary evidence of its existence and good standing with financial and tax authorities, there is a recognition of the ultimate futility of such efforts due to the prevalence of counterfeit documents. Moreover, affidavits confirming the absence of debt on customers' bank accounts have only fleeting value. Typical is an affidavit stating that, as of a particular date, the customer "did not have debts on loans to the bank or in the kariotk to the [state] budget or to suppliers." Sometimes the bank's language is more definitive. For example, a Saratov bank sent a statement to MBT stating that, "The enterprise is financially stable, it fulfills its payment obligations in a timely and complete fashion, and has no debts at the bank." From MBT's point of view, the problem with both is that the bank can make no guarantees about the future solvency of any customer. Constant monitoring of customers' bank accounts is simply not feasible. By the spring of 1998, the sales director had given up on assessing reliability through documentary evidence. Instead, customers had to earn her trust. She requires full prepayment for the first sale and has set up a sliding scale thereafter. Once customers have proven themselves, which generally takes six months of steady activity, she allows them 20-30 bank days to pay.

Despite the best efforts of the sales department, non-payment by customers remains all too common. As I have documented elsewhere (Hendley, 1999), MBT pursues its delinquent customers to the full extent of the law. It has established a highly regimented timetable for processing delinquent payments. Neither the sales department nor the lawyers have discretion to make exceptions. Indeed, the sales department personnel begin the pursuit immediately. Its personnel has a powerful incentive to collect these overdue payments, since they receive 15 percent of all amounts so collected. As a rule, reminders are sent even before payment is due, thereby telegraphing MBT's innate suspicion of its customers. Once the due date has passed, the sales department turns up the heat. If its efforts prove fruitless, the claim is turned over to the legal department, which files a petition in arbitrazh court to recover the amount owed, together with interest and penalties to date.

MBT is drowning in debt. According to its chief financial officer, MBT began taking on debt in 1992 and sinks deeper into debt with each passing month. It seems locked in a downward spiral as a result of its customers' inability to pay for MBT's goods in a timely fashion, which leaves MBT without sufficient funds to pay its debts either to its private creditors (banks and suppliers) or to the state. The imposition of penalties and interest means that these unpaid debts continue to mount. Without exception, MBT's bank accounts have kariotki attached. In the view of MBT management, this renders these accounts unusable. Any money that comes into these accounts from customers is automatically funneled to its creditors (both state and private).

MBT's solution to its dilemma has been to do business through TDBT. Although registered as a limited liability company in 1991, it had not become operational, given that MBT's financial difficulties had forced it to put aside the goal of creating a retail network. It now offered MBT the chance for a fresh start without the bother of bankruptcy proceedings. All debt would remain on the books of MBT, while sales income would flow to TDBT. On a superficial level, no connection between the two companies was apparent. TDBT was not a subsidiary of MBT. Indeed, MBT was not even listed as one of its founders, and it had no key managerial personnel in common. As a result, MBT's creditors were not entitled to make claims on the assets of TDBT.

As a practical matter, however, MBT management continued to call the shots. The main function of the general director of TDBT seemed to be to sign his name. All substantive decisions were made within MBT. At the beginning of 1997, MBT sent a form letter to all of its customers, informing them that it would now be doing business as TDBT. Sales contracts for 1998 made no reference to MBT; TDBT was identified as the seller. Only a few customers balked at the change. For the most part, these tended to be the very large urban department stores, who resisted doing business with an entity that was completely unknown to them. These customers were given contracts with MBT, though efforts were made to avoid having them make payment through bank transfers. These customers were strongly encour-

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19In contrast to U.S. law, which allows the wronged party to recover compensatory but not punitive damages for contractual breaches, Russian law permits the recovery of penalties. For a number of years, it was common to recover both interest and penalties, beginning in 1997, however, the arbitrazh courts refused to award both interest and penalties, regarding such claims as an effort to "double-dip." For a discussion of this shift in policy on the enforcement of penalties, see Hendley (1998a). In an effort to get around this norm, MBT's form contract included a clause that specifically allowed for both interest and penalties, in which the parties stipulate that they are different remedies. In a 1998 arbitrazh case that I observed in which MBT sought to collect the debt owed by a Moscow department store, together with interest and penalties, the arbitrazh judge questioned the validity of this clause. Before the court issued its ruling, the MBT lawyer amended the complaint to eliminate the claim for interest. For a more detailed analysis of MBT's rationale, see Hendley, 1999.

20According to the chief financial officer of MBT, the state imposes penalties of 0.03 percent per day on the outstanding debt. As a rule, penalties on private debt are lower. Typically, they are 0.01 percent per day of the amount owed. Whether the state or private creditors require debtors to pay these penalties is a separate question, but they remain a potent bargaining chip.
aged to make their payment in cash in order to allow MBT greater flexibility. More specifically, MBT insisted on actual cash (nalichnye den'gi) from these customers, and refused to accept payment in so-called cashless money (beznalichnye den'gi), since it would have to be processed through a bank account.

No one at MBT made any effort to camouflage the reason for this change in operating procedure. Managers at all levels acknowledged that the sole purpose was to gain access to the cash flow from their output. They understood that if these funds went into MBT's bank account, they would be automatically transferred to others. They saw the use of TDBT as a path to continued survival. No one criticized the scheme. When I raised ethical concerns, the MBT managers reacted with surprise, noting that the use of shell companies has become routine within the Russian business community. When I pushed them, their responses were laced with self-righteousness. They used the chaotic environment to justify their behavior. At the same time, no one seemed cognizant of the fact that the scheme amounted to a criminal diversion of funds from secured creditors. When I drew this to their attention, the MBT managers showed no contrition. They raised the now-familiar argument that staying in business and full compliance with the law are mutually exclusive in contemporary Russia due to the inability of Russian law to respond to the actual needs of economic actors (Hendley, 1997).

MBT has pursued a multi-faceted survival strategy that includes demands for prepayment from new customers, an activist litigation strategy, delays in wage payments, and diverting cash flow into a shell company. Equally interesting are the tactics it has eschewed. Although production has been scaled back in response to financial difficulties, MBT has never suspended production entirely. Along similar lines, it has not reduced the length of the work week. Nor does its management believe that joining together with related companies to form a vertically integrated financial industrial group (whether registered or unregistered) would be helpful. Even more intriguing is MBT's refusal to barter. It requires customers to repay their debts with money and accepts in-kind payments only as a last-ditch solution when the customer ceases operations. Usually this involves repossessing its own goods. It follows that MBT has no dealings with the "intermediaries" (posredniki) who facilitate barter transactions. The general director explained that because MBT sells to retail outlets, which then sells to the public for cash, MBT can realistically demand cash payment for its goods. The sales director elaborated, noting that in order to engage in barter, MBT would need to develop a capacity to sell a wide variety of goods, which it currently lacks. MBT's behavior suggests that tax avoidance is not always the primary impetus for barter. Despite being almost hopelessly in debt to the tax authorities, MBT did not resort to barter. Extended conversations with management revealed that barter was seen principally as a way of surviving in a cash-free environment, and because MBT had relatively easy access to cash, barter was not needed.

Unlike a majority of the firms surveyed, MBT has resisted the use of veksely and other forms of commercial paper that operate in present-day Russia as forms of quasi-money. Its managers were openly unimpressed by these financial instruments. They did not consider themselves qualified to assess their value, and preferred to forgo the potential gain rather than risk likely loss.

What factors are most helpful in explaining MBT's strategy for dealing with its payments problem? The cash-based nature of the business cannot be discounted. MBT stands in contrast to many other Russian companies that have no access to the retail market and, consequently, no access to cash. MBT's place in the production process is relevant for other reasons. It provides its consumer goods on a take-it-or-leave-it basis. It almost never customizes its output. Negotiations are rarely protracted. In fact, upon entering the sales department, a visitor encounters a stack of form contracts that have been pre-signed by the general director of TDBT. Likewise, MBT arrives at trade shows armed with plenty of pre-signed contracts. MBT does not regard a fully executed contract as obligating it to ship its goods. It does so only when the sales director feels sufficiently confident of the

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202Why Russian enterprises engage in barter is much debated among social scientists (e.g., Woodruff, 1999; Aukutis, 1998; Commander and Mumessen, 1998; Gaddy and Iekes, 1998). A full analysis of the debate is beyond the scope of this paper.

203When asked to assess their tax arrears on a 0 to 10 scale, MBT's general director gave a score of 10. The mean response for the surveyed enterprises was 5.6. Not only were MBT's tax debts high, but they continued to mount at a rate of 0.03 percent per day, according to the chief financial officer. He felt confident that MBT would ultimately succeed in negotiating away these penalties, but in the meantime, it was recorded as debt on the kartoteka and continued to limit MBT's financial flexibility.

204Sixty-one percent of the firms surveyed had used veksely recently.

205A veksel is a negotiable promissory note. It may be issued by banks, governmental agencies, and enterprises, among others, and may be denominated in currency or goods. A veksel's worth may fluctuate according to the value placed on the issuer and/or the underlying currency or goods. For a description of how veksely work in the Russian context, see Woodruff (1999) and Commander and Mumessen (1998).

206MBT entered into annual contracts with its customers; those serve as base agreements establishing the basic parameters of the relationship. Approximately 10 percent of customers sign MBT's form contract. Goods are not shipped on the basis of the contract alone. Customers send periodic invoices or telegrams in which they agree to pay the market price for the desired quantity. This procedure is not unique to MBT in Russia, but is standard the world over (Kenworthy, Macaulay, and Rogers, 1996).
customer's credit worthiness. Of the 47 representative sales contracts from 1997 that I reviewed, 10 (21.3 percent) were never activated.

MBT has a large and constantly changing customer base, resulting from instability within the retail sector as well as the wide range of alternative sources of consumer goods available. Over 90 percent of its customers are new since 1992. Most customers had no objection to the switch from MBT to TDGB, suggesting that reputation is not critical. Transactions tend to be quick, thereby minimizing the importance of trust and long-term relationships. MBT's sales director made it clear that she will not continue to supply any customer who fails to meet its obligations, regardless of the history of the relationship. The highly routinized nature of the collections process, which leaves no room for the sales director or others to make exceptions for special customers, is indicative of the arm's length quality of MBT's business.

The impersonal nature of MBT's interactions with customers also helps explain its coping strategy. When asked to estimate the personal dimension of its relations with customers on a 0 to 10 scale, the sales director gave a response of 0, indicating that the relationships are purely professional. I confirmed this in my on-site conversations. The sales director detailed the breakdown of Soviet-era networks due to a combination of turnover in personnel and trying financial times. She recognizes the value of maintaining cordial relations, given that she believes that the limited resources of customers often go to their favorite suppliers. At the same time, there are certain lines that cannot be crossed. As she put it, "friendship is friendship, but work is work." Her primary responsibility is to the work collective, not to her customers.

Pattern 2: The Middleman Game

The second pattern occurs in cash-poor enterprises that are immersed in dense networks of similarly situated enterprises. Survival is far from guaranteed. They are constantly adapting their behavior to new challenges. Subsistence is achieved through a complicated combination of barter, offsets, and diverted payments. This pattern is best represented by a Moscow auto parts factory, Auto-Detaly.

Auto-Detaly began production in 1929 and is housed on the premises of a gigantic electrical equipment plant. At one time, it was a subdivision of this Soviet colossus, but was split into a separate entity in the late 1970s and had a stable existence during the years of the planned economy. It was privatized in September 1994 and is currently an open joint-stock company. Insiders (managers and workers) maintain a 38 percent interest, with the remainder held by outside shareholders. The state retains no equity interest. Unlike MBT, Auto-Detaly has no foreign shareholders, and the largest shareholder owns only 12 percent. The latter is represented on Auto-Detaly's board of directors. Indeed, four of the seven board members are technically outsiders, yet closer examination reveals close and long-term links to the enterprise.

Auto-Detaly manufactures generators that are used in the production of Russian cars, trucks, and tractors. Its output is not suitable for export. Thus, its customer base is small and finite. Ninety percent of its output is purchased by only four assembly plants. The situation is further complicated by the existence of a vigorous domestic competitor with newer production equipment. Absent a complete reprofiling of the plant, its fate is inextricably linked to that of the domestic automobile industry. Moreover, the much-publicized efforts by the Luzhkov administration to resuscitate the Moscow-based assembly plants (ZIL and AZLK), which may have provided some short-term benefits to those plants, have not trickled down to its suppliers. Auto-Detaly managers regard appeals to the Moscow government as pointless. As this sector has declined, so too has the financial condition of Auto-Detaly.

Like MBT, Auto-Detaly is locked in a cycle of debt. It is hopelessly behind in payments to the tax authorities and to local utilities. Its bank accounts are laden with debt, which renders them unusable. Auto-Detaly's management has stitched together a set of coping tactics aimed at ensuring the short-term survival of the enterprise. It has drastically slashed the workforce. By 1997, the number of workers represented only 20 percent of the 1992 level. It also delayed the payment of wages by an average of four months and instituted a reduced work week for over one-third of the employees. These practices continued through 1998. Indeed, one top offi-

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27Among the surveyed enterprises, the mean response was 47 percent.
28Among the surveyed enterprises, the mean response was 24.
29Auto-Detaly privatized via Option 1 (see Åslund, 1995).
30Obtaining more detailed information about ownership proved impossible. The chairman of the trade union committee, who handles the organization of the annual shareholder meetings at Auto-Detaly, would admit only that workers own less than 10 percent of the outstanding shares.
31Since Auto-Detaly has more than one thousand shareholders, its board is elected through cumulative voting. The board member who represents the 12 percent stakeholder used to work for the ministry to which Auto-Detaly was subordinate during the Soviet era. Two other board members work for spinoffs from Auto-Detaly, and another used to be a top manager at Auto-Detaly.
32Prior to 1992, its generators were exported to Eastern Europe, but that market has dried up.
33Virtually every profile of Luzhkov highlights his leadership role in having the Moscow government obtain a majority interest in these two assembly plants and his subsequent efforts to encourage Muscovites to purchase the locally produced cars and trucks (e.g., David Hoffman, in The Washington Post, December 19, 1997, p. A1; Boris Allatuyev, in Moscow Times, March 23, 1999).
34Auto-Detaly has not sought the assistance of the Moscow government when problems have arisen with its trading partners during the past two years. Among the Moscow enterprises surveyed, 13 percent had asked the city government for help with supplier problems and 7 percent had sought its assistance with recalcitrant customers (Hendley, Murrell, and Ryterman, 1999b).
35Employees numbered some 6,000 in 1992, but had decreased to 1,200 by 1997.
cial remarked that wages had come to be regarded as the "unofficial bank" of the enterprise.

Auto-Detaly consistently negotiates from a defensive mode, starting from the assumption that it will have to renegotiate its obligations. When negotiating the purchase of inputs, every effort is made to mitigate the potential impact on the burgeoning kartoteka 2. Whenever possible, Auto-Detaly seeks to exclude provisions imposing penalties in case of late payment. Since its precarious financial position leaves it in a disadvantaged bargaining position, Auto-Detaly rarely wins that argument. It then seeks to include a clause that allows only debt (not penalties) to be attached to kartoteka 2 in case of default. Although liability for penalties may be unavoidable, at least they will not clog up Auto-Detaly's bank account. In a review of 20 representative supply contracts, I found two in which such a clause had been inserted. The effort to include such a clause vividly illustrates management's concern over its inability to use its bank account.

The debt crunch also affects how Auto-Detaly deals with its customers. In those rare instances where customers are able to pay in monetary form, Auto-Detaly routinely diverts these payments from its bank accounts. The in-house lawyer explained that it would be "pointless" to put the money in Auto-Detaly's account since it would immediately "disappear." In her opinion, the unfairness of the confiscatory banking rules leaves Auto-Detaly no choice but to engage in this subterfuge. It has even been institutionalized. The form contract for non-barter sales (dogovor postanki) contains a provision that permits Auto-Detaly to ask that payment be made to a third party. In contrast to MBT, Auto-Detaly has never set up a shell company through which it runs its cash income. Instead, it asks customers to pay its creditors directly. Although the customers are contractually obligated to go along with Auto-Detaly's request, its creditors need not accept payment in this form. To date, none have balked at such arrangements. The scheme is not entirely ideal from Auto-Detaly's point of view. The result is a loss in control over its own income. It is forced to rely on its customer (agent) to make the promised payment, but must bear the consequences when the customer fails to do so.

Recognizing that Auto-Detaly's status as a mid-stream producer accords it little access to cash, managers are resigned to doing business through barter. In an ideal world, they would demand payment before shipment, but this would alienate their customers. They would flock to the other manufacturer of automobile generators who is willing to offer more generous terms. The workers are extraordinarily resentful of barter transactions. The chairman of the trade union committee recounted numerous instances when workers refused to load generators for which prepayment had not been received and which were to be traded for engines and cars. The workers understand only too well that money received for these goods is likely to be diverted long before making its way into their paycheck.

Top management views barter as a "dead end," but as inescapable. In the words of the sales director, "barter is horrible, but no one has any money. What else can we do?" It offers them a lifeline to survival, given the cash-poor status of the assembly plants that make up their customer base and their own need to divert resources from state and private creditors. By the spring of 1998, 90 percent of Auto-Detaly's output was "sold" via barter, and virtually all of its inputs were obtained through barter. Only one of its more than 80 suppliers is paid with money. At some enterprises that rely heavily on barter, formal written contracts have waned in importance. Not so at Auto-Detaly. The in-house lawyer insists that all transactions be fully documented. Although a distinct form contract has been developed for barter transactions (dogovor vzaimopostanki), it is used less than 10 percent of the time. There is a preference for using the standard sales contract (dogovor postanki) because it offers greater flexibility. This contract provides for payment in monetary terms, but includes the following escape clause: "per written agreement, the parties can make arrangements for payment by any method." This allows for the possibility of barter while permitting Auto-Detaly to maintain the protections afforded by the use of its own standard form sales contract.

As has been well documented by others, barter brings substantial transaction costs that are otherwise absent (e.g., Commander and Mums-

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36Auto-Detaly's lawyer copied the clause from a rival's form contract. It has not yet been tested in arbitrazh court.
37The experience of other similarly situated enterprises suggests that Auto-Detaly has just been lucky. The other case study enterprise that fits this second pattern, Saratovskiy Kauchuk (SK), has had a different experience. The large oil company that supplies it with paraffin has refused to accept third-party payments. It has insisted on payment by bank transfer. It has demanded acceptance in cash or by in-kind transfers. Its justification is the desire to minimize transaction costs.
sen, 1998; Gaddy and Ickes, 1998). My field research confirms this common wisdom. After all, more people are involved at every step of the process. While the sales department handles non-barter transactions on its own, in-kind transfers require further approvals, since the sales department is not responsible for selling the goods so acquired. Once the transfer has occurred, the goods must be sold and the sales agent must be reimbursed. The 15–20 percent surcharge imposed on barter transactions does not fully compensate the enterprise for the additional expenses incurred.

For the most part, Auto-Detaly’s customers “pay” with vehicles. Unfortunately, Auto-Detaly is rarely able to “pay” for its inputs with these vehicles. While its suppliers might have wanted cars or trucks at some point, this need has long since passed and they refuse to absorb the cost of disposing of what is not needed on-site. Auto-Detaly has had to find some way of obtaining value for the vehicles received in payment for its generators. Sometimes the vehicles are “liquid,” i.e., they can be easily sold to the public. Given that Auto-Detaly is not in the business of selling cars, it works with intermediary firms that sell these cars on its behalf. Typically, these intermediaries are identified by the auto assembly plants. Sometimes they are openly affiliated with these plants, leaving Auto-Detaly few options in its choice of agent if it wants to stay in its customers’ good graces.

Money generated through these sales is usually funneled directly to creditors at the direction of Auto-Detaly management in order to avoid having it confiscated automatically by the bank to pay the debts sitting on the kartoteki. The driving goal is to stay in business. Management is not diverting these funds to its own purposes. Rather it is diverting them to cover current operational expenses, instead of passively allowing the funds to be used to pay long-standing debts to the government or to the other secured creditors.

Working with intermediaries has undermined Auto-Detaly’s ability to control its own affairs. The intermediary controls both the sale of the bartered goods and the transfer of this money to the creditors of Auto-Detaly’s choice. For example, at the instigation of GAZ (a large auto assembly plant in Nizhny Novgorod), Auto-Detaly began selling cars received in payment through a Tomsk intermediary in late 1996. The two parties agreed that cars would be sold on Auto-Detaly’s behalf, with the intermediary retaining 15 percent. According to the files, cars worth several billion 1997 rubles were shipped to this intermediary as payment for sums owed to Auto-Detaly. Also in the files are a series of detailed instructions as to where the intermediary was to send the proceeds from the resale of the cars. The proceeds were to go toward operating expenses, such as prepayment for the metal needed to make generators and inter-city phone charges.

The intermediary failed to make the payments. As a result of the intermediary’s failure to pay the supplier, it did not receive the metal and had to shut down production. Ironically, the intermediary responded by offering to settle the debt by providing raw materials. But Auto-Detaly did not need more goods, but cash that it could use to pay pressing debts. In early 1998, the dispute still had not been resolved and Auto-Detaly was contemplating legal action.

When the goods obtained are not “liquid,” the attendant costs are even greater. On occasion, Auto-Detaly receives payment in the form of “specialized goods,” for which buyers have to be sought out. Auto-Detaly’s marketing director spends most of his time piecing together deals to ferret out some value for these goods. For example, Auto-Detaly received some fire trucks from one of its customers. The marketing director learned that the electric company, to which Auto-Detaly owed a substantial debt, needed trucks of this kind. Together with the commercial director, he put together a mutually beneficial transaction. This sort of simple bilateral arrangement is the exception. Much more common are the so-called “barter circles” (isepochki) sometimes involving ten or more participants. The time and energy of top managers required to concoct these schemes is immense and, needless to say, could easily be put to more productive use.

Along similar lines, Auto-Detaly’s managers spent considerable time and energy working with local utilities and others to arrange debt offsets. Money rarely changed hands as a result of these deals. The goal was to get debt off the books of the participants. A relatively simple three-way arrangement was made between Auto-Detaly, the Moscow energy concern, and a local construction company in late 1997. There was a circle of debt. Auto-Detaly owed more than 150 million rubles to the local electric company, which owed a similar amount to the construction company. The construction company, in turn, owed approximately the same sum to Auto-Detaly. The contract incorporated a flow chart of the debt forgiven. Auto-Detaly had entered into analogous arrangements with other utility companies, though most involved more than three participants. The basic principle is simple enough; the trick is to match up debitors and creditors so that none of the parties ever has to produce actual resources. According to enterprise management, the utility companies often take the initiative.

Between the overdue payments and the interest and penalties that continue

42See Aukusutionek (1998, pp. 164–166) for a discussion of how the character of barter changes over time.

43For example, of the vehicles provided by ZIL, only 15 percent are likely to be “liquid.” ZIL is a large Moscow assembly plant and a key Auto-Detaly customer.

44Although Auto-Detaly has been sued several times by disgruntled creditors, this is the only lawsuit it has initiated in several years. Its willingness to contemplate a lawsuit against this intermediary is prompted by the one-shot nature of the transaction, which contrasts with the long-term relationships it enjoys with most of its trading partners. Because management regards litigation as a high-risk proposition, the decision to proceed will be made by the in-house lawyer (as at MBI), but by top management at Auto-Detaly. See Hendley (1999) for an analysis of the circumstances under which Russian enterprises resort to legal action to resolve non-payments claims.

45Williamson (1985) provides the classic elaboration of transaction costs.

46Woodruff (1999) and Commander and Muesen (1998) provide an overview of debt offset arrangements.
to cumulate, the debts owed to these companies are truly staggering. The utilities realize that they are unlikely to be repaid in a straightforward fashion. As a stopgap measure, they have sought out these multi-sided debt swaps in an effort to clean up their own books.

Tax offsets sometimes resemble these arrangements. As with other offset arrangements, those involving the tax authorities can be more or less complicated. Auto-Detały has generally been unable to settle its debts to the state by direct in-kind exchanges. The financial officials of the enterprise indicated that this was due to the intermediate nature of the goods produced by Auto-Detały. Instead, the simplest version of tax relief involved Auto-Detały receiving credit on its tax debt by supplying its generators to an auto assembly plant to which the central government owes money. All three parties to the scheme benefitted, though no cash changed hands. My review of recent Auto-Detały contracts turned up a fair number of multipart transactions that contemplated the exchange of tax offset notes.

Unlike MBT, Auto-Detały is willing to use vekseli, though most managers still approach them with considerable trepidation. Neither the sales director nor the procurement director is authorized to enter into a deal involving vekseli on his own. Both welcome this limitation on their authority. They do not understand how to value these financial instruments. When a trading partner proposes the use of vekseli, these managers immediately call in the assistant general director for economic questions, who decides whether to go forward. This official likewise struggles with valuation. For the most part, the vekseli proposed for use by Auto-Detały’s trading partners have been issued by banks. Often he turns for advice to friends at unrelated Moscow banks. He characterized the negotiations over the value of vekseli as “extremely heated.” Also, he described circumstances when he felt pressured to accept a customer’s demand that a veksel be accepted at face value or risk losing that customer’s business.

Auto-Detały’s survival strategy is basically conciliatory. Its goal is to maintain cordial relations with its customers even as their unpaid debts mount. Turning adversarial by pursuing unpaid claims to their logical end, i.e., filing lawsuits, is not regarded as a viable option, given management’s conviction that this would inevitably lead to a severing of the relationship (Hendley, 1999). Management is highly skeptical of its ability to obtain a fair trial when suing politically prominent auto assembly plants on their home turf. The assistant general director for economic questions scoffed at the prospect of suing AutoVAZ in Toliat. When I asked whether his suspicions were based on experience, he conceded that they were not. Even so, they shaped the behavior of Auto-Detały. Eschewing litigation, Auto-Detały relies heavily on barter and other non-monetary forms of exchange. Periodic efforts are made to reduce the dependence on barter. For example, in late 1997, the assistant director for economic questions issued an order forbidding barter with ZIL. He was under no illusion that this would actually end barter overnight, but hoped that it would serve as a signal to ZIL management that Auto-Detały was serious about reducing its debt. It worked. Over the next several months, ZIL became more pliant in setting the terms of trade for barter and its debt was lowered by 40 percent.

Auto-Detały also counts on the acquiescent nature of its workforce. Routine delays of four months in the payment of wages have not provoked any hue and cry among the workers. Rather, they have given rise to a sense of resignation. Yet management seems aware that the workers’ patience is not infinite. Production has not been suspended for any sustained period of time.

Auto-Detały’s policy of appeasement stems in large part from its fear of alienating customers. Taken together, the small and finite set of possible customers and the existence of a domestic competitor leave enterprise management without much room for maneuver. When asked why they do not make their terms of trade stricter by requiring monetary prepayment or by limiting in-kind exchanges to goods that can be used in their own production process, Auto-Detały’s managers invariably react with exasperation. They fear that such assertive behavior will impel customers to take their business elsewhere. They are convinced that the other generator manufacturer would take advantage of the situation by agreeing to any terms of payment in order to attract new business. Likewise they are apprehensive about pushing too hard for payment of overdue claims. At heart, Auto-Detały is risk-averse and works to mollify its customers.

Also motivating Auto-Detały’s behavior is its belief in the existence of a community within the Russian automobile industry. The sales director repeatedly emphasized the importance of personal relationships with customers, describing it as a “brotherhood.” The present-day conciliation is rooted in a long-standing tradition of partnership between suppliers and assembly plants that began during the Soviet era and persists to the present day. Reputation is critical at every stage, as the willingness to accept letters of guarantee demonstrates. In contrast to the situation at MBT, customers are not fungible. There are no hard-and-fast rules for dealing

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64Woodruff (1999) details the special challenges facing utilities. Hendley (1998a, pp. 320–326) explains how the disproportionately high debts and penalties of utilities have contributed to a shift in policy by arbitrazh court judges on the enforceability of penalties.

65I observed a slightly different scenario at SR. Like Auto-Detały, it had substantial tax arrears. Periodically, SR management received a list of items needed by local hospitals. SR would obtain the desired items through complicated barter transactions, and would have its tax debt reduced accordingly.

66On rare occasions, the use of vekseli issued by enterprises may be proposed. Auto-Detały’s managers are highly suspicious of these instruments and rarely accept them as payment. Their feeling is that the likelihood of repayment is much lower than with bank-issued vekseli.

67Unless the contract provides otherwise, Russian law grants jurisdiction to the arbitrazh court closest to the defendant.

68When I raised the prospect of shutting down production, managers expressed more fear of the potential damage to the machinery due to non-use than concern over the fate of Auto-Detały’s workers.
with overdue payments. Different modes of interaction have evolved for each customer. The sales director prefers negotiation to confrontation, and favors legal action only when it has become evident that the customer will not survive. Although such a strategy seems nonsensical if we assume the goal is to maximize debt recovery, it makes a great deal of sense if we understand that the true goal is to preserve the relationship for as long as possible.

The reality is that Avto-Detail is stuck in the middle. As an intermediate producer, it makes parts that become part of the cars sold to Russian consumers. It has no direct access to that market, which naturally limits its access to cash (Macauley, 1963).

Pattern Three: The Dealer Game

The third pattern occurs among enterprises where the financial situation is more auspicious. Although seemingly secure, such enterprises risk being dragged down by their debt-laden customers. When these enterprises enjoy sufficient market power due to the demand for the goods produced, they may seek to sidestep this danger by developing a network of dealers that will take on the task of interacting with customers and will assume the risk of contractual defaults. This pattern is nicely illustrated by an Yekaterinburg clothing factory, Venera, that manufactures women’s underwear.

Venera differs from the other case studies in two critical respects. The first relates to the ownership structure. It is not a former state-owned enterprise. The general director and his top lieutenants left a Yekaterinburg defense plant to create it in 1990, taking advantage of the Gorbachev-era legislation that legalized new forms of property ownership (Maggs, 1992). Venera is a closed joint-stock company with only 20 shareholders. Ninety-eight percent of its stock is owned by top management, with the general director holding a controlling interest. The remaining two percent is held by a former manager who left to start his own company. Not surprisingly, the board of directors is composed solely of insiders. Some of these directors favor transforming the company into an open joint-stock company on the grounds that it would offer new opportunities for raising capital. The vehement opposition of the general director to opening up the company has stymied any moves in that direction.

Second, Venera is a profitable and growing business. Over the last few years, it has purchased new capital equipment and has expanded into new lines of production. It follows that its debt structure would diverge from the other case studies. Venera’s kartoteki, for example, are clean. From time to time, it falls short in paying its tax obligations, but this is a short-term problem, not a perennial sword of Damocles. Its most serious debts are to local banks for operational loans. Venera’s success made it attractive to local bankers—especially prior to August 1998—and its loans were negotiated at arms’ length.

Venera is patently dominated by insiders. The true locus of power is the general director. He has an authoritarian streak and a tendency to micro-manage all aspects of the business. For example, he makes all key decision and personally selects suppliers. Early in 1998, one of his deputy directors were beginning to chafe under this regime, but the success of the company muted their complaints. For the past few years, dividends had been paid regularly, and no one wanted to rock the boat.

It has 9 employees in 1990 to 90 in 1992 and to 300 in 1998. It is located in a sort of industrial park region on the outskirts of the city not served by public transportation. Management provides a bus service for workers and subsidizes the cafeteria. Wages are occasionally delayed, though usually by days, not months.

The company began as a cooperative that, according to the general director, made an extraordinary amount of money “speculating” in deficit goods. His main asset was his access to key officials at the ministry of construction. At the same time, he also began two lines of manufacturing: parts for television and women’s underwear. He had no prior experience with either. Within a few years, it became clear that the greatest opportunities were in producing underwear. Consumer goods were notoriously in short supply during the Soviet era. Women’s underwear was no exception. The only producer was located in Belarus, and its goods were hardly cutting edge from a fashion point of view. One reason is that few of the

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53When asked to rank the importance of the personal aspect of his relationship with customers on a 0 to 10 scale as part of the survey, the sales director gave a response of 2, which is only slightly less than the mean response of 2.9.

54Letters of guarantee promise future payment. Avto-Detail’s customers use them to avoid prepayment. They are typically issued by the customer and are signed by the general director and the top financial officers. Occasionally a bank may issue a letter of credit attesting to the capacity of an enterprise to pay. These documents are not enforceable on their own, nor are they negotiable. From a legal point of view, they are little more than affidavits of future intent. Their value is measured by the degree of trust placed in the issuer. Letters of guarantee were used by 70 percent of the surveyed enterprises, indicating that they are more common than naively, which were used by 60 percent of these enterprises.

55Twelve percent of the surveyed enterprises had never been state-owned.

56All of these manager-shareholders are men. Even more intriguing, they uniformly took great pride in the fact that their wives did not work outside the home.

57Neither MBT nor Avto-Detail has substantial bank loans. When asked to assess the seriousness of arrears to banks on a 0 to 10 scale, both responded 0. By contrast, Venera gave a score of 9. Venera’s indebtedness to banks marks it as somewhat unusual among the surveyed enterprises. More than 60 percent of these enterprises responded like MIBT and Avto-Detail, with a score of 0. The mean response among all surveyed enterprises was 2.1.

58The general director is in his mid-40s, and used to be a member of the Communist Party.

59Venera’s profitability distinguishes it from both MBT and Avto-Detail. Neither of these has ever paid dividends.

60Workers receive coupons (tonoly) entitling them to lunches. The general director bragged that this ensured that they could have lunch even when wages were delayed.

61Wages payments were delayed by ten days in April 1998 and by five days in May 1998.
a network of dealers cannot be built overnight. Venera continues to work directly with many customers, though it plans to gradually shift this burden onto the dealers. The third track of its sales strategy focuses on Moscow. As a Yekaterinburg manufacturer, Venera feels a bit like a rube when interacting with the big retail establishments in the capital. Without exception, all of Venera’s top managers emphasized the critical importance of cracking the Moscow market, because of both the symbolic value and the impressive sales volume of these Moscow stores. Its eagerness is evident from a review of its current sales contracts. Although Venera usually insists on using its own form sales contract, it regularly submits to the form contracts of these big Moscow stores. Further, it agrees to payment terms that it otherwise rejects out of hand, thereby demonstrating its servility vis-à-vis these stores.

Venera’s decision to work through dealers was a direct response to its customers’ high level of debt. Like other Russian manufacturers, Venera has struggled to get payment from its customers in a timely fashion. According to sales department personnel, almost no one paid voluntarily on time. Cajoling delinquent customers grew to become the central focus of sales department personnel. This was a time-intensive process because Venera, unlike MBT, had not routinized the process. Each instance of non-payment has been treated individually. Even the decision about when to begin the pesterig varied. Whether the calls began after a day or a week had elapsed depended on the customer’s record. Most of the time, payment was forthcoming. If not, then Venera’s usual remedy was simply to terminate the relationship. In contrast to MBT, it did not pursue legal action. Venera’s management regards litigation as an extreme option, not as the normal response to a persistent refusal to pay. The reasons for its ambivalence toward the arbitrazh courts are a complicated mix of generalizing from one bad experience in the courts, a lack of competent legal counsel, a fear of alienating customers, and a preference for mediative rather than adversarial methods of working out problems. Also distinguishing Venera from MBT is its greater confidence in the desirability of its output. Whereas MBT made no pretense that its consumer goods were atypical, Venera believes its underwear to be of exceptional quality and is trying to build a brand loyalty. Following the example of its Western competitors, it has developed a glossy catalogue of its products which it distributes at trade shows, though it does not use it in the consumer market.

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61Venera looks for suppliers at trade shows. The general director makes the final decisions. When asked to evaluate the importance of personal connections on a 0 to 10 scale as part of the survey, the response was 7, graphically demonstrating the highly personalized attitude toward supplier relations that is shared by everyone from the general director to the secretaries in the supply department. (The mean response among all surveyed enterprises was 2.4.) The head of the department confessed that he regarded formal contacts as superfluous, and resorts to this format only because Venera’s banks and Russian customs officials insist upon it. He claims not to read them, relying instead on his conversations with suppliers.

62Of the 23 contracts that Venera concluded in 1998 for direct sales to retailers, 11 (48 percent) called for full prepayment, 5 (22 percent) provided for payment within 20 days, and the remaining 7 (30 percent) had a variety of payment terms. These do not include the contracts with dealers.

63Venera has two assistant directors (samostitelle direktora) for sales. Their responsibilities are divided geographically. One concentrates on the European regions of Russia, while the other focuses on Siberia and the Far East. The former has certain obligations in the realm of security. He visits prospective customers in order to evaluate their ability to pay and non-paying customers in order to “encourage” them to pay their debts to Venera.

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64Of the twelve contracts in place with Moscow stores, only one uses Venera’s form.

65The sales directors generally refuse to condition payment on the customer’s ability to sell its goods. Instead, it insists on payment upon delivery and puts the risk of poor sales onto the retail outlet. As a result of its eagerness to penetrate the Moscow market, Venera has agreed to payment only if and when its goods are sold by the retailer in 9 (75 percent) of its 12 Moscow contracts. It did not make this concession in any of its non-Moscow sales contracts.

66Hendley, Murrell, and Ryterman (1998) lay out a spectrum of strategies enterprises use when problems arise with their trading partners, including termination of the relationship, and analyze the use of these strategies.
In order to refocus the energy of sales department personnel toward increasing sales, Venera has transferred the responsibility for managing the relationships with many of its retail customers to dealers. It is these dealers—presently numbering eight—who are charged with obtaining payment for goods. In essence, Venera has off-loaded its payments problems onto the dealers. It sells relatively large quantities of its goods to these dealers, who then resell to retail outlets in a specified geographic region. The dealers’ obligation to pay Venera is independent; it is not conditioned on whether sales to retailers are actually made or whether the retailers have remitted payment to the dealers. Most dealers are required to pay Venera within 40–50 days of receiving the goods.

The selection of dealers is highly personalized. Each relationship is slightly different and has its own dynamics. Although all potential dealers are thoroughly vetted by the sales department, the general director makes all final decisions on their selection. He feels comfortable with the current set of dealers because, in his words, Venera and these dealers “grew up together.” All of them began operations at the close of the Soviet period, and surviving through difficult times has created a strong bond.

The relationship with the dealers is governed by contract. Venera has developed a form contract for this purpose that is distinct from its form contract for direct sales in several key respects. Most obvious is the time period covered. Like most vendors worldwide, Venera renews its direct sales contracts annually. Given the laborious process of establishing alliances with dealers, it is not entirely surprising that the underlying contracts last five years. Even more important are clauses that require dealers to purchase a predetermined minimum quantity per quarter and to sell only Venera’s underwear. The violation of either of these provisions gives Venera the unilateral right to terminate the contractual relationship. It has never had this extreme step. Venera threatened to invoke it once, but the dealer modified his behavior accordingly.

Presently, 60 percent of sales go through dealers. Venera’s management is eager to increase this figure by increasing the number of dealers and the geographic coverage. Ultimately, they hope to sell only through dealers (except in Moscow). They are motivated by a desire to cut down on the transaction costs associated with direct sales. When working through dealers, Venera need not concern itself with the credit worthiness of individual customers and need not worry about day-to-day bill collections. At the same time, recognizing the burden being placed on these dealers, Venera has deliberately proceeded slowly, taking care to ensure that the dealers are worthy of this trust.

As a general rule, Venera shies away from barter. Indeed, Venera is the only one of the case studies where the level of barter has decreased over the past five years. In 1992, barter accounted for 90 percent of its output. By 1997, it had shrunk to a trivial one percent. The general director attributes the sharp decline to changes in overall economic conditions. He contends that the shortage of consumer goods during the early years of the transition facilitated in-kind payments to trading partners and workers alike. The increased availability of goods has changed all that. Now in-kind wage payments are greeted with loud complaints, and in-kind payments for inputs or outputs are seen as a mechanism for survival and/or tax evasion, not as a means of acquiring deficit goods. His subordinates’ explanation for the low levels of barter differs; it more closely parallels the sentiments expressed at MBT. In their view, the barter avoidance policy stems from a lack of expertise in selling goods produced by others. The sales department fears getting stuck with shoddy merchandise that no one wants. They have no desire to find themselves in Auto-Detaily’s situation, where they are interacting with various intermediaries who resell the goods they get for a fraction of the value claimed in the original transaction. Like their counterparts at MBT, the Venera managers regard barter as a means of survival for cash-starved enterprises. Given that they sell to retailers who have ready access to cash, they need not resort to barter.

Along similar lines, Venera generally resists requests by its trading partners to use veksels or other types of commercial paper. Like the other case study enterprises, its management feels ill-equipped to evaluate these financial instruments and prefers to stick with cash. This attitude places Venera at a disadvantage in dealing with its foreign suppliers, who are accustomed to using letters of credit in international transactions and find their refusal to do so odd. Venera responds to such requests by agreeing to full prepayment, which means that they have to pay sooner than they would if letters of credit were used. Upon closer examination, I learned that their negative reaction resulted from a basic lack of knowledge. Neither the general director nor any of his top lieutenants had any idea

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69The only lawsuit Venera has filed was against a store in Nizhnny Novgorod. Venera resorted to litigation not because of the amount at issue (which was not substantially greater than the debts of other customers), but because of its outrage at the behavior of this store’s general director, who, during a meeting of Venera’s general director, promised to take personal responsibility for the contract. One manager explained that they could have tolerated such a lie from a mid-level manager or a clerk, but not from a general director. Venera obtained a judgment in its favor, but has been unable to collect. The defendant has gone out of existence and its bank accounts are empty. Venera has sent its representatives to Nizhnny Novgorod to see if anything is salvageable. The lesson that has been taken away from the experience is that filing claims in arbitration courts is unsatisfying. For a more complete analysis of how Russian enterprises approach non-payment disputes, see Hendley (1999).

60In 1997, Venera obtained only 5 percent of its inputs through barter. Procurement department personnel explain this by pointing to the high incidence of foreign suppliers and the rather unusual nature of Venera’s output. It did no bartering for supplies in 1992, which makes sense, given that it was engaged primarily in trading electronics and not manufacturing at that time. When compared to other Yekaterinburg enterprises, Venera emerges as somewhat unusual. Among the 53 Yekaterinburg enterprises surveyed, the mean response for the percentage of inputs obtained via barter in 1992 and 1997 were 9 and 41, respectively (Hendley, Murrell, and Ryterman, 1999).

61The amounts vary and are set on the basis of the sales history for the region.
how letters of credit worked, which is not terribly surprising, given that the transition is less than a decade old.\textsuperscript{70}

This conservatism is also reflected in a skittish attitude toward schemes to offset taxes and/or debt. The chief accountant emphasized the difficulty of persuading the general director to go along with her plan to obtain a tax offset by having \textit{Venera} pay directly to its workers the "children's subsidies" (detskije posobiya) that are owed to them by the state. Ultimately, the general director was persuaded to go along on the grounds that the plan would benefit the workers. Such practices were outlawed by the Chernomyrdin government in 1997. \textit{Venera} subsequently paid its federal taxes in monetary form. In her view, the workers were the losers since the state routinely fails to make good on its obligations to them.

\textit{Venera} is circumspect in its dealings with the government. Its managers do not meet regularly with governmental officials on any level, nor have they sought any special treatment. Quite the opposite—the company has forgone certain tax benefits offered to start-up businesses because of a fear of hidden administrative costs. Its success has attracted the attention of the oblast government, which sent over a busload of officials for a tour of the plant in 1997. This was followed in relatively short order by a visit of the tax inspectorate. No irregularities were found, but \textit{Venera} managers see the incident as justifying their choice to adopt a low profile vis-à-vis the government.

Thus, \textit{Venera} has developed a set of strategies that have allowed it to prosper in a business environment dominated by debt. Of the three case studies, its practices are closest to those typically seen among manufacturers in established market economies. It does not engage in subterfuge in its dealings with customers, suppliers, or governmental authorities. Nor does it participate in transactions involving barter or vekeśli. Clearly it has benefitted by producing goods that were in short supply in the former Soviet Union. But it has not taken demand for granted and has recognized the existence of potent foreign competitors. It has earned a loyal following among retailers by stressing style and quality. Moreover, it has taken advantage of its strong market position to distance itself from debt-laden customers and to delegate the responsibility for collecting overdue payments to dealers.

\section*{EXPLAINING THE VARIATION IN ENTERPRISE BEHAVIOR}

The analysis of these three enterprises reveals wide variation in the strategies adopted for dealing with high levels of debt in the Russian economy. The empirical richness provided by the case study methodology yields a more complete picture of how ordinary enterprises cope than can be gleaned through the quantitative approach that is predominant in the scholarly literature. These three patterns cannot capture the full range of possible behavior; they are intended as ideal types. Other examples are likely to be variations on these themes. What factors account for the differences in behavior? Because of their small number, the cases do not allow for a definitive answer to that question, but they do point to a set of possible explanations that can then be tested and further refined among larger samples.

\section*{Place of Enterprise in Production Process}

A comparison of the case studies suggests that the place of an enterprise in the production process is critical in shaping its behavior. Enterprises with access to the consumer market have access to cash, which seems to make them less willing to engage in barter and/or vekeśli-financed transactions. By contrast, mid-stream producers have less flexibility. If the assembly plants to which they are selling have no money, then these producers feel they have no choice but to accept payment in-kind.

What the enterprise is producing and the financial viability of the industrial sector also are relevant.\textsuperscript{71} Even the most talented management team at \textit{Avto-Detaliy} would be hard-pressed to escape the downward pull of the Russian automobile industry. Its managers feel trapped in a vicious circle. Their current customers are consistently delinquent, and they cannot attract the financing necessary to modernize the production process so that they could produce for export because they are embedded in such a hopeless sector. By the same token, other manufacturers have had better luck and have been buoyed by sectoral success. \textit{MBT}, for example, survives in large because of the high demand of Russian consumers for household appliances of any sort. The relative success of the sector affects the willingness of banks to take a risk. \textit{Venera} was able to attract start-up financing from Yekaterinburg banks not thanks only to a convincing business plan, but also because of banks' confidence in the persistence of demand for the merchandise to be produced.

\section*{Competition}

The nature of the customer base and the relationship of the enterprise with its customers also appear to have a discernable effect on its behavior. This is, of course, interrelated to the place of the enterprise in the production process. Mid-stream customers are more likely to have a fixed customer base and to have highly personalized relations with their customers. Given the fickleness of the retail market, industrial enterprises that are geared to that market are likely to have more turnover among customers,\textsuperscript{72}

\begin{footnote}
\textsuperscript{70}Our survey indicates that letters of credit (akreditivy) are not commonly used by Russian enterprises. Only 15 percent of the surveyed enterprises (50 enterprises) had confronted a demand for a letter of credit as a condition of sales and, of that group, only 20 percent (10 enterprises) describe it as a routine demand.
\end{footnote}

\begin{footnote}
\textsuperscript{71}Aukutsioneck (1998, pp. 179-181) analyzes the sectoral variation in levels of barter.
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and to have arms’ length relations with them. Indeed, in some cases, the customer base may be literally inexhaustible.

When the enterprise has a finite set of customers and a viable competitor, the tendency is to accommodate the payment preferences of customers. The enterprise is unwilling to risk alienating any of its customers, since this might drive them into the arms of its competitor. *Auto-Detaly* is a superb illustration of this pattern. It adopts a subservient attitude and accepts any sort of payment terms offered by the assembly plants. As a result, it absorbs the transaction costs associated with having intermediaries resell the cars and other items received in payment for its generators.

At the other end of the spectrum, when the enterprise has a constantly changing set of customers that number in the hundreds, the tendency is to adopt bright-line rules regarding payments and to brook no exceptions. Neither customers nor producers exhibit any particular loyalty. The decision as to the identity of trading partner is based on bottom-line concerns, with little regard for reputation or personal ties. *MBT* embodies this pattern. The impersonal nature of its relations with customers is demonstrated by their ho-hum attitude toward *MBT*’s decision to route payments through *TDBT*. Its customers care only whether the goods show up, not what corporate entity sends them. If and when they fail to pay, *MBT* pursues them relentlessly to the full extent of the law, with no regard for the length of the relationship. The highly routinized approach taken by *MBT* to non-payments graphically demonstrates its take-it-or-leave-it attitude to individual customers.

Somewhere in the middle are enterprises that have significant customer turnover, but work at building long-term customer relations that are grounded in personal (as opposed to calculative) trust (Williamson, 1993). Such enterprises tend to deal with customers at all stages in a highly individualized manner. *Venera* reflects this approach. Its goal is not necessarily to sell the most women’s underwear, but rather to develop a reputation for cutting-edge style and quality. Its management is keen to attract the best retail outlets as customers, believing that the reputation of these stores will reflect back onto *Venera*. They have no desire for their goods to be sold in the kiosks that have sprung up all over Moscow, for example. *Venera* has developed a general policy regarding payment, but regularly bends it to accommodate a preferred customer. In contrast to the absolutist approach of *MBT*, *Venera* considers each instance of late payment on a case-by-case basis. In reaching a decision about how to proceed, *Venera* openly considers the history of the relationship and the desirability of maintaining some connection. Moreover, it refuses to contemplate pursuing legal action, preferring to resolve problems through negotiations.

**Restructuring**

The extent to which enterprise management can determine its own fate is widely debated. To be sure, competent management is preferable. But the macroeconomic realities of post-Soviet Russia place significant constraints on what management can accomplish. This is particularly evident with regard to privatized enterprises that were formerly state owned. Such enterprises often have difficulty escaping their past. Many of them clung to their bloated work forces for too long and squandered the profits earned in the early days of the transition on wage payments rather than upgrading their production facilities. By the time these carryover managers woke up to their financial predicament, it was too late to attract investment.

Such criticisms can certainly be made of both *MBT* and *Auto-Detaly*. Whether either could have avoided its current difficulties if its management had pursued different policies in the early years of the transition is now a pointless inquiry. Although many scholars are highly critical of the failure of Russian enterprises to restructure (e.g., Commander, Dutz, and Stern, 1999; Stiglitz, 1999; Gaddy and Ickes, 1999), few of these commentators evidence much understanding of what it is like to manage a low-profile enterprise in the rough-and-tumble of the post-Soviet Russian economy. The fact is that both enterprises have tried to restructure. Both have radically reduced their work forces and are working to make their out put more appealing to a wider variety of customers.

In an ideal world, *Auto-Detaly* should have changed its production profile to maximize profitability and/or begun to market its generators to the public directly. I found no evidence that management had seriously considered repurposing the plant. But they had explored direct sales, and they found that establishing a customer network among retail outlets (which are only starting to develop for the sale of auto parts) was beyond their means. In reality, both of these options, which appear completely rational on the surface, would have required substantial outside investment. Few investors have shown much interest in *Auto-Detaly* in recent years.

*MBT* has had more success in attracting investment, perhaps because of the appeal of the consumer goods sector. An American company currently holds a 46 percent equity stake. At the outset, the managers had high expectations of this foreign investor. They sold much of their own stock to this American company and encouraged workers to do the same in the hope that the Americans would reinvigorate *MBT*. Thus far, the promises of capital investment have proven elusive. *MBT*’s management has been disappointed at the lack of interest shown by this outside investor in resolving the problems faced by *MBT*. Although representatives of this outside investor sit on the board, little has changed in terms of day-to-day management.

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22 Commander, Dutz, and Stern (1999, pp. 6-7) are dismissive of “survival-driven restructuring,” such as labor shedding, which they regard as insufficient, and even counterproductive. In their view, what is needed is “growth-oriented restructuring,” which “generally involves substantial new investment in fixed and human capital as well as strategic changes in product mix.” For a more comprehensive analysis of what constitutes restructuring and when it is helpful, see Bowman, Singh, Useem, and Blodgett, 1999.
Ownership

As this suggests, ownership cannot always be taken at face value. Though much of the scholarly literature trumpets the critical role of outsider stakeholders in transforming moribund former state-owned enterprises into profitable firms (e.g., Commander, Dutz, and Stern, 1999), these case studies show the reality to be considerably more complicated. Although a majority of the stock of both MBT and Auto-Detaly is owned by outsiders, these outsiders have had little effect. In the case of MBT, the outsiders have remained passive, despite entreaties from management to participate more actively. Auto-Detaly poses a different case. Many of its outside shareholders have close links to the enterprise and are unlikely to pose a challenge to existing management. To be frank, there is little incentive for those completely unaffiliated with Auto-Detaly to purchase its stock, since the chances of any return on the investment seem slim at best. This is probably true of many mid-stream producers, and it suggests that hoping for reform through outside ownership is a pipe dream.

Ironically, it is Venera, the enterprise dominated by insiders, that has enjoyed the greatest success among the case studies. It is tempting to attribute this success to the size or the newness of the enterprise. But such explanations do not hold up to scrutiny. Venera is approximately the same size as MBT. It is certainly true that Venera is less weighed down by bureaucratic management than the former state-owned enterprise, but the propensity of Venera’s general director to run the company as his own personal fiefdom also has its roots in the Soviet era. It harkens back to the “one-man management” style (edinomnachal’’ and is no less problematic in its contemporary manifestation. Venera’s success probably has more to do with its ability to exploit a market niche than with the details of corporate governance.

Debt and Desperation

Overarching all of these factors is the ever-changing financial condition of the enterprise. As enterprises sink into debt, they become increasingly desperate. In the post-Soviet Russian context, debt has proven to be a slippery slope. The combination of the kartoteka system and the imposition of interest and penalties onto debt of all kind makes it difficult to climb back up that hill. Although few creditors (including the state) actually enforce penalties, they continue to multiply on the kartoteka while negotiations are underway and have the effect of restricting the debtor’s options. Once an enterprise finds itself in debt, whether to its trading partners or to the state, preserving its remaining assets becomes an all-consuming passion. Survival justifies almost anything. The effect on creditors is rarely considered. Some enterprises have responded by putting diversionary schemes into place. MBT, for example, routinely diverted customers’ payments to an apparently unaffiliated shell company that it controlled rather than allowing them to be used to pay its own creditors. Other enterprises have resorted to doing business through in-kind exchanges and/or debt offsets. The case studies tend to confirm that barter is a last-ditch alternative used as a means of surviving in the short run (e.g., Aukutusheve, 1988; Commander and Mumpsen, 1988).

POSSIBLE INSTITUTIONAL IMPLICATIONS

The irony of the situation is that the behavior that allows for the survival of Russian enterprises in the short run may have long run consequences that are troubling for the polity as a whole. Behavioral patterns that are functional and even rational under contemporary conditions are becoming ingrained. This is alarming not only because such behavior is likely to outlive its usefulness, but also because it is likely to have unintended effects on key institutions and on the underlying culture of doing business.

Banks

The peripheral role of banks in the lives of ordinary Russian industrial enterprises is well known and is further documented by the case studies. To some extent, the banks themselves are responsible for this unusual state of affairs. As the market for government securities heated up in the mid-1990s, many of them pursued quick profits at the expense of the traditional banking functions of providing credit for manufacturers. Certainly the banking crisis of August 1998 exposed the true nature of many Russian banks.

But the confiscatory policy relating to the accounts of net debtor enterprises, which required banks to redirect all deposits to creditors, has further distanced banks from enterprises. The goal was to encourage enterprises to discipline themselves and to pay their bills on time. Enterprises that failed to do so risked losing control over their bank accounts and, presumably, their financial affairs. The sanction proved inadequate. The response was not increased compliance with tax or contractual obligations. Instead, debtor enterprises demonstrated remarkable ingenuity in circumventing these restrictive policies by avoiding contact with banks. Their trading partners have been willing to accept such schemes. As a result, the only punishment for debtor enterprises was the increased transaction costs associated with these schemes, not the loss of financial autonomy. While this evasive and extra-legal behavior has facilitated the survival of borderline enterprises, it has established an idiosyncratic relationship between enterprises and banks that may persist even when the Russian economy becomes more stable. There is, after all, no tradition of commercial banking in the Russian context and, by contrast, a long and noble history of evading state regulation that predates the Soviet era.

See Hendley, Murrell, and Ryterman (1999) for an analysis of the propensity of enterprises to enforce penalties when their trading partners default.
Enterprise Relations

Not only have relations between banks and enterprises been skewed by the need to respond to the specific circumstances of the transition, so too have relationships among enterprises. Many of the coping strategies uncovered during the case studies are openly acknowledged as responses to exigent circumstances. Even though management appears unconcerned by the ethical and legal overtones of some of their diversionary schemes, they see them not as desirable, but as necessary. They recognize that these tactics involve additional costs, measured in monetary costs, time, and lost opportunities.

To assume that this behavior is merely temporary and will cease when circumstances change would be utopian. The transition has lasted longer than had originally been hoped, and behavior that might have started as a quick fix has become routine. Altering these routines will not be easy (Murrell, 1992; Nelson and Winter, 1982). After all, privatized enterprises still engage in many practices that were required during the Soviet era, but which no longer make sense. When challenged, managers explain that they are accustomed to doing things a particular way and see no reason to change. Whether managers will exhibit the same sort of defensiveness with regard to barter or offset schemes remains to be seen. While tax evasion may not have been the reason why an enterprise first started bartering, it may prove to be a difficult habit to break.

Legal System

Most of the studies of survival-oriented strategies of Russian enterprises have overlooked the impact on the legal system. The tendency is to focus on the prospects for the economy more generally (e.g., Stiglitz, 1999; Gaddy and Ickes, 1998). But the perverse effect on the legal system of these behavioral patterns is inescapable. Enterprises that obey the law and follow the procedure for collecting debts are effectively penalized. More specifically, creditors who file lawsuits to recover overdue payments typically win in court, but then discover their debtors’ bank accounts are empty. The law provides a mechanism by which these victorious creditors will be paid when funds come into the debtors’ accounts. This, of course, assumes that the debtors will continue to use their banks. As the case studies suggest, once kartoteki have been attached to their bank accounts, debtors cease using them. The creditors can wait for funds to come into these accounts, but their patience is rarely rewarded. Further discouraging reliance on law are the well-known shortcomings of the state-sponsored institution (sudbennyye pristavy) charged with helping creditors recover the value of court judgments (see generally Hendley, 1998a and 1998b). When examined on a system-wide level, these must be seen as creating a powerful disincentive for playing by the rules.

The point is not that we should expect creditors to collect debts through the courts as a routine matter. In Russia, as elsewhere, it is reasonable to expect most disputes to be resolved through informal negotiations between the parties. But the presence of litigation as a viable option is invaluable to creditors in persuading delinquent customers to pay their bills. When these customers are aware that they can easily outrun the law by abandoning their bank accounts, then the threat is empty. Even more disquieting is the awareness that such behavior, which has the effect of defrauding the secured creditors who are registered on the kartoteki and is a blatant violation of Russian law (arts. 159, 177, UK), results in no criminal or reputational sanctions. The very ubiquity of this practice explains why it is not prosecuted. Perhaps it also explains why no one looks askance at it. Perhaps a majority of Russian enterprises are living in glass houses on this issue. Sometimes they are the victims and are frustrated by their inability to access their debtors’ resources. But they are equally likely to be the perpetrator of a diversionary scheme at some other point. Consequently, the logic of collective action dictates that no one is likely to blow the whistle.

This illustrates the essential dilemma of legal reform in Russia. In this case, the necessary rules have been enacted and the institutions have been put into place to implement these rules, but they are disregarded with apparent impunity. Some argue that the solution is a combination of more and better laws and legal institutions, and a stronger commitment on the part of the state to enforcement (e.g., Hay and Shleifer, 1998). This argument may be convincing in the arena of law and order, but not in the economy. The law is adequate to the task and the failure to enforce it cannot be laid at the door of the state, since the debt is a minor actor in economic disputes where parties have full freedom of contract. Instead, the lack of enforcement is a reflection of a business culture in which those who skirt the law are lionized, not ostracized. Improving the substance of the law, while always helpful, will not solve the problem.

Applying this lesson more broadly, the sad truth is that there is no simple remedy for the stalled transition in Russia. The case studies demonstrate the complexity of daily life for industrial enterprises. Their ability to survive is a testament to their capacity for innovation when pressed. What is more disappointing is their inability or unwillingness to demonstrate that ingenuity by engaging in meaningful restructuring when given the opportunity to do so. This speaks to the presence of a cultural milieu in which survival is the ultimate goal and anything is permissible in pursuit of that goal.
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The Novgorod Region: A Russian Success Story

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Abstract: A specialist on Russian politics and society examines the apparent success of economic and political liberalism in Novgorod oblast in the 1990s. The article is based on published and unpublished documentary sources from the region, as well as in-depth, repeated interviews with local officials during 1997-1999. Focus is on progress in economic reform, finance, and foreign investment, forms of political decentralization and representation, the growth of civic associations, and styles of political leadership. Several explanations for these outcomes are proposed and discussed.

The Novgorod region is situated in the northwestern economic area of Russia, approximately three hours southeast from St. Petersburg along the main highway to Moscow. The most important natural resource of the region is timber; 65 percent of the region is covered with forest. The region has a population of about 740,000 and covers an area approximately the size of West Virginia. The largest city, Novgorod-the-Great, has 230,000 inhabitants, and the second largest town is Borovichi, with about 61,000 inhabitants. The urban population constitutes about 71 percent of the region's inhabitants, 96 percent of whom are ethnic Russians.

In the midst of Russia's general turmoil, the Novgorod region² has emerged as an island of social stability and relative prosperity. Its success in attracting foreign investment has largely overshadowed its other accomplishments but, as local officials never tire of repeating, attracting foreign investment is just one part of a broader social transformation the region must undergo. This transformation centers around reviving local self-

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²Throughout this paper the term “region” will be used for “oblast” and “district” for “raion.”