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### **Russian government activities during social and economic space formation of the Russian retail<sup>8</sup>**

#### **Abstract**

The main reason of continuing discussions about differently oriented government actions during the formation of quite contradictory social and economic space of the Russian retail is that the dynamics of retail trade turnover and paid services to the population from the end of 2014 start to fall rapidly. The article presents the results of original research of relationship between government, business, and retail, in the context of key societal changes taking place in the Russian economy and politics. The government is represented as a special organization of political power, which has a special coercive power, and expresses the will and interests of the ruling group; is noted that the executive and legislative branches of government are both important in analyses of retail market. The article deals with the real impact of business projects during acceptance of amendments to the Federal Law No. 381-FZ "On the Fundamentals of State Regulation of Trade in the Russian Federation" on the basis of expert and statistical data. The article analyzes the consequences of informal practices of the new Russian national project to support small and medium-sized enterprises, using the terminology of R. Merton and P. Sztompka.

**Keywords:** economic space formation, Russia, retail

#### **Działania rządu podczas tworzenia przestrzeni społecznej i ekonomicznej dla rosyjskiego handlu detalicznego**

#### **Streszczenie**

Głównym powodem kontynuowania dyskusji o różnie ukierunkowanych działaniach rządu podczas tworzenia zupełnie sprzecznych społecznych i gospodarczych rosyjskich przestrzeni detalicznych jest to, że dynamika obrotów handlu detalicznego i płatnych usług dla ludności od końca 2014 roku zaczęła szybko spadać. W artykule przedstawiono wyniki oryginalnych badań relacji między rządem, biznesem i handlem detalicznym, w kontekście głównych zmian społecznych zachodzących w rosyjskiej gospodarce i polityce. Rząd jest reprezentowany jako specjalna organizacja władzy politycznej, która dysponuje szczególną mocą przymusu, i wyraża wolę oraz interesy grupy rządzącej. Należy zauważyć, że zarówno władza wykonawcza, jak i ustawodawcza są ważne w analizach rynku detalicznego. Artykuł porusza problem rzeczywistego wpływu projektów biznesowych w odniesieniu do poprawek przyjętych do federalnej ustawy nr 381-FZ "O podstawach regulacji handlu w Federacji Rosyjskiej". Wykorzystano do tego dane statystyczne i eksperckie. W artykule, używając terminologii R. Mertona i P. Sztompki, analizuje się konsekwencje nieformalnych praktyk nowego rosyjskiego projektu wsparcia małych i średnich przedsiębiorstw.

**Słowa kluczowe:** kształtowanie przestrzeni gospodarczej, Rosja, rynek detaliczny

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**JEL CODE:** M1, M2, M3

### **Introduction**

Russian retail developed without interference from the government regulations for a long time. The situation has changed radically in recent years, with the government now actively controlling the important market segments. However, the effectiveness of such controls is not clear. On the one hand, retailers and suppliers form their own relationship of cooperation and try to find new ways of mutual control over each other's activities. On the other hand, almost all activities in retail form both formal and informal relationships, which contributes to promoting their products effectively, shifting the government representatives from this interaction process. This contradiction determines the actuality of present research.

The authors have formulated a hypothesis about the nature of the relationship between leading market participants and government institutions. This interaction does not have a definite character; it manifests in the active government control over the trading sector, but in disputed areas, unsupported by direct market participants. Such sensitive issues as the protection of small and medium-sized enterprises, quality control of manufactured goods, the labor market in the area of trade and production remain open. The purpose of this work is to disclose conflicts of interaction between government, business, and retail, in the context of key societal changes, taking place in the Russian economy and politics.

Scientific methods of theoretical and applied research, including systematic, comparative analysis, statistical data, and study of database materials: Ebsco, Elibrary, Emerald, Scopus, Web of Science, data from Federal State Statistics Service (Rosstat) were used by the authors. This paper includes main economic and sociological theories about interaction between government and business in the retail sector, analyzes actual information about the Russian retail market in figures, presents the subject-object scheme of regulation in the retail sector, describes its elements and discusses the consequences of government regulation in retail with some challenges and solutions.

### **Economic and sociological concept of government, business and retail interaction**

The theoretical basis in the study of government and business interaction is institutional research (Brown 1987, pp. 5-36; Commons 1924, 1931, pp. 69-76; Veblen 1984, 2007). Representatives of institutionalism focus on the problems of authority, vertical mobility, property, monopolization, increasing government intervention in social and economic processes, in the context of economic realities research (Blaug 1992, 1994; Stiglitz 2000, 2012). Developments in the institutional dynamics and deformalization of rules are also of interest to researchers (Radaev 2007, 2008, pp. 20-50, 2009, pp. 3-30, 2011). Issues relating to the impact of government policy on the development of economy and society, conflicts of different interest groups in the economy (Akhmedzyanova 2013, pp. 84-96; Davydenko, Romashkina, 2013, pp. 95-104; Kaźmierczyk 2013, p. 65).

The discrepancy between the formal ideology of market reforms and the real socio-economic environment directs a large numbers of people to self-interpretation of the shared expectations and the search of appropriate adaptation forms on the basis of formed ideas and experience. R. Merton's conclusion made as a result of explicit and latent institutions functions analysis, according to which the functional defects of official organizations generate an alternative, informal structure for implementing existing needs more effectively seems appropriate (Merton 1968, 1976). Most of social relationships, including economic ones, are informal. The formation of an informal organization within the formal structure contributes to the more efficient functioning and to meeting the needs of its members in some cases (Sztompka 1993, 1999, 2005). The scale of informal economic relations is primarily associated with the ineffectiveness of formal institutions, constraining the process of implementing its activities

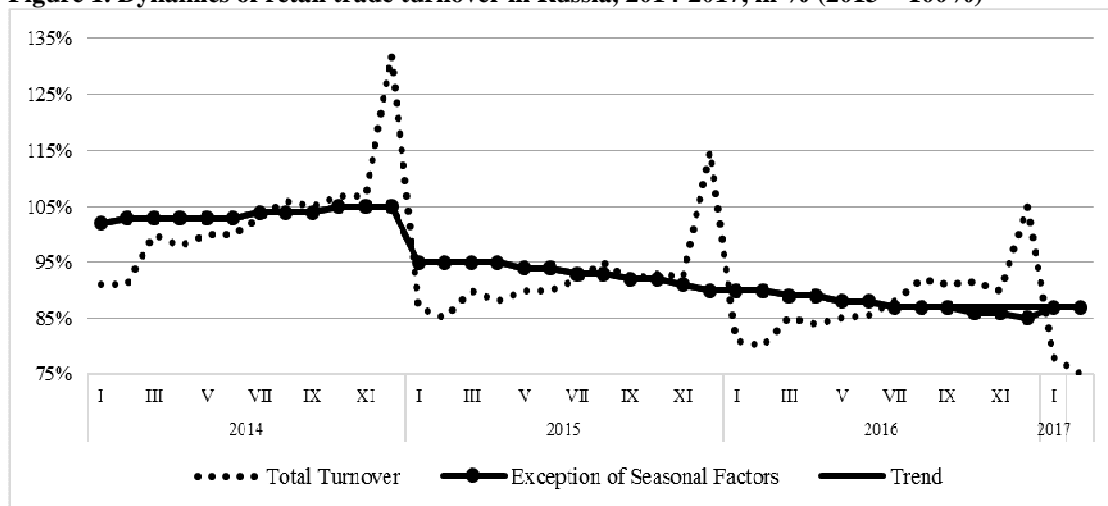
by market participants, according to the Hernando de Soto's neoinstitutional theory (de Soto 1989, 2000, 2006).

D. North's approach seems to be more effective. Three interrelated elements regulating specific areas of public relations were singled out in the internal structure of any institution. There are systems of formal and legal, administrative and organizational norms and rules established and regulated by the authoritative and administrative structures; informal rules, embedded in the culture of each society; norms and patterns of behavior and legal mechanisms of social control and the implementation of these rules. Correlation between the effectiveness and extent of presented elements define those institutional constraints that could pursue own free activity (North 1997; North, Wallis, Weingast 2011). Theories of modern researchers reveal the problems of trust between market participants, their interaction in different types of economies (Rippe, Weisfeld-Spolter, Dubinsky, Arndt, Thakkar 2016, pp. 344-362); formation of strategic alliance between market actors (Butigan, Benic 2016, pp. 77-112); different business strategies of retailers, manufactures, government structures (Binkley, Chen 2016, pp. 557-584). Author's research complements the analysis of interaction between government and business on an example of contradictions disclosure arising between the key participants at retail market, demonstrates the effects of government regulations during the formation of social and economic space of the Russian retail.

### Russian retail market dynamics

The main reason for the continuing discussions about divergent government actions during the formation of quite contradictory social and economic space of the Russian retail is that the dynamics of retail trade turnover and paid services to the population began to fall rapidly at the end of 2014. Retail trade turnover fell by 10% at the end of 2015, it was the worst figure in the last years of statistical surveys. Further decline in retail trade turnover in 2017 is observed (Figure 1).

**Figure 1. Dynamics of retail trade turnover in Russia, 2014-2017, in % (2013 = 100%)**

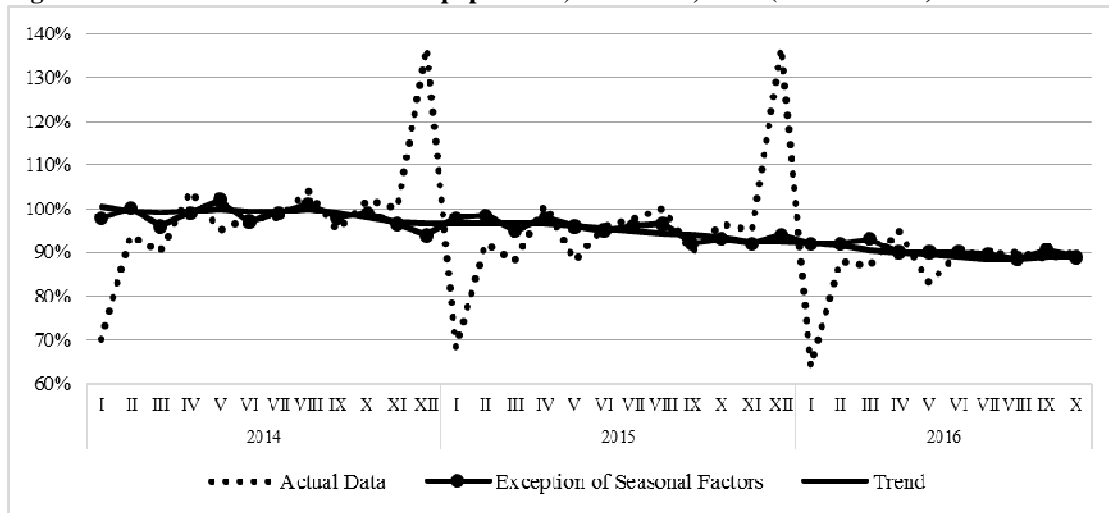


Source: Rosstat (Federal State Statistics Service) website, retrieved 25th April 2017, [http://www.gks.ru/wps/wcm/connect/rosstat\\_main/rosstat/ru/statistics/enterprise/retail/#](http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/enterprise/retail/#).

The rate of monthly reduction of retail trade remains one of the most alarming indicators for the Russian economy. Retail turnover was lower by 5.3% in November 2016 than in November 2015. The rate of retail sales falling ranged in the interval from minus 6.4% to minus 4.9% with no apparent signs of slowing down since the beginning of 2015. The average reduction in retail trade turnover was minus 5.6% in the first seven months of 2016, according to Rosstat. This statistic takes into account the decline in sales of both food and non-food goods. Moreover, the rate of non-food goods sales drops slightly higher – from minus 7.1% to

minus 5%; while sales of food products decreased with a rate of minus 3.2% to minus 6%, from the beginning of the year. Retail trade turnover is falling during two consecutive years. Decrease is stable by 5-6% at last few months to the previous year, according to Rosstat data (Figure 1). Considering that the retail sector has been one of the most rapidly developing in Russia and its dynamics were strictly positive from 2000 to 2014 (except the period of financial and economic crisis in 2009)<sup>9</sup>. The increase from 4% to 7% was observed during this period, and therefore the downward trend of the retail business in Russia causes a strong concern in the last two years<sup>10</sup>.

**Figure 2. Real incomes of the Russian population, 2014-2016, in % (2013 = 100%)**



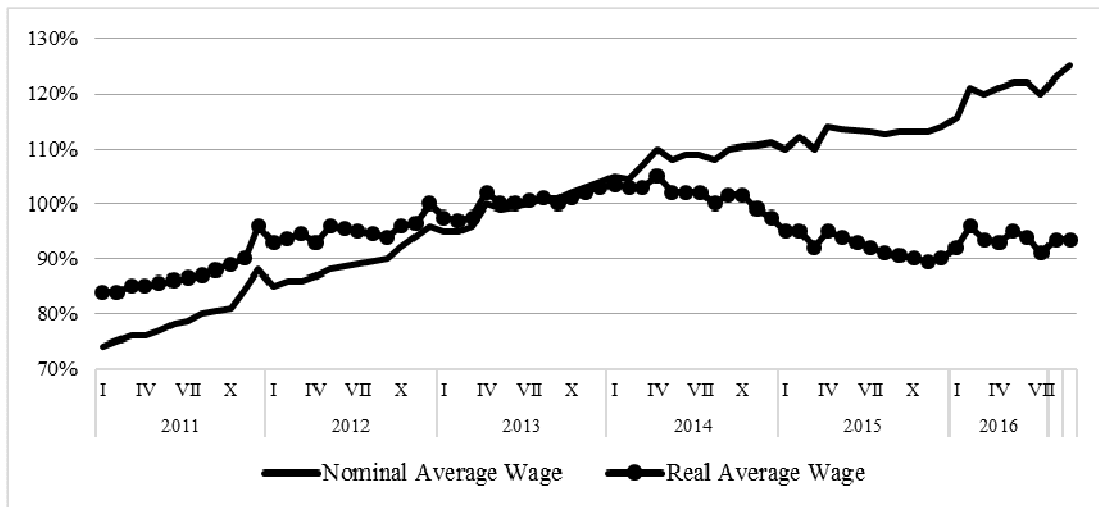
Source: Rosstat (Federal State Statistics Service) website, accessed 25th April 2017, [http://www.gks.ru/wps/wcm/connect/rosstat\\_main/rosstat/ru/statistics/population/level/#](http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/population/level/#).

It makes sense to compare the downward retail business trend with the dynamics of household income in Russia. Real disposable income (after obligatory payment deduction) has been continuously falling during last two years (2015-2016), according to Rosstat (Figure 2). These values decreased by 5.9% year-over-year in October 2016, which is twice more than in September 2016. The peak decline was in August 2016, when Russian incomes fell by 8.3%, and reached the maximum since 2008. In turn, the negative trend of real wages dynamics (Figure 3) decreases the possibility of a recovery in demand among Russian consumers.

<sup>9</sup> According to the data of Federal State Statistics Service, section Retail trade, public services, tourism [http://www.gks.ru/wps/wcm/connect/rosstat\\_main/rosstat/ru/statistics/enterprise/retail/#](http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/enterprise/retail/#). (retrieved: 25th April 2017).

<sup>10</sup> According to the data of Federal State Statistics Service, section Retail trade, public services, tourism [http://www.gks.ru/wps/wcm/connect/rosstat\\_main/rosstat/ru/statistics/enterprise/retail/#](http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/enterprise/retail/#). (retrieved: 25th April 2017).

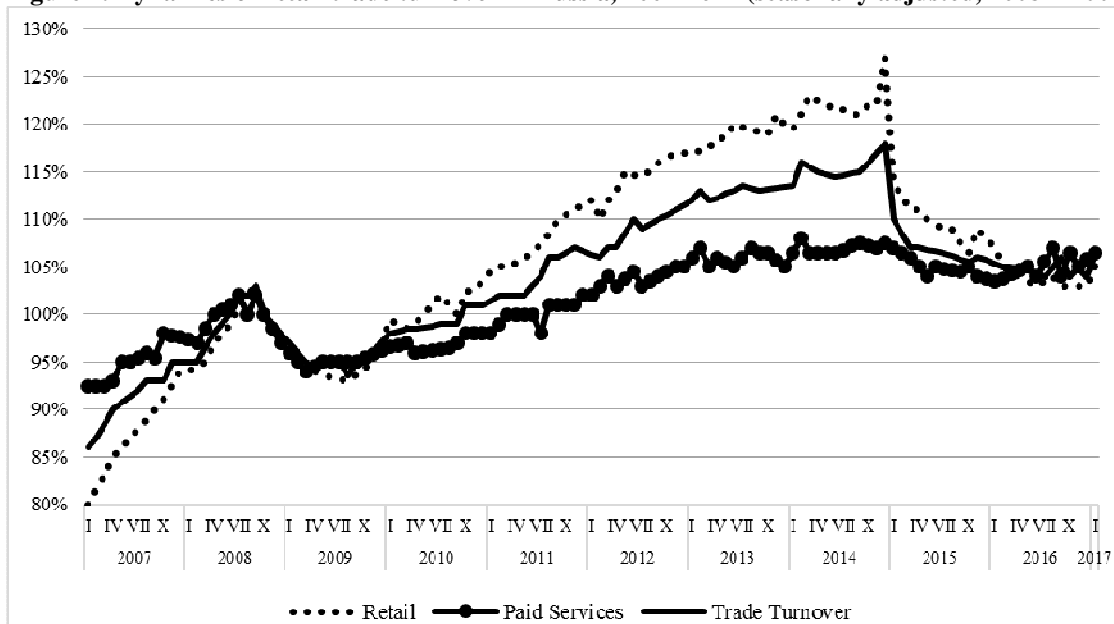
**Figure 3. Dynamics of average nominal and real wages in the Russia, 2011-2016 (seasonally adjusted, 2013 = 100%)**



Source: Institute Development Centre, Higher School of Economics (2016) Comments about the state and the business. No. 122.

The dynamics of trade turnover and paid services to the population in 2007-2016 (seasonally adjusted, 2008 = 100%) for the following positions: retail trade, paid services, trade and services is shown in Figure 4. The dynamics of retail trade, paid services to the population and trade turnover in Russia, were positive from July 2009 to January 2015, but then they declines – in July 2016, all three trends fell below the level as at July 2012 (Figure 4).

**Figure 4. Dynamics of retail trade turnover in Russia, 2007-2017 (seasonally adjusted, 2008 = 100%)**



Source: Institute Development Centre, Higher School of Economics (2017) Comments about the state and the business. No. 130.

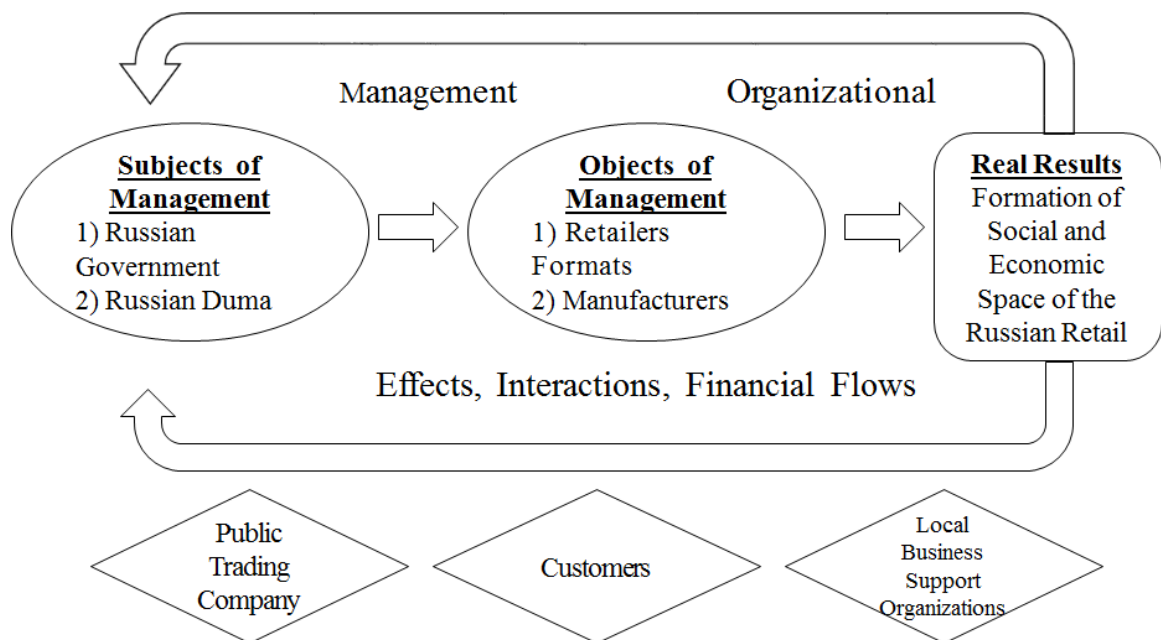
This decline is particularly strong when compared with January 2015: the scale of the fall was about 15% to the average level of 2014. Strictly positive dynamics in December 2014 and in January 2015 is caused by consumer excitement because of the weakening ruble to record levels. The trends shown in Figures 3 and 4 can be explained by: the confrontation of sanctions; the dependence of the Russian economy on currency jumps; the inability of the Russian industry for large-scale substitution of banned import of goods; the high increase of the goods

and services prices in different categories as a consequence. Such macroeconomic factors obviously have a significant impact on the interaction of all market participants. The question arises: what has been happening in Russia during the last two years (2015-2016)? Are we seeing a long-term level of recession in the considered parameters? Are there any other reasons except economic dependence on resources and Western innovation?

### The model of Russian retail management

It makes sense to identify the most important players and their special interests in the research process from the standpoint of the subject-object management analysis of retailing in Russia for a more precise description of the current and forecasted situation (Figure 5). Government actions and real results during the formation of social and economic space of the Russian retail market can be represented in the form of three large blocks of the subject-object retailing management scheme in Russia with feedback, using the known methodology of system analysis (Optner 1965; Van Gigch 1978).

Figure 5. Subject-object scheme of Russian retail management



Source: own study.

Substantial elements of the "Block 1" management subjects as regulators constitute the concept of "government activity": (1) Government of the Russian Federation, represented by the Ministry of Economic Development, Ministry of Industry and Trade, Ministry of Finance, Ministry of Transport, the Federal Antimonopoly Service, each of which carries a targeted and quite fundamental impact on retail as an object of management; (2) State Duma, which generates the basic laws for the retail sector. "Block 2", management objects include: (1) retail, retail formats, stores and their representatives, (2) manufacturers.

Public trade organizations are particularly important: Retail Companies Association (AKORT), which brings together the largest retailers; Regional Chambers of Commerce and Industry, which bring together representatives of the business community and the administration in order to promote the development of regional economies; Intersectoral Expert Council on development of the consumer market (MES), which includes both retailers and suppliers, and which supports the principles of self-regulation of markets, reflecting the honest, transparent and fair retailers-suppliers relationships both at formal and informal levels. Social

and political organization of business support, protecting business interests are also important ("Russian Union of Industrialists and Entrepreneurs", "Support of Russia", "Business Russia" and others). "Consumers" are essential in the developed subject-object retailing management scheme. They buy and consume all various products, goods and services provided by retail, pay for them, and thereby generate cash flows which have an absolutely life-saving and fundamental influence on all of the components provided by the presented model (Figure 5).

All communications – both direct and inverse – expressed not only in the management and organizational impacts and interactions, but most importantly – in the financial flows, which are fixed between the subjects and objects of management, in the form of actual results of their interaction. "Block 3" includes actual results in the considered subject-object management scheme – it is the results factually obtained or to be obtained in the process of subjects and objects management's interaction. The real results of the proposed conceptual identification are dynamic data presented in Figures 1-4, namely the dynamics of retail trade turnover, the dynamics of real disposable income, the dynamics of the average nominal and real wages, the dynamics of trade turnover and paid services to population – all consequences of the interaction between presented subjects and objects of management in Russia.

### **Government regulations for retail business**

According to the expert survey commissioned by the Federal Antimonopoly Service among the representatives of business, 51% of the respondents consider procedures of trading activities control as effective (Federal Antimonopoly Service, 2016). Only a third of the respondents positively evaluate the impact of sectoral business associations on the development of competition. It is noted that companies often have to apply for explanations of trade law application in particular situations. However, the answers are usually formal, in particular, only the citation of legal articles. Experts believe that the application of trade law is still shifted toward retailers, while ignoring the large suppliers with significant negotiating power, and able to put pressure on the retailers. One should also note the absence of coordinated action at different levels of government regulation in trade sector. Also, according to experts, in crises, government regulators should focus on stimulating measures to support the economy and avoid introducing strict regulation at legislative level, in particular related to issues, which can be resolved by stimulating measures or at self-regulatory level (Federal Antimonopoly Service 2016).

In this article, the authors attempt to draw attention to one of the key management decisions during the formation of public social and economic space of the Russian retail market, namely the approval of amendments to the Federal Law No. 381-FZ "On the Fundamentals of State Regulation of Trade in the Russian Federation" by the Federation Council on June 29, 2016 adopted earlier (on June 24, 2016) by the State Duma. Market participants continue to adapt themselves to the new environment, despite the fact that every such amendment toughens the activities of retail chains. Prices of goods rise and fall, instead of seeing shopping shelves filled with cheap and quality goods. The new version of trade law was published on July 3, 2016. One of its key provisions is the next revision of the contractual relationships between retail chains and goods suppliers.

The concept of "trade network" is specified, which is now recognized as a combination of two or more commercial properties. Thus, the effect of trade law applies to a larger number of trade objects. The total remuneration paid to the retail chains by suppliers for the purchase of certain amount of product is limited to 5% (Federal Trade Law 2009). At the same time the value added tax and excise duties are excluded from the calculation of this total amount. Various payments figured in the supply agreement previously, for example, charges for marketing and payment product placement on shelves, different bonus payments, and their sizes were unlimited. In accordance with the new editing maximum payment, postponement for retail

chains is reduced in favor of goods suppliers, for 4 days, on average, for different categories of goods (Federal Trade Law 2009).

According to analysts, reduction of goods payment delays will lead to the growth of leverage for the major retailers, growth of average debt for retailers. Decrease of the size of bonuses from suppliers will lead to a decrease in profits and profitability of retailers in the short term. Although the major operators of retail chains have more opportunities for adapting to new rules than small enterprises, the adopted amendments will have an impact on them as well. Retailers will be limited in the ability to compensate for lost bonuses by raising prices because of the low purchasing power of the Russian people and increased competition. They will find it difficult to change suppliers due to the current food embargo. Trade formats will require additional investments in working capital as a result. The limitation period for bringing to administrative responsibility for violation of legislation is also increased from 2 months to 3 years, with the purpose of tightening control (Federal Trade Law 2009). The formulations of offenses and sanctions for their fulfillment are now clarified.

Nevertheless, market participants continue to seek new ways of working around the rules, e.g. the signing of contracts with suppliers about marketing promotion of goods, contracting supplies through subsidiaries, and so forth. All this, of course, increases the volume of document circulation - all payments used to be registered in one supply agreement, but now retailers sign several contracts with supplier and thereby try to comply with the terms of the authorized amendments of the Russian trade law. In addition, retail chains are deprived of creditors, who used to function as suppliers, and they are looking for new ways to recover the losses incurred, including attempts to shift the costs on to consumers.

### **Conclusions**

The analysis of Russian government actions and their real results during the formation of social and economic space of the Russian retail sector make it possible to conclude with a few clear conceptual theses. The growing distance between the market actors, representatives of legislative and executive authorities, and the subjects of trade sector, including small and medium-sized enterprises, leads to misunderstanding and rejection of the state institutions, which can lead to their deformation. It should be understood that all retail formats, including retail chains, are complex socio-economic organisms, huge and branched, the main advantage of which is to provide the widest assortment of goods at affordable prices to consumers, and appropriate distributing of manufactures' goods, which certainly promotes development of consumer culture and prompts expansion of the retail market. Consequently, management and regulatory actions from all control subjects should be, according to the authors, directed at maintaining the activity of retailers and the retail sector, rather than trying to implement support for manufacturers at the expense of retail formats. It is obvious that in order to increase the competitiveness of production, especially food products, additional investments in production will be required.

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