

# **Entrepreneurism Rising from the Ashes of Communism**

## **Jeffrey C. Dilts**

Department of Marketing

University of Akron

Akron, OH 44325-4804

Phone: 330-972-5136 e-mail: dilts@uakron.edu

## **Stephen F. Hallam**

University of Akron

## **Fletcher Birmingham**

Roadway Express, Inc.

## **Frank Craig**

SCORE

## **Abstract**

Entrepreneurship and small businesses are likely to play a critical role in the development of a market-based economy in Russia and Poland. Major issues facing entrepreneurs in these countries are examined. Consideration is given to the role that international developmental agencies are playing in this economic transitional process. Here, attention is given to the authors' consulting experience with recently privatized firms and support organizations in Poland and Russia. The discussion concludes with a number of observations and recommendations for nurturing the emergence of the small business sector and doing business in these countries.

## **Introduction**

Entrepreneurs in all cultures are those who are willing to assume a level of risk for the opportunity of future gain and independence. Imagine venturing out into the uncertain waters of entrepreneurship within a culture that has never really experienced a free-market system. Further try to imagine starting a new business when your country's currency is fluctuating wildly, the legal system is frantically struggling to understand such basic concepts as private ownership and the elements of a contract, and the people have all been schooled to expect lifetime full employment regardless of productivity and profitability.

The fall of communism in the former Soviet Union and Eastern Europe offers opportunities beyond imagination, but dangers equally challenging. But there is much to be learned about the fundamentals of free enterprise by studying the growth of private enterprise in countries formerly under the controlled economic approach of communism.

This paper examines the entrepreneurial environment using specific examples in Poland and Russia. We first provide a background description of major issues facing entrepreneurs in these countries and then examine several international support organizations trying to assist. Next we describe specific aspects of our recent consulting assignments in Poland and Russia. The conclusions provide several observations and recommendations for nurturing the emergence of the small business sector and doing business in the new Commonwealth of Independent States and Eastern Europe.

## **Contribution of Small Businesses**

The critical role that small businesses play in the global economy has sparked recent debate (Acs 1992). The conventional wisdom surrounding small enterprises has been revised and attention refocused on the important economic role they play in the creation of new jobs, incomes, innovations and markets. Young entrepreneurial enterprises have made a vital contribution to innovation and job growth not only in the U.S. (Dugan 1996), but have also been a catalyst for growth in other countries as well (Acs 1992); and is considered crucial to the competitive development of the union of Western European countries (Mulhern 1995).

The private, small business sector in the former Soviet Union and Eastern Europe is also likely to play a critical role in the transformation of these economies from a command to a market-based economy (Karwowska and Mrozinska 1993). At the center of this economic transformation is a new breed of entrepreneurs. These entrepreneurs differ from other managers (Gatian and Gilbert 1996) in that they are more self-sufficient, creative and risk-taking. As a consequence, they bring new habits and behaviors which may serve as new models for action in a changing economic situation. As the market evolves, they are likely to be more willing to adapt their business and products to fit the circumstances (Karwowska and Mrozinska 1993). And in so doing, they place pressure on other competitors, large and small, to adapt; thereby, serving as a change agent.

If economic revitalization is to be realized, then assistance will be necessary to nurture the entrepreneurial spirit evident in Russia and Eastern Europe. While entrepreneurs may possess the desire and technical skills, they do not have the management skills to successfully start and grow a for-profit business (Gatian and Gilbert 1996). It is at the grass roots level, working with individual enterprises and local governmental authorities, that economic assistance can have the greatest impact on economic development.

## **Nature of Entrepreneurship in Eastern Bloc Countries**

Dramatic changes are taking place in Eastern Europe and the Commonwealth of Independent States in the former Soviet Union. The nature of the business environment, in which entrepreneurs are operating, is examined below for Russia and Poland--two areas in which the authors had a chance to interact and work with executives and governmental authorities.

## Russia

With the collapse of the Soviet command economy, Russia has undergone sweeping political and economic changes. These changes have their origins in the mid-80's with glasnost (openness) and perestroika (restructuring), and were accelerated with the birth of an independent Russia in late 1991 (McCarthy, Puffer and Simmonds 1993). As a result, many formally state-run enterprises have been privatized and thousands of new independent firms have been created. Presently, the private sector accounts for two-thirds of all jobs in core industries and 90 percent of the small businesses (Galuszka, Kranz and Reed 1994). It is this entrepreneurial, small business sector upon which much hope is placed for further economic growth (FitzRoy 1993).

Yet, if the development of a market-based economy is to be realized, Russian entrepreneurs will need to become more experienced and focused to fully capitalize on the opportunities presented by these changes. As former managers of state-run operations and many entrepreneurs attempt to establish their own businesses, they do so with little comprehension of what that involves. In the past, the state decided who would produce what, how much and when. As a consequence, an understanding of basic management practices is very limited (Hamilton 1993; Hisrich and Grachev 1995).

Many Russian businesses lack a strategic focus, attempting to be many things. It is not unusual to see a manager or owner pursuing opportunities that are unrelated to their primary line of business. This diversity of activities may be due to a variety of reasons. Some entrepreneurs are focusing on highly speculative opportunities that require little creativity or commitment and promise quick cash returns (Radaev 1993). In addition, the need for more immediate cash flow often motivates some entrepreneurs to pursue unrelated activities as well. However, this lack of focus is likely to prove short-sighted; it does not permit the firm to concentrate on its core strengths.

The need for a marketing orientation, where products are created to provide meaningful benefits for a defined market need, is not well understood or accepted. This failure to see the importance of customer issues would appear to be a carryover from a Soviet mind set, where the state was responsible for disposing of whatever was produced and where consumers had no alternatives (Hamilton 1993). With the presence of quality imported products, their competitive position will continue to deteriorate until they address this problem.

Externally, owners and managers of businesses encounter contradictory and unstable political, economic and social circumstances. Corruption, bribery, gangland activities and stiff taxes all have had an impact. Taxes on businesses have been extremely high; as high as 90 percent of profits (Galuszka, Kranz and Reed 1994). And as a result of inflation, managers must deal with a devalued ruble. Two years ago, a dollar was exchanged for 3,000 Russian rubles. Today, the dollar commands 5,400 rubles.

Successful entrepreneurs must also deal with a unique social situation in which many Russian citizens equate a profitable business with illegal activities (Hamilton 1994). The idea of

private ownership and making a profit is viewed as suspect, due to the emergence of a strong criminal element and a historically strong presence of an egalitarian philosophy. Contrary to the "success ethic" in the West, many Russians believe it is morally wrong to excel, particularly at the expense of others (Richmond 1992, p. 34).

Legitimate businesses often seek out a kryshe (a roof) by making regular payments to the Russian Mafia. The roof provides a shelter or protection from criminals even worse than the Mafia. It is estimated that up to 80 percent of the commercial banks and private enterprises pay for this security (Nadler 1996). One author observed entrepreneurs making payments estimated at a cost of 15 percent of sales.

Despite the difficulties, entrepreneurship is gradually becoming a real economic force and a catalyst for change in Russia. As the pace of economic reform quickens, old practices and norms may give way to the pressures of change (Radaev 1994).

## **Poland**

Because of its size, central location and recent political and economic accomplishments, Poland may serve as an example and a stabilizing influence in Eastern Europe, according to the U.S. Agency for International Development (USAID 1996). Poland was the first East European country to experience reform. Despite dramatic changes and future hurdles, Poland is succeeding in making the transition to a more market-based economy (Dandridge and Dziedziczak 1992). However, further economic restructuring will be necessary if the supporting infrastructure that Western entrepreneurs take for granted is to be realized (Gatian and Gilbert 1996).

The Polish economy, overall, appears to be mixed, although not as depressed as in Russia. There is high unemployment, caused in part by past restructuring, and high interest rates. Due to high inflation, the currency (zloty) was converted during the past year. Under the old standard, fifty American dollars equaled a hundred and forty thousand zlotys. With the recent changes, 10,000 zlotys became 10 zlotys, about four American dollars.

Differences in outlook exist across workers and managers alike. There is a strained dichotomy between newer employees that "want things to change" and older workers that are "set in their ways" and see any change as a major threat. For the past 40 years, people had placed their reliance on the government to make the right decisions. Consequently, initiative is a new concept to many (Dandridge and Dziedziczak 1993). Likewise, the organizational climate differs among privatized and entrepreneurial firms; where managers of the former are affected by the "baggage" that they bring with them from previous jobs with state-run operations (Gatian and Gilbert 1996).

The development of a real private sector and entrepreneurship did not take place in Poland until administrative barriers were removed (Karwowska and Mrozinska 1993). Before deregulation, private enterprises were limited in size (10-12 employees) and were not allowed to grow. Most were dependent upon the state sector for resources and, in many cases, served as cooperating subdivisions of the larger state-run enterprises (Paradise 1990). Today, a number of

these private enterprises not only compete with the former state-run operations that are now privatized, but are a source of significant competition for them and remaining state-run organizations.

As the private sector develops, entrepreneurs face many challenges that they must address if they are to grow and have a significant impact on their economy. Access to capital is limited and most depend upon "FFA" funding, involving Family, Friends and Acquaintances (Lent 1995).

As a consequence, many engage in lowcost, low-technology production processes (Karwowska and Mrozinska 1993). In some cases, customers provide suppliers with the necessary equipment to satisfy their requests. Although the educational and aptitude levels of many entrepreneurs are high, they lack the managerial training and the ability and experience to select and implement appropriate business techniques (Gatian and Gilbert 1996).

## **International Support Organizations**

The U. S. Agency for International Development (USAID) and other partnering organizations, such as the Citizens Democracy Corps, have placed a high priority on this. Of particular interest is the development of small and medium-sized enterprises (SME's), which have the potential to generate much of the economic growth and create new jobs. By providing assistance at the grass roots level, they hope to strengthen the private sector and nurture the transition to democracy, thereby advancing U.S. economic and political interests in the process (Russia Business Watch 1995).

U.S. Agency for International Development. Since its founding in 1961 by President John F. Kennedy, the U.S. Agency for International Development (USAID) has participated in developmental activities overseas. To more effectively accomplish this task, the agency has worked with American businesses, universities and voluntary organizations, as well as host country partner organizations and governmental authorities. New and existing private enterprises and support organizations (e.g., business schools and developmental agencies) in the host country have benefited from the technical and managerial assistance provided. As development has evolved, the opportunity for U.S. investment and trade has increased; thereby further nurturing and strengthening the growing market-based economies of the host countries and providing economic benefits for American interests (USAID 1966).

In the New Independent States (NIS) of the former Soviet Union, the USAID's New Business Development Program has stimulated business growth in more than 50 regions by (1) working directly with entrepreneurs and (2) working with local authorities to improve the overall environment in which businesses operate. Activities of the partner organizations have ranged from operating local business services, organizing training programs and planning curriculum development to offering direct assistance (USAID 1966).

Citizens Democracy Corps. The Citizens Democracy Corps (CDC) is an independent, American, nonprofit organization that has supported and developed hundreds of SME's in the former Soviet Union and Central and Eastern Europe. Since its founding in 1990, CDC's purpose has been to promote the development of the free enterprise system in these regions.

The assistance program involves matching volunteer American business people and specialists with Russian and East Central European SME's and business support organizations (e.g., Russian business schools and government developmental agencies) that have requested assistance. Management and technical assistance are then tailored to the needs of each participating client organization in the host country. The advisory assignment serves as a springboard for a variety of activities that impact not only the client organization and the local economy, but also facilitates trade, investment and creates market opportunities for those firms that do business both in the region and in the U. S. (CDC Russia 1996).

Advisors may continue to aid the client organization long after completion of the assignment, seeking out financial sources and potential customers and suppliers, thereby creating new commercial links with firms in the U.S. By focusing on the personal commitment of volunteers and building on the partnership with other business development programs (e.g., Deloitte Touche, Morozov Project, Peace Corps), CDC is able to leverage these resources and skills into tangible results that benefits the client organization (CDC Russia 1996). For more information on the Citizens Democracy Corps and examples of its impact, the reader may refer to their web site ([www.cbi.co.ru/partner/cdc/index.htm](http://www.cbi.co.ru/partner/cdc/index.htm)).

## **On Assignment With CDC**

Participating in CDC's Enterprise and Economic Development Program, the authors had an opportunity to work alongside Russian and Polish executives as they attempted to cope with the dramatic market changes taking place in their homelands. Assignments ranged from helping a Polish manufacturer of furniture accessories develop a quality management system; providing training and consultation on curriculum development to a new, private business school in Russia; to helping a Russian transportation company develop a business plan. These experiences are described below.

### **PPH Nomet in Torun, Poland**

ISO in Poland? Yes! As Poland converts to a market-based economy, existing and newly formed firms are recognizing that, if they are to compete on the world markets, they must certify their quality management system in compliance with ISO 9000. ISO 9000 is a structured process through which a firm can demonstrate quality performance and raise the quality of products and services they provide their customers. Certification standards are set by the International Organization for Standards (ISO) in Geneva, Switzerland (Shaw 1996).

As part of a three-week CDC assignment in Poland, one author had the opportunity to help a small, privately owned manufacturer, PPH Nomet, develop a quality management system. The firm is located in Torun, Poland, a city of 250,000 in northern Poland, about 220 km north of Warsaw.

The client firm, Nomet, makes furniture accessories (e.g., metal and plastic handles,

knobs, drawer locks) and sells directly to distributors and furniture manufacturers. Annual sales are 2.5 million dollars. As a result of economic reform, the firm, like other private enterprises in Poland, has been allowed to grow from a previously regulated size of 10 to 15 workers. Presently, Nomet has 300 employees; too many by our standards. But, it has become a formidable competitor to the state-run furniture business.

In many ways, their manufacturing capabilities are impressive; yet there are concerns. Nomet has the ability to design and produce their own forming tools (dies), which are used for injection molding and die casting. However, the firm lacks even the most basic form of shop floor control, work instructions, inspection plans and procedures. And, instead of allocating the cost for each forming tool to a specific product, tool costs are treated as overhead expense and spread across all products, thereby preventing an effective profit and loss evaluation.

The assignment was accomplished in ten working sessions, with English to Polish translation provided by the firm's marketing manager. Participants in the training exercise were asked to create a product flow diagram showing the departmental roles and responsibilities, from receipt of a customer order through production and delivery. A procedure for contract review was also developed.

To help implement the quality management process, a step-by-step plan was prepared, along with an employee quality orientation booklet. While actual certification will take some time, it was recommended Nomet should be ready in a year for an initial assessment and future CDC advisors should periodically monitor the progress made.

## **IABB in Togliatti, Russia**

Although many would be Russian entrepreneurs have the desire to create and grow their own enterprise, they lack the necessary management skills to do so (Hamilton 1993; Gatian and Gilbert 1996). As Russia makes the transition from a command to a market-based economy, business training of existing and future business people will be critical. Recognizing the importance of the role that support service organizations play in the development of SME's, CDC provides assistance to local business schools and training centers in Russia.

Two of the authors had the opportunity to work with a business school in Togliatti, Russia during a three-week assignment. Togliatti is a city of about 700,000 located in central Russia in the Samara Oblast. The region is highly industrialized and is the home of Autovaz, Russia's largest manufacturer of cars. The area has long been open to the West and has many international ties.

Consultation on business training and curriculum development was provided to the International Academy of Business and Banking (IABB), a relatively new private university. The Academy envisions itself as becoming the premier international business school in Russia. During the morning, business training was provided to a class of young, English-speaking adults. As part of their assignment, students worked in teams developing a business plan for starting a new business. Afternoons were filled with meetings with Russian business executives. The hope was

to eventually establish commercial links with U.S. firms that would create new trade and investment opportunities and lead to the exchange of business student interns.

When we first began working with IABB over two years ago the school was 80% financed by a large private Russian bank. Unfortunately that bank experienced serious financial difficulties and was taken over by the Russian government in the fall of 1995. A consequence to IABB was the immediate and shocking loss of 80% of their operating budget. Now the academy is in a desperate struggle for survival.

To increase revenues the academy was forced to raise student tuition and re-consider their extremely rigorous admission and retention standards. Some families pulled their sons and daughters out of the school and sent them to schools in Moscow, St. Petersburg, or in Europe or the U.S. Other students decided they couldn't wait the five years for graduation and elected to take the plunge into business ownership. As students see some adventuresome entrepreneurs becoming suddenly wealthy the temptation to jump on the privatization bandwagon was too strong to remain a full-time student. After all, those with only one or two years of business education already have far more business training than almost anyone else in Russia.

Therefore, many of the high aspirations of IABB have been modified. The need to survive has replaced the future vision of becoming an exclusive academy accepting only the best; demanding students be fluent in English, French, German, and Italian, and devote five years of intense study to learn the equivalent of an American style bachelors of business administration.

Despite the recent financial hardships the Russian spirit is strong and the dedication of the faculty and administration is remarkable. To survive and eventually excel, we recommended IABB become a business development center offering services for fees to American and other business firms seeking business opportunities in Russia and especially the Samara region. Since all current students have been required to work on live cases involving most of the businesses in the region, IABB already has strong ties to the local business community. They can offer foreign business representatives an array of services including translation, networking contacts with local business and government officials, and practical business advice regarding proven solutions to a host of obstacles to joint ventures.

## **Taxi Park in Novgorod, Russia**

Managers of privatized firms that were previously state-run may have more difficulty in adapting to free market forces than entrepreneurs. Coming from an environment in which most major decisions were made by the state, they have little comprehension of how to operate a business in an open market (Hamilton 1993). In addition they often must deal with major transitional problems, including working with obsolete equipment and methods and a poorly motivated work force geared to satisfying government quotas, not organizational goals.

As an initial step, advisors need to help management develop a strategic focus in which a business plan and related managerial controls are developed and implemented (Gatian and Gilbert 1996). The process of creating a business plan by the establishment of objectives and managerial

controls not only provides management with a document to support the request for funding, but also with a sense of strategic direction and aid in the internal management of operations.

During a three-week CDC assignment in Russia, another author had the opportunity to help a recently privatized transportation company, Taxi Park, develop a business plan. The focus was two-fold: (1) to develop a business plan along with cash flow and P/L statements that would be used to secure funding for new equipment and (2) to develop internal controls for evaluating the performance of each of their operations. The firm is located in Novgorod, Russia, which is about 160 km south-southeast of St. Petersburg. The modern, industrial city has a population of 240,000.

However, like many Russian firms, Taxi Park is involved in many businesses on a grand scale; attempting to be many things in different market segments. In addition to the taxi business, operations include a bus company in Siberia; a repair store for Ford vehicles under warranty; an auto accessory retail store; and a wholesale auto parts supplier to repair shops in the area. Overall, operations employ 200 employees and generate sales slightly under one million dollars.

Taxi Park was a former state-run operation that has been privatized. As a newly created private firm, they were required to keep all former state employees, regardless of merit; with workers holding stock in the new enterprise. By failing to educate workers to the meaning of being a stockholder, or helping them to understand the connection between their job performance and organizational goals and performance, management has lost an initial opportunity to motivate present employees.

While all five of the top managers have been exposed to an in-depth, Western business management program, they lack the experience to apply this knowledge. Using a cash accounting system, where everything is expensed, made it difficult to determine profitability. It was remarked that Taxi Park had great sales charts, but had no handle on costs. With no adequate accounting system nor controls in place, and no business plan, lenders were unwilling to provide the needed capital funding to secure additional equipment.

Working closely with the executive director of the company and an independent interpreter, the CDC advisor was able to put together a plan of action. Because of a reluctance to change from the Russian accounting system, the chief accountant had to be bypassed. A young woman was hired and trained to prepare the cash flow projections and P/L statements that would be needed. Consequently, two sets of accounting books are maintained: one, based on Western accounting standards, to satisfy the lending organization and to provide for internal controls; and the other, based on the Russian system, to satisfy governmental authorities.

Follow-on activities, conducted by the CDC, found Taxi Park to be following the recommendations made. An accounting ledger system is now in place, along with internal controls for evaluating the performance of each of the firm's operations. A strategic plan and cash flow projections have also been submitted to the Italian lending organization for consideration.

## Recommendations

Our research and our recent personal experiences in Poland and Russia lead to the following recommendations, which are applicable both to business people seeking new business opportunities and to consultants attempting to provide business advice:

1. Study the culture and the common business practices of the country. It will make a difference! For example, while Americans regard compromise as desirable and an inevitable way of doing business, Russians view it as a sign of weakness--as a retreat from a correct and morally justified position (Richmond 1992, pp. 140-141). For a valuable perspective on Russian culture and habits, the reader should refer to the book, From Nyet to Da, by Yale Richmond (1992).

2. Develop a personal working relationship with your client. This will take time and patience. Friendships and personal contacts play an important part in getting business accomplished, especially in Russia. Any meaningful acceptance of advice or deals will depend upon the quality of the relationship.

3. Use the time of seemingly endless talks, dinners, toasts, etc. to listen carefully. Your hosts will eventually tell you what you need to know. Resist the urge to suggest solutions until you fully understand the problems and the surrounding circumstances. Listen, listen and listen. Then communicate clearly and forcefully.

4. Help the entrepreneur establish a strategic focus that is consistent with their core strengths. It is not unusual to see an entrepreneur pursuing opportunities that are unrelated to their primary line of business. This lack of focus may prove short-sighted.

5. Focus on home markets first. Often, entrepreneurs want to enter international markets before they have fully considered or developed their local or national markets. By focusing on domestic markets first, entrepreneurs will gain valuable experience that will better prepare them for the more competitive international arena.

6. Prioritize. Help the entrepreneur focus on what is of immediate importance. For instance, a Russian spark plug manufacturer was more preoccupied with studying the packaging for the product; yet it did not know if product quality was acceptable for the international market based on ISO 9000 standards.

7. Think small! Big may be beautiful, but it is not practical. Under communism everything was done on a grand scale. This mentality persists today, even in operations and planning. Starting small allows one to be more flexible, to learn and recover from mistakes more readily, and to grow effectively as experience, resources and opportunity allows.

8. Focus on the customer. Listen to the marketplace and develop products that provide meaningful benefits for a defined market. The firm's competitive position will depend on it. According to a Russian consultant in the service industry, the idea that "a complaint is a gift" is

not well understood. By listening and acting on customer complaints, businesses may be able in the long-run to keep the customer and create a favorable reputation.

9. Manage human resources effectively. Help the workforce to understand the connection between their job performance and organizational goals and performance in the new competitive environment. When operational changes are made, provide employees education and training.

10. Develop external relationships. Because of the lack of access to capital and the difficulties in obtaining current technology, watch for opportunities to develop long-term relationships with customers that have the capabilities to invest both capital equipment and management expertise.

11. Use the emerging business schools as partners. They are almost all in a desperate financial situation, so any financial support will be greatly appreciated. They can provide business training, translation services, networking contacts with local business and government officials and practical business advice regarding the region.

## Conclusions

Our recent experiences agree with the bulk of the literature which contends while opportunities abound in the former Soviet Union and the Eastern bloc countries, the dangers are still great. Decades of a centrally controlled economy cannot be reversed over night. For instance, Russia's problems are unlikely to subside in the foreseeable future and the chance that this huge nation may once again turn to a strong autocratic leader and away from democracy cannot be ignored.

Despite the huge risks involved, the potential for huge returns is also present. Citizens are much more free to travel around the globe, read foreign newspapers, and watch television from America and elsewhere. In the former closed society most of the population was unaware of what they didn't have. Now they are painfully aware and the desire is strong for western-style products and services.

As Russia, Poland and other Eastern bloc countries make the transition to a market-based economy, U.S. economic and political interests may be best served by nurturing and strengthening the emerging private sector. Assistance at the grass roots level will be critical. Although many Russian and Polish entrepreneurs have the desire and the technical skills, they do not have the management skills to successfully start and manage a business. Entrepreneurs are especially curious about marketing because now they must make an effort to actually determine what customers need, not just blindly produce what the state demanded. As one Russian put it, "We don't want your charity, but we need your business know how."

Based on the authors' experiences and that of other volunteer advisors, international assistance programs, such as the Citizens Democracy Corps, are playing a critical role in the developmental process of these countries. And by assisting private enterprises in Russia and

Poland, we are also helping ourselves by creating new investment and trade opportunities.

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