

# **The Volkhov International Business Incubator**

Leningrad Oblast, Russia

## **The Role of the Business Incubator as an Economic Development Tool in Provincial Russia: A Case Study**

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### **ABSTRACT**

The small business incubator is an important economic development strategy for provincial Russia. The model that the Volkhov International Business Incubator (VBI) has found to be most effective combines the characteristics of the traditional *small business incubator* with the objectives and methodology of *empowerment* or *micro-enterprise incubators*, plus the functions of a *business services center* and a *training center*.

The Incubator was established in 1955 by the Alliance of American and Russian Women and the mayor of Volkhov and funded for three years by the USAID/Moscow New Business Development Program. It has attained 75% sustainability, despite the current economic crisis. The Incubator is managed by a Russian staff. It is the first and only institution in the region to focus on women-led businesses; to have an independent board of trustees; to offer credit and equipment leasing to small businesses at reasonable interest rates and for long periods; and to offer computer training and courses on the computer.

The Incubator has become the catalyst for business development in the region; has helped create and sustain 120 businesses and 450 jobs; trained and consulted with 4500 individuals; has 44 equipment leasing clients; and ten tenants. Today, the staff is training representatives from other cities in Russia and the NIS how to establish and manage a small business incubator, an equipment leasing program and a women's business support program.

The management and financial challenges of such an operation are immense, particularly in a region where human and financial resources are scarce and political, economic and regulatory barriers are considerable. Nevertheless, the VBI is evidence that the outcomes are worth the effort and can be expected to have a long-term impact.

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# **The Volkhov International Business Incubator**

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### **The Role of the Business Incubator as an Economic Development Tool in Provincial Russia: A Case Study**

#### **OVERVIEW: THE SERVICE**

The Volkhov International Business Incubator (hereafter referred to as the Incubator or VBI) was founded in 1995 by the city of Volkhov<sup>1</sup> and by the Alliance of American and Russian Women<sup>2</sup> to support the development of small businesses in the Volkhov region, with a particular emphasis on women-led businesses. The Incubator offers secure office and production space for rent; business training; computer training; office services; business consultation; a program for women's empowerment in business; access to credit for qualified small businesses, sole proprietors and agricultural enterprises; plus a wide network of commercial, non-profit and political contacts among Russian and international agencies and organizations.

The Incubator is registered as a Russian educational institution. It has received licenses to conduct business training from the Leningrad oblast Ministry of Education, as well as the Federal Ministry of Education in Moscow. The former certifies Incubator business training in the oblast, while the latter certifies training throughout the Federation.

The Incubator is located in an 1800 square meter building, contributed rent-free for 49 years by the city of Volkhov. It is managed by a Russian staff and overseen by a board of trustees. The board consists of senior incubator staff, four local entrepreneurs, representatives from two St. Petersburg financial institutions, and two representatives of the Alliance of American and Russian Women.

The Incubator received funding under a three-year cooperative agreement with the United States Agency for International Development New Business Program, 1995-1998. To sustain its small business development activities, the Incubator charges fees for training and services. It offered free business consultation until October 1998, when it instituted fees for that activity also, in view of the need for financial viability during the economic crisis.

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<sup>1</sup> Volkhov is a city of 60,000 people on both banks of the Volkhov River, 130 km north east of St. Petersburg. It is the site of the first Soviet hydroelectric plant and the first Soviet aluminum factory, both still more or less operational. Until recently, it was a closed strategic city, largely because it is an important railroad hub. Nonna Mikhailovna Volchkova, for 15 years mayor of Volkhov, is one of two female mayors in Russia.

<sup>2</sup> The Alliance of American and Russian Women (AARW), a non-profit organization, was founded in New York in 1992 to enable American businesswomen to work with Russian women to facilitate their participation in the emerging market economy.

The Incubator's need for earned income to become financially viable and clients' need for access to credit on terms they could afford led the Incubator to develop an equipment leasing program to lease equipment for light manufacturing, agriculture and services to small businesses in the Leningrad oblast. The Incubator was the first non-profit organization in the entire Russian Federation to be granted a leasing license from the Ministry of Economics in Moscow, as well as the first organization of any kind in the Leningrad oblast to receive a leasing license.

Clients for Incubator training and services are residents, sole proprietors and legal entities of Volkhov and neighboring regions, in addition to the Incubator tenants whose businesses are located inside the building. Individuals are welcome to come to the Incubator to inquire about products and services. After an initial interview with potential clients, the staff determines whether they qualify for a training program; whether they simply wish to purchase office services; whether they should be referred elsewhere; whether they may apply to become Incubator tenants; or whether they may be candidates for equipment leasing. In the latter cases, clients are required to develop an appropriate business plan, either on their own or in consultation with the staff consultant on business planning.

Clients for the leasing program are small businesses, which are engaged in farming, light manufacturing or services. Eighty percent of the businesses are start-ups, led by new entrepreneurs based in the city of Volkhov, the Volkhov region and neighboring towns and regions.

The development of the Incubator concept and its implementation was led by two representatives of the Alliance of American and Russian Women, who today co-chair the board of trustees. Day-to-day management is under the leadership of a general director. Rachel M. Freeman, the first general director, was a young American woman with extensive experience in Russia. She spearheaded the effort until the summer of 1997, when Igor Gruzdev, a banker from St. Petersburg, moved to Volkhov to become general director. The dedicated, committed and exceedingly competent staff was recruited in Volkhov, with the exception of the CFO, who was a St. Petersburg banker. Today, the staff is 100% Russian and entirely local.

### **How the Volkhov Business Incubator Differs from Traditional Incubators**

A business incubator is commonly defined by its mission: To grow profitable businesses and create jobs. Businesses are expected to graduate from an incubator after approximately two years incubation and then to survive and prosper in the community. The primary task of incubator staff, which in the U.S. consists of two to three people, is to service and nurture tenant businesses.

*Microenterprise* or *empowerment* incubators have the additional challenge of incubating

businesses in economically depressed regions, where business owners may require additional support services and where an articulated goal may include invigorating the local economy or strengthening minority or gender-based business ownership, as well as creating profitable businesses. It will be immediately apparent to the reader that such an approach requires additional skills, and may incur additional costs.

In the United States, as incubators have developed over the past thirty years, or in western Europe, where they have developed more recently, an economic support infrastructure has evolved among federal, state and local governments. Incubators have proven to be flexible, cost-efficient tools to develop and grow businesses, to create local employment and to strengthen or diversify local economies. Incubators may qualify for a broad array of government grants, tax incentives, contributions of underutilized land, buildings or utilities, university or corporate support and participation. By the 1990s, it was generally recognized that small businesses were a major factor in the GDP and that policies to enhance small business development contribute to national or local economic growth. None of these features exists in Russia. It is noteworthy that in the United States, 80% of business incubation programs receive subsidies and that their programs would suffer if public funders withdrew support.<sup>3</sup>

The city of Volkhov, when the mayor invited the AARW to establish an incubator, could be characterized as an extremely depressed, socialist municipality. Enterprises large and small were shut down or simply not paying salaries; no new businesses nor jobs had been created; no municipal services had been developed or upgraded. Trading had sprung up in the streets. It was not unlike the depths of the dust bowl in a small mid-western American town in the 1930s: No hope, no incentive, no activity and a lot of lethargy. The single exception was the highly energetic, charismatic, political mayor.

- In 1993, when the project was first considered, the concept of growing small businesses was novel. The concept of a business incubator was non-existent.
- In 1994, when the feasibility study was undertaken, and in 1995 when the Incubator opened, it was greeted with skepticism or bemusement by most city officials, potential staff, potential tenants and future clients. They viewed the undertaking as a charity, not a business, run by well-meaning but naive Americans, with only a superficial understanding of how things operate in Russia.
- Transparency and qualifications in recruiting and hiring staff and in recruiting tenant businesses was a new practice for Volkhov. The mayor assumed that her appointees would constitute the staff and her favored municipal businesses would become the tenants.
- No one in the region had been exposed to western business training or practices.
- No one in the region had prepared business plans or used international accounting.
- There were few computers, no computer training or sales, no email, few fax machines no business services.
- There was no access to credit for small businesses.

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<sup>3</sup> University of Michigan, Business Incubation Works, 1997.

- There were no independent non-profit organizations or associations.
- There was no particular help or attention to women, despite the fact that they constitute 80 percent of the unemployed.

Today, similarities between the VBI and business incubators in the west include the following:

- The Incubator is located in a building, contributed by the city
- There are eleven business tenants in the Incubator and four in the pipeline
- Three former tenants have graduated, two have relocated in the city
- The Incubator collects rent, provides security, maintains the building and grounds, provides telephone answering and mail collection services
- The Incubator staff has developed a special relationship with the tenant businesses
- The staff is highly regarded and valued by entrepreneurs, officials and residents
- The VBI as an institution has earned a reputation in the region and throughout Russia as a serious and important contributor to the development of small business in a provincial town and as a model participant in the market economy.

The list of differences is longer:

- Regional catalyst.  
The Incubator has major social and economic objectives that do not encumber traditional western incubators. It serves as a catalyst for entrepreneurship and business development for the entire community. The intended outcome is that individual citizens in the region and the local city administration develop a stake in the success of a market economy.
- Training.  
It is a training ground for basic international business practices: Finance, accounting, management, marketing, communication, human resources, customer service and common office practices. This entails formal courses, conferences, seminars, consultation, counseling and day-to-day interaction among staff and clients.
- Business services.  
It offers a wide range of professional office services, business planning and business consultation, as well as training to the entire region, not just to tenant businesses.
- Credit and equipment leasing.  
It is the only institution in the region that offers credit and equipment leasing to small businesses at reasonable interest rates and for long periods.
- Computer training.  
It is the only institution in the region that offers computer training and courses on the computer.
- Governance.  
It is the first and only institution in the region to have an independent board of trustees.
- Focus on women.

It is the first and only institution in the region to focus on women-led businesses, to offer a women's business empowerment program, to encourage and support women to start and manage businesses and to offer credit and leasing to women entrepreneurs.

## **OUTREACH**

The Incubator philosophy is that it offers a service for everyone. However, in 1995 and 1996, the task was not simply to recruit clients, but to introduce them to the basic concepts of a business incubator and the fundamentals of running a private, profitable business. Local residents were invited to public forums, sponsored by the mayors of Volkhov and cities in the region, to learn about the Incubator and its services and to talk informally with the staff. The local press ran articles about the Incubator and eventually the Incubator placed paid advertisements regarding specific services. Local and national TV and print media frequently cover seminars or events at the Incubator, as well as interviews with the staff. Poster advertisements are positioned at strategic locations. Finally, there is an extremely active personal network of staff and Incubator clients. The most effective outreach is done by satisfied clients, face-to-face or over the telephone. Marketing the Incubator continues to be a daily preoccupation.

The result of this outreach is that, as of 1998, the Incubator helped establish **50 new businesses**, creating **190 new jobs**. It helped to **sustain an additional 70 business** and **260 jobs**.

- The Incubator currently rents office or production space to 10 tenant businesses. Sixty percent (marked by an \*) are led by women.
  - Wholesale and retail bakery\*, which operates around the clock with 24 employees and has successfully established a subsidiary in a neighboring town.
  - Appraisal firm for real estate and real property, the only such firm in the city.
  - Appliance repair for refrigerators, TVs, etc.
  - Print shop\*
  - Knitwear production, wholesale and retail\*
  - Delta Telecom mobile phone franchise
  - Auditing firm\*, the first in the city
  - Automobile alarm systems, sale and installation
  - Women's clothing design atelier\* and production
  - Interior design and construction firm\*

- Cash registers and scales sales and servicing
- The Incubator has sponsored **120** training programs and seminars:
  - **1494** people have participated in the courses
  - **1200**, or 80 percent of the participants were women entrepreneurs
  - **289** of the participants were managers of functioning businesses
  - **45** artisans have participated in seminars “How To Organize Your Business”
  - **144** unemployed have participated in training
  - **146** students have participated in training
- Incubator staff consultants have worked with **2749** individuals, including **1115** women and farmers to assess their business ideas and help them develop business plans.
- The VBI developed the Women's Business Support Program, a special ten week course to help women overcome fears connected with opening and running a business. It is a form of group counseling, in which:
  - **57** women have participated
  - **22** women graduates have organized their own businesses
  - **55** new jobs have been created
- Over **4400** clients have purchased office services, including fax, xerox, logos, graphic design, business image/marketing products, presentations, publications, laminating, scanning, business cards, brochures, advertisements, etc..

### **Leasing Program**

This program renders a unique service. It is the only credit available to small businesses and start-ups in the oblast. The Incubator staff business consultant works with clients who apply for equipment leasing to help them complete and refine a business plan. The plan is then subject to rigorous scrutiny and analysis by the VBI financial officer to determine whether the business can support interest payments. The analysis is followed by site visits, further assessment of the business and the client, and input from all members of the Incubator staff. The final step entails a review by the credit committee, which consists of senior staff and members of the board of trustees.

Leases are offered for two years, and require equal monthly payments of interest and principal. At the end of the period, the client owns the equipment. The maximum lease amount was raised recently from \$25,000 to \$60,000, and interest rates were raised from

35% to 60-90% annually, in rubles, in view of inflation during the economic crisis. Interest rates are based on those of the Central Bank. In addition to the business plan, the Incubator requires that the client registers the business with the municipal and tax authorities; a 12.5% up-front payment on the equipment; and full insurance coverage in the name of the Incubator.

As of the end of 1998, the Incubator had 56 lease agreements with 48 clients, at an average of under \$10,000 a lease. An extremely popular arrangement with select clients is the lease buy-back agreement. In a lease buy-back, the Incubator may purchase title to the client's building, equipment or transport to provide working capital which could not be obtained otherwise. The client then repurchases the equipment over time as with a regular lease.

The following table demonstrates that women play a significant role in the VBI leasing program. Women-led businesses constitute nearly 50% of the leasing clients and over 50% of the dollar volume of all leases. Women held all the leases in the manufacturing sector but less than half the leased equipment in services, trade and agriculture.

#### VBI Leasing Clients by Gender

| Activity           | Number of Leases |                      |                         | Revenue to Incubator |                      |                         |
|--------------------|------------------|----------------------|-------------------------|----------------------|----------------------|-------------------------|
|                    | Total            | Women-led Businesses | Women-led as % of Total | Total \$US           | Women-led Businesses | Women-led as % of Total |
| <b>Agriculture</b> | 6                | 2                    | 5%                      | \$44,723             | \$ 8,138             | 2%                      |
| <b>Production</b>  | 4                | 4                    | 9                       | 37,514               | 37,514               | 9                       |
| <b>Services</b>    | 13               | 6                    | 14                      | 182,156              | 142,856              | 32                      |
| <b>Trade</b>       | 21               | 9                    | 20                      | 176,213              | 45,525               | 10                      |
| <b>TOTAL</b>       | <b>44</b>        | <b>21</b>            | <b>48%</b>              | <b>\$440,606</b>     | <b>\$234,033</b>     | <b>53%</b>              |

#### VBI Tenants, Loan and Leasing Clients by Business and Gender

| Activity           | Number of Enterprises | Percent of Total | Percent of Women Managers | Percent of Women Workers |
|--------------------|-----------------------|------------------|---------------------------|--------------------------|
| <b>Agriculture</b> | <b>6</b>              | <b>11%</b>       | <b>33%</b>                | <b>50%</b>               |

|                   |           |             |             |            |
|-------------------|-----------|-------------|-------------|------------|
| <b>Production</b> | <b>8</b>  | <b>14.5</b> | <b>100</b>  | <b>95</b>  |
| Food              | 4         | 6.8         | 100         | 90         |
| Clothing          | 3         | 5.2         | 100         | 100        |
| Other             | 1         | 1.7         | 100         | 50         |
| <b>Services</b>   | <b>23</b> | <b>40</b>   | <b>54.5</b> | <b>38</b>  |
| Photo lab         | 3         | 5.2         | 100         | 60         |
| Hairdresser       | 1         | 1.7         | 100         | 100        |
| Car repair        | 3         | 5.2         | 30          | 5          |
| Other             | 16        | 27.5        | 66.7        | 30         |
| <b>Trade</b>      | <b>21</b> | <b>36.2</b> | <b>42</b>   | <b>90</b>  |
| <b>TOTAL</b>      | <b>58</b> | <b>100%</b> | <b>64%</b>  | <b>70%</b> |

Annual turnover among VBI tenants, loan and leasing clients ranges from \$3000 to \$600,000. Incomes range from less than \$500 to \$50,000, and the number of employees from two to fifty.

### **Client Networks**

In evaluating the outcome of Incubator work with clients, it is important to consider not just the tangible support, but the reciprocal and interconnected working relationships which are established. This is particularly evident among Incubator tenants. The Incubator provides an environment where tenants can learn from and support one another, build networks, strengthen their businesses, and develop their professional skills.

One example is the Incubator's work with a tenant auditing firm. The firm's owner, Margarita, required about 15 sq m at the Incubator to service three clients. After several months in the Incubator, and participating in general tenants' meetings, she acquired three additional clients among the tenants. Today, nearly all the tenants rely on her bookkeeping services.

Margarita also participated in the meetings of the Volkhov Business Association. Established through the initiative of the Incubator, it is the only independent, non-profit organization in the region. Her comments and recommendations in those meetings brought her additional clients, most of whom are also leasing clients of the Incubator. During the year her business grew significantly. She has tripled her space and employs four additional people.

One of Margarita's new employees, Irina, moved to Volkhov one year ago. As an unemployed woman, she participated in the Incubator's Women's Business Support Program. This led her to undertake all the research and preparatory work necessary to establishing a credit union, primarily for women entrepreneurs--the first in the region. At the same time, she enrolled in the Incubator's computer course for professional book-keeping certification. For practical training, she interned with Margarita's auditing firm. Another outcome has been Irina's participation in League of Women Voter's training for

lobbying. As a result of these combined experiences, she will serve as the sole staff person for the Volkhov Business Association. The Association and the Incubator will co-sponsor the credit union.

Similar stories could be told about a majority of the Incubator tenants and many of the leasing clients. The support network continues to grow through the initiative of an alert staff and the now self-perpetuating efforts on the clients.

## **MARKET**

### **General Market Context**

The competition for Incubator services in the regional market is low to nil, depending on the service. The Incubator is the only organization in the region with private or public sector donor support. Some St. Petersburg and local banks are said to provide credit to small businesses, but if so the clients the Incubator serves do not have access to such services. The oblast government and private leasing firms in St. Petersburg presumably offer equipment leasing, but the Incubator has yet to come across evidence of such a lease in the region. Business training is offered by several fine institutions in St. Petersburg, but these are financially beyond the reach of Incubator clients, or probably 95% of the population of the oblast. Evidence of competition in office services is beginning to emerge. In September, the post office in the center of the city began to offer copying services at half the cost of the Incubator.

Despite substantial rhetoric and lip service, Russian government support at any level for the development of private, small business has been non-existent. To the contrary, federal and oblast governmental actions have tended to support large business at the expense of the small entrepreneurs. Municipal government policies and regulations have the effect of supporting municipal enterprises at the expense of private entrepreneurs.

There are international providers in St. Petersburg and other major metropolitan areas of Russia. However, the country is vast and donors and providers are few, particularly in provincial areas. There is no question that their number could be multiplied many times over without encroaching on each other's territory or competing with the private sector. Opportunities to support small business in Russia have barely been tapped, and to date the impact on a macro basis has been infinitesimal. In the long term, leasing and credit to small businesses promises to be an immensely lucrative market. It will be really effective, however, only when an institutional infrastructure serving small business can be encouraged and when regulatory and tax barriers can be lessened.

### **Taxes and Regulatory Constraints**

Taxes in Russia are burdensome to the extent that it is difficult or nearly impossible for a

small business to understand and adhere to all requirements. The cost and time factors alone are prohibitive. A few examples will illustrate the point.

VAT Tax. There are two kinds of small businesses in Russia: legal entities (juridical persons and sole proprietors (entrepreneurs)). They have different tax systems, although they may be identical in size or turnover. The former pays the VAT tax, the latter does not.

Both are clients of the incubator, but the VAT tax disparity works as a disincentive for them to do business with each other. The result is that legal entities do not patronize entrepreneurs, because it is not profitable; and entrepreneurs pay higher prices because of the VAT tax.

Profit/Income Tax. Legal entities on balance pay a higher profit tax than entrepreneurs. The tax is owed whether the legal entity has profits or losses. If a business suffers losses during the quarter, it must pay the profit tax on the sum of its losses. The logic behind the tax is based on the government viewing all businesses as intending to cheat the government on tax payments. If there were not a profit tax on losses, all businesses would declare a loss. This applies equally to non-profit business entities such as the Incubator.

The definition of expenses which may be deducted to reduce the tax base of a business is purely arbitrary and changes frequently. For example, interest payments on a loan are not deductible as a business expense, while the same payments on a lease are deductible. It is extremely difficult for small enterprises to know exactly which expenses are deductible, since the list is long and changes frequently. For this reason alone, most entrepreneurs have problems with the tax inspector.

Other Taxes. In addition, the entrepreneur must pay 100 percent of salaries to off budget social funds, pension funds and other special funds, *pluss* 30 other federal, regional and local taxes. Clearly, the sum of these taxes places an unbearable financial and regulatory burden on small businesses and is a major barrier to the development of a market economy. Such a tax system, creates a negative environment for business development, leads to a reverse reaction from businesses and does not create a normal attitude toward business in society. In fact, the current tax system pushes business in to the gray economy.

Additional Barriers. The conduct of business in Russia is determined largely by government approvals. Local government regulatory entities require approvals, certificates and fees for the components, ingredients and production of nearly every product: Computer placement in offices, electric systems, fire systems, etc. Licenses are required to produce mayonnaise; or to bake bread (a separate license for each type of bread); or to produce a line of knitwear (a separate license for each style). Approvals and licensing fees are determined largely by bribery or direct extortion and

involve paying additional sums, above the official cost of the license--e.g. for "expertise".

In many cities and towns, criminal groups collect more money than the tax inspectors or the regulatory entities. This is an obvious additional burden.

Finally, it is not unusual for small businesses to confront negative attitudes from local government authorities. Some authorities are more interested in supporting municipal and government enterprises than they are in promoting the development of private enterprise. Entrepreneurs confront outright hostility or hidden negative barriers on the part of municipal authorities who often view private business as competitive.

It is not an exaggeration to say that in Russian provincial towns and cities, there are no financial institutions to support the development of small business; government structures have other priorities; and effective non-profit or international organization support is absent (since it is concentrated in major metropolitan areas).

## VBI FINANCIAL SUSTAINABILITY

Financial sustainability is difficult to forecast as of this writing, because of current financial and economic developments in Russia: Implosion of the banking system, the absence of a federal economic program, devaluation of the ruble, and imminent hyper-inflation. Like other private institutions in Russia, the Incubator has had to cut expenses drastically to live within its means. The Incubator has always operated at a bare bones level. The only fungible area is staffing. The staff has agreed to a substantial cut (up to 80% in dollars, 60% in rubles) and lay-offs are inevitable. Despite current events, the Incubator is forecast to be not just financially self-sustainable, but financially self-sufficient<sup>4</sup>, when the leasing fund can be capitalized at \$2 million. The currently available capital pool is \$666,000.

### **Incubator Earned Income, 1998 Showing Effect of Economic Crisis**

Average exchange rate 12.5

| Category                     | 9 Months 1998 |           | 1998      |           |
|------------------------------|---------------|-----------|-----------|-----------|
|                              | Rubles        | \$US      | Rubles    | \$US      |
| <b>Income</b>                | 998 340       | \$124,793 | 1 389 752 | \$111,180 |
| <b>Expense</b>               | 409 546       | 51,193    | 808 662   | 64,693    |
| <b>Net Income Before Tax</b> | 588 794       | 73,599    | 581 090   | 46,487    |
| <b>Profit Tax</b>            | 175 605       | 21,950    | 212 755   | 17,020    |
| <b>Property Tax</b>          | 30 094        | 3,762     | 32 975    | 2,638     |
| <b>VAT</b>                   |               |           |           |           |
| <b>Road Tax</b>              | 32 930        | 4,116     | 29 826    | 2,386     |
| <b>Land Tax</b>              | 855           | 107       | 2 130     | 170       |
| <b>Net Income</b>            | 349 310       | \$43,664  | 303 404   | \$24,273  |

The Incubator started with a grant of \$900,000 over three years from USAID, of which \$400,000 was used to capitalize the credit and leasing programs.<sup>5</sup> Monthly operating expenses in 1997-98 were \$18,000-\$20,000. During the current economic crisis, these have been reduced to \$7,000 a month and are expected to continue below \$10,000 a month through 1999, unless additional investment can be obtained.

In 1999, the Incubator will be 75% financially self-sustainable at that reduced level. Incubator earned income will be derived 54% from interest payments on leases, 12% from tenants' rent payments, 8% from training and 2% from office services. A grant

<sup>4</sup> Financial sustainability (samaokypaemost) means that the Incubator can function on income from operations, plus additional capital investment in the leasing program and grants for non-income-producing programs. Financial self-sufficiency (samafinansirovaniye) will have been attained when revenues from an expanded leasing program and Incubator services cover all operating expenses.

<sup>5</sup> Almost \$1 million was spent in the U.S. on direct and indirect expenses, equipment and travel. An additional \$2 million was contributed in cost sharing.

program will contribute 25% of Incubator revenues next year.

In the spring of 1997, The U.S. Russia Investment Fund and the VBI signed a loan agreement for \$250,000 at 5% interest to enlarge the capital pool for leasing. Projections for 1999 assume that the loan will be operational at that time.

The Incubator aims to continue to serve the region and to maintain services during the economic crisis with the flexibility it has developed with experience. Training programs and businesses services will be modified, deleted or added, based on demand. Prices will be raised or lowered, based on inflation, costs and competition, but always with an eye to producing revenues sufficient to sustain the activity.

The training program, for example, is focusing on computer courses, including professional bookkeeping courses on computer, because demand is greater and the fees can be higher than for traditional business training. All graduates are hired by firms in the region immediately upon graduation. The Incubator has discontinued micro-loan program which offered loans up to \$10,000 in cooperation with Baltiisky Bank. Bank fees, regulations and required promissory notes up front to cover Incubator guarantees, make this program no longer profitable and excessively time consuming.

To date, the Incubator has experienced only one default from a client who had accepted credit beyond her ability to pay. However, additional defaults can be anticipated in the leasing program during the current economic crisis.

The need for Incubator services and programs continues to be immense. Demand for leasing is expected to increase, during (or perhaps because of) the current economic crisis. Clients and potential clients with cash are eager to invest their savings in hard goods, particularly transport, with the assistance of leases from the Incubator. Retail and wholesale trade, particularly in food products, continues. Local production is expected to increase. But plans for an expanded leasing program in terms of a larger capital pool, will probably be put on hold pending the outcome of the current economic crisis.

#### Tax Exemptions

After sustained lobbying at the oblast and municipal levels, and in recognition of the revenue produced by the businesses the Incubator supports, the VBI expects to be exempt from a number of taxes in 1999: Property tax, road tax, land tax, etc.

#### Beyond 2000

The VBI sustainability strategy anticipates seeking additional grant funding to capitalize the equipment leasing program at \$800,000 to \$1 million over the next two years. By 2001, it should be possible to seek private investment to double the leasing program and thereby bring the VBI to financial self-sufficiency.

Modest grant support will also be sought to sustain the Women's Business Support Program. This important counseling program, as opposed to other Incubator services,

was never designed to generate revenues for the Incubator, although its outcomes have led to income producing businesses for the participants.

In the out years, if funds are available, the VBI will consider offering equity investments to select clients, as well as the current debt products offered through equipment leasing.

## **INSTITUTIONAL ISSUES**

The VBI has been a path-breaking institution in the region. It has the first and only independent, volunteer board of directors in the region, with ten Russian and two American trustees. The board meets formally at least three times a year, and trustees are consulted individually by Incubator staff several times between meetings. Initially, the trustees tended to be passive, but they have evolved to the point where they now initiate contacts with the general director and offer suggestions, recommend clients or discuss new services or business opportunities for the Incubator. Through the operation of this board, the trustees are exposed to and gain experience in principles of governance and voluntarism for the first time. As influential individuals, they are carrying this experience over into their other activities.

Russians who come to the VBI as clients, tenants, business or organizational partners comment with amazement on the atmosphere, the "culture". The Incubator is a team effort; the staff support each other; there is a strong customer service orientation; the atmosphere is friendly. This is a result of human resources policies and management practices which respect the individual, foster a team approach in all activities--from the development of Incubator strategy to the creation and delivery of products and services. The future of the Incubator is directly related to the inputs and outputs of the staff at all levels, and this has created what for provincial Russia is an unusual,"can do" culture. There is a modest bonus system for performance, but this does not drive the activity and enthusiasm for the business development effort. Rather, it is a belief in the importance of the mission and the evidence of concrete results that motivates the team.

## **IMPACT**

Federal data indicates that the number of small businesses throughout Russia have declined over the past few years, and the decline is accelerating during the current crisis. In Volkhov, the number of registered small businesses which pay taxes in the city has increased from 540 to 1420 over the past three years. Volkhov is the only city in the oblast which can claim such an increase. The Incubator has been a major factor in creating a climate where entrepreneurship is encouraged and supported.

As the sole creator and sustainer of registered businesses and jobs in the region, with regularly reported income, the Incubator has impacted hundreds of families and thousands of individuals, directly and indirectly. It has also had a financial impact on hundreds of

suppliers to Incubator-supported businesses, and to the municipal budget, by virtue of taxes paid.

The VBI has changed the face of the city and the leisure pursuits of its residents. The first modern cafe in town and the first youth entertainment center would not have been established without the Incubator. These attract clients from distant regions and offer adults and young people healthy entertainment that is otherwise not available locally. These institutions are also profitable and contribute to the city's coffers.

The mayor established a municipal department for small business to "compete" with the Incubator in supporting small business. The director of the department works closely with the VBI to spotlight small business and to attract support from other levels of government. It has led to more accurate data gathering, discussion at cabinet meetings, and tender offers to small business to rent municipal property.

A "Noncommercial Business Partnership" became the first independent, voluntary association to be established in Volkhov, as a result of the VBI initiative. It meets regularly, has united 80 small businesses, is a registered organization with a governance structure modeled on the Incubator. The Partnership has worked with and/or against the mayor on local business issues, has lobbied on behalf of small business at the oblast and local levels, is hiring a part-time director and seeking additional funding.

The VBI and the Partnership lobbied successfully at the oblast level to reduce the tax on transport leasing from 20% to 2% on both the lessor and the lessee! As a result, transport is expected to become the Incubator's most popular leasing program.

Ten Volkhov residents, including the mayor, have had the opportunity to travel to the U.S. and western Europe on various small business programs, training programs, and incubator trainings, because they were nominated by the VBI.

Incubator staff have been exposed to numerous training programs and participated in meetings and conferences, in Russia and internationally, to increase their professional skills and make them better able to serve their clients and the community.

Representatives from dozens of Russian cities have traveled to Volkhov to visit the Incubator and to participate in VBI training programs, to learn how to replicate the VBI and promote small business development and women's entrepreneurship in their localities. VBI formal training programs include: How to establish and run a small business incubator; how to establish and run a leasing program; how to establish and run a women's business support program.

The Belarus Minister of Economic Development and the UNDP in Belarus have designated the VBI (from among incubators in Russia, the Ukraine and Poland) as their choice to train managers for a network of 15 small business incubators to be established in Belarus.

The first credit union in the region is being established with the support of the VBI.

The VBI was awarded first place in the Federation-wide competition of business incubators, held in Moscow, December 1997.

The VBI was instrumental in conceiving and establishing the Russian National Association of Business Incubators, with the intention of replicating incubators in Russia and establishing relationships with incubators internationally.

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December, 1998