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# Outsiders in an Inside Game: The Effects of the Traditional Soviet Economy of Favors on Foreigners Doing Business in Contemporary Russia

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**Outsiders in an Inside Game:  
The Effects of the Traditional Soviet Economy of Favors on Foreigners  
Doing Business in Contemporary Russia**

by

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## Introduction

One evening while I was living in Moscow as a student, a Russian friend of mine invited me to a concert. I was unfamiliar with the band, but he assured me they were one of the most popular groups in the country. When we arrived at the club at which the concert was to take place, we were stopped at the door by two strikingly beautiful Russian women who informed us that the tickets for the concert cost fifteen thousand rubles – about five hundred dollars. My Russian friend, unperturbed, mentioned the name of an acquaintance that apparently worked at the club. Although the name meant nothing to me, the women’s faces lit up and they welcomed us inside without asking for a single kopek.

This was just one example of how I learned that in Russia, who you know is often more important than what you do or how much you earn. While the use of one’s personal connections for access to lavish clubs and expensive concerts might seem like just another byproduct of post-Soviet excess, it is actually rooted in Soviet traditions that developed in conditions of shortage. The use of personal connections to gain access to hard-to-find goods or services is known as *blat*, and it continues to play an important role in modern Russian society. In fact, *blat* – and the corruption that the practice often engenders – remains the main stumbling block for many firms trying to do business in Russia. This has been especially true for foreign companies, who have been deterred from investing in what they see as an unpredictable and difficult to access environment. Much of this perception is due to the opacity of the Russian business sphere, in which personal ties and informal agreements are often more important than official contracts.

By discouraging foreign investment, corruption and *blat* have stalled development and made Russia a peripheral player in international business. Russia is still considered to be an important market for many Western corporations, but the risks of investing there often outweigh the potential returns. Russia's unfriendly business climate has deterred foreign investors, leading to slower growth for the country's economy as a whole. I argue that *blat*, and the corruption that results from it, is the main reason behind Russia's stragglng performance.

Despite the importance of *blat* in both the Soviet and post-Soviet environment, surprisingly little research has been done on the phenomenon. Some of the most instructive work has been done by Alena Ledeneva, a political scientist who has contributed extensive research tracing the cultural origins of *blat* (1998; 2008). Ledeneva has provided us with the most comprehensive overview of the historic roots and the cultural characteristics of the phenomenon. She explains *blat* as an exchange of favors, a system in which people form personal connections in order to gain access to goods or services that would otherwise be difficult to obtain. Her more recent studies have commented on the political aspects of the phenomenon and the role of *blat* in the Russian market economy, but do not fully explore the consequences of *blat* in a business environment. She also focuses mainly on the consequences of *blat* for Russians themselves, and does not address the effect that the phenomenon has on foreign entrants in the Russian market.

Many recent studies have focused on the post-Soviet business environment, and the important role that networks and connections play in Russia (e.g. Batjargal, 2003; Hunter, 2003; Michailova & Worm, 2003). These studies, among others, have found that

informal personal connections remain an important factor when doing business in Russia. In fact, belonging to a business network was often found to be the main determinant of success in the post-Soviet environment. However, these studies do not always link the use of connections in the current business environment to the phenomenon of *blat*. Those that do refer to *blat* do not fully explore the cultural origins of the phenomenon. Others have explored the differences in business ethics between Western and Russian firms, and the challenges that Western investors face when entering the Russian market (Puffer & McCarthy, 1995; Ariño et al., 1997; Barnes et al., 1997; Kuznetsov & Kuznetsova, 2005). These articles emphasize cultural differences between Russian and Western businesspeople, such as the Russian desire to form close personal relationships with business partners, and the Western inclination toward more formal arrangements. These authors have also tended to emphasize the problems associated with Russian corruption. While these studies are instructive, they do not address the root cultural causes of the differences between Russian and Western business practices, and therefore leave Western investors without a full understanding of the Russian business environment.

Previous studies, while informative, have focused on historical, cultural, or business angles of *blat*. However, these are just individual pieces of a much larger puzzle. I hope to contribute to the understanding of the post-Soviet business environment by providing a more complete picture of *blat* – a scholarly study of this peculiar cultural phenomenon. My approach differs from that of other authors in that it gives a multidisciplinary analysis of *blat*, with the goal of providing more complete insight into the challenges of doing business in Russia. By combining cultural and literary evidence, historical information, and analysis of Russian business practices, I hope to provide a

comprehensive overview of *blat* in the Soviet and post-Soviet environment. A more complete understanding of the use of connections will allow us to better understand the Russian business environment and how *blat* affects Western firms.

This paper begins by tracing the origins of *blat* in Soviet society and examining the transformation of the phenomenon during the transition to a market economy. It then looks at the instrumental role *blat* plays in contemporary Russian business, and how this distinctly Soviet phenomenon affects Western companies who invest in Russia today. By looking at the cultural roots of the use of personal connections in Russian business and examining the experience of Western companies in Russia, I hope to provide additional insight into the difficulties that foreign companies face when entering the Russian market. With a fuller understanding of the intricacies and idiosyncrasies of the Russian business environment, multinational corporations may be better prepared to succeed in their Russian ventures, or at least better informed when making the decision to invest there.

## **I. *Blat*: The Soviet Economy of Favors**

### **Background**

*Blat* is a uniquely Soviet word that refers to the use of connections to obtain goods that are in short supply. As the economist Joseph Berliner (1957) eloquently put it, *blat* is “one of those many flavored words which are so intimate a part of a particular culture that they can be only awkwardly rendered in the language of another” (p. 182). Indeed, the concept of *blat* is difficult to define. The word implies “the use of personal influence for obtaining certain favors to which a firm or individual is not legally or formally entitled” (Berliner, 1957, p. 182). According to political scientist Alena Ledeneva, who has done more recent work on the phenomenon, the term *blat* refers to “the use of personal networks and informal contacts to obtain goods and services in short supply and to find a way around formal procedures” (1998). Thus, *blat* involves the use of personal connections to circumvent the rigidity of the Soviet command economy. In this chapter, I will attempt to trace the origins of *blat* and its evolution throughout the Soviet period.

### **A working definition of *blat***

Given its multiple definitions, its evolution over time, and the varied contexts in which it is used, the term *blat* can be difficult to define. Ledeneva attempts to summarize *blat*'s features with the following definition:

*Blat* was an exchange of ‘favours of access’ in conditions of shortages and a state system of privileges.

A ‘favour of access’ was provided at the public expense.

It served the needs of personal consumption and reorganized the official distribution of material welfare.

*Blat* exchange was often mediated and covered by the rhetoric of friendship or acquaintance: ‘sharing,’ ‘helping out,’ ‘friendly support,’ ‘mutual care,’ etc.

Intertwined with personal networks *blat* provided access to public resources through personal channels. (Ledeneva, 1998, p. 37)

This definition can help guide an analysis of whether *blat* continues to operate in contemporary Russia. Such analysis, however, also requires a better understanding of the history of *blat*, its evolution through the fall of the Soviet Union in 1991, and its current role in the post-Soviet period.

*Blat*’s significance in the Soviet period can be attributed to the unique nature of the Soviet command economy. The Soviet Union relied on central planning, rather than market forces, to determine the operation of its economy. One of the consequences of such a system was a phenomenon referred to as “repressed inflation.” Repressed inflation occurs when excess demand on the consumer goods market does not translate into an appropriate price increase. This, in turn, leads to shortages, because the price of a particular good does not reflect the level of demand (Brus & Laski, 1983). Indeed, according to surveys of Soviet citizens, the main difficulty in purchasing necessary items was simply their absence from store shelves (Grushin, 2003). Thus, while earning money

was necessary in the Soviet economy, money alone was often not sufficient to obtain necessary goods and services.

Because many of the goods Soviet consumers demanded were in shortage, people were often forced to queue in order to obtain access to various items. The culture of lining up to buy shortage goods is perhaps best described in Vladimir Sorokin's novel, *The Queue* (1983). First published in 1985, the novel depicts the queuing process as a daily ritual in Soviet life. The novel's characters must stand in line for hours to purchase a particular object. Sorokin's novel satirizes the absurdity of the queuing process as his characters are forced to sleep on the street to keep their place in line: "Why don't we all spread out in the square, comrades? We can keep our places in the queue there" (p. 51). This process was, of course, a significant use of time for many people. Therefore, the ability to skip the queue and obtain shortage goods through other means was invaluable.

This is where the so-called "shadow economy" came into play. The term shadow economy refers to the non-regulated, unreported, or private aspects of economic activity (Marrese, 1981). *Blat* and other aspects of the shadow economy compensate for the inadequacies of the official economy, which is plagued by inefficiency, disequilibria, and rigidity (Grossman, 1982). As mentioned before, one of the consequences of the official economy's inefficiencies is shortage. In conditions of shortage, "there is a crucial need to establish wide-ranging social exchange networks" (Sampson, 1987, p. 131). *Blat* was the practice of establishing and exploiting these social exchange networks, and thus allowed many Soviet citizens to gain access to otherwise unavailable goods and services.

### **History of *blat***

The term *blat* dates back to the pre-revolutionary period in Russia. According to Max Fasmer's etymological dictionary, the term came to Russia from the Polish *blat*, which refers to providing a cover or umbrella for someone, and the Yiddish word *blat*, which means close, familiar, or "one of our circle" (1964). The term *blat* also refers to petty criminal activity, such as minor theft. For the purposes of this paper, however, we will analyze the more recent, Soviet understanding of the word, referring to what Alena Ledeneva terms "the economy of favors" (1998). This usage of the word appeared shortly after the Bolshevik revolution in 1917.

Most Russian language dictionaries contain only the pre-revolutionary meaning of *blat*, referring to minor criminal activity. Furthermore, "*blat*" is "not a 'polite' word and people of more refined manners are half-embarrassed to use it" (Berliner, 1957, p. 183). However, an analysis of sources representing everyday life in the 1920s, such as memoirs, letters, and novels, reveals that the word's meaning did indeed change following the revolution. These sources demonstrate that the concept evolved over time and eventually became a part of the Soviet system (Ledeneva, 1998).

It is difficult to find detailed information about *blat* during the period from the 1920s to 1940s, most likely due to the questionable nature of the practice and the less than polite connotations of the word itself. Nonetheless, certain themes reappear in various sources, particularly in satirical periodicals. One humorous example is a poem that appeared in the satirical publication *Krokodil* in 1933. The poem, called "Blat-book," jokingly referred to a notebook in which one kept all the contact information of one's *blat* connections, along with notes about what could be obtained from whom. The book was

like a secret code that instructed the user how to get help: “Just call—and in a minute you have ‘Nik. Nik.’ He will get you everything you need” (Lebedev-Kumach, 1933). Useful as this blat-book was, the poem cautioned that anyone in contact with such suspect characters could wind up at the public prosecutor’s under interrogation.

Other depictions of *blat* evoked such themes as its use to get jobs for friends and relatives, or to obtain ration tokens for necessary items (Ledeneva, 1998). *Blat* was also used to avoid a reduction in living space, as depicted in the 1925 novel, *Heart of a Dog*, by Mikhail Bulgakov. The novel, which was not published in the Soviet Union until *glasnost*, depicts the favors available to well-connected citizens in the 1920s. One of the main characters, the surgeon Professor Preobrazhensky, is facing a reduction in housing space. He is able to avoid losing rooms in his apartment, however, by calling in favors to officials on whom he operates. When the house management committee threatens to lodge a complaint with the authorities, Preobrazhensky calls the Chairman of the house committee, who also happens to be his patient. Preobrazhensky threatens to cancel all of his scheduled operations unless the Chairman issues an order ensuring that nobody “will be allowed even to approach the door of my apartment. A final and definitive order. An absolute one! A real one! Ironclad” (Bulgakov, 1968, p. 28). The Chairman, in response, instructs the house management committee to leave Preobrazhensky alone. By using his connections, Preobrazhensky is able to hold on to one of the most coveted privileges of the 1920s: extra living space.

Over the course of the 1930s and 40s, *blat* became more associated with consumption of goods that were in short supply. Rather than simply being used for necessities, *blat* was now a means for obtaining more prestigious items, such as books,

food items, clothing, makeup, or vacations. Conversations with people who lived in the USSR at that time also reveal a great deal about the importance of *blat* in Soviet society. Many of these personal accounts emphasize the near indispensability of *blat* connections. As concerned citizen Petr Gatsuk pointed out in a 1940 letter to the deputy chairman of the Council of Ministers,

Not to have *blat*, that's the same thing as having no civil rights, the same as being deprived of all rights.... Come with a request, and they will all be deaf, blind, and dumb. If you need...to buy something in a shop—you need *blat*. If it's difficult or impossible for a passenger to get a railroad ticket, then it is simple and easy *po blatu*. If you live without an apartment, don't ever go to the housing administration, to the procurator's, but better to use just a little *blat* and you will at once get your apartment.” (qtd. in Fitzpatrick, 1999, p. 62)

According to Gatsuk's account, *blat* is not just a useful tool for obtaining sought-after items. It is essential to everyday life in Soviet society.

Although *blat* was an important phenomenon in everyday Soviet life, it was not widely acknowledged. Many people who had lived in the Soviet Union were reluctant to talk about *blat* or to acknowledge their own use of it. The Harvard refugee interview project, which surveyed over 700 refugees from the USSR in the early 1950s, reveals a great deal about the discomfort associated with *blat*. Respondents in the interviews typically distanced themselves from *blat* as much as possible. Those who did talk about *blat* emphasized the human element of *blat* relations, describing the practice as a way that friends helped one another (Russian Research Center, 1950). Thus, although the concept of mutual assistance that is so integral to *blat* made it more acceptable to some, the

phenomenon was still considered something that others did, and that was best not to admit to oneself.

However, the Harvard project's respondents also pointed out that some people were much more involved in *blat* practices than ordinary citizens. These *blat* professionals had contacts with higher persons and knew the Soviet system well enough to manipulate it. *Blat* professionals knew whom to approach in order to obtain a specific good or get a particular need taken care of. *Blat* experts cultivated relationships with and had access to many more contacts than the average Soviet citizen, and were able to use *blat* to a much greater extent and much more effectively (Fitzpatrick, 1999).

The Soviet film "Ty – mne, ya – tebe" provides a comedic depiction of the *blat* professional in Soviet society (Seryi, 1976). The protagonist, Ivan Kashkin, is the ultimate *blat* professional – although he has a job as a bath attendant, his real work is in the establishment and use of connections to obtain sought-after goods. Kashkin exchanges gifts with his clients at work, owns various foreign records and other luxury items, and is able to skip long lines simply by mentioning the name of an important official with whom he has a connection. In short, Kashkin lives by the reciprocal principle of "ty – mne, ya – tebe" ("you to me and I to you" or "you scratch my back, I'll scratch yours"), which allows him to live a remarkably comfortable and luxurious life.

In the post-war period, *blat* merged further with the Soviet system. Ledeneva attributes this to the appearance of *tolkachi* (1998). The word *tolkach*, which literally translates as pusher, refers to people who were charged with expediting the production of goods in Soviet factories. The *tolkachi* were responsible for ensuring that production targets were achieved. In order to meet the necessary quotas, *tolkachi* had to obtain

materials through a variety of networks, using their connections to procure goods that would otherwise be hard to find. These practices, which were technically in violation of the Soviet system's rules, actually became more transparent and were accepted as part of the institution of Soviet production. Indeed, production quotas would have been almost impossible to fill without the use of connections, so in many ways, the Soviet system actually encouraged *blat* practices.

*Blat* became even more prevalent and tolerated during the Brezhnev era, when it became a more widespread method of obtaining goods that were in short supply (Ledeneva, 1998). The growth in the use of *blat* can be attributed to several factors. One reason for the growing use of *blat* was that consumer demands for specific goods were changing and growing, and the inefficient planned economy was unable to compensate for the higher levels of demand. Because of this, people turned more frequently to the shadow economy to obtain necessary goods and services. A second reason for increased use of *blat* is that citizens simply believed less and less in Soviet ideology, and were more inclined to circumvent official channels. Thirdly, authorities became more willing to turn a blind eye on *blat* practices, because they had actually become instrumental in ensuring that the command economy could function (Ivanova, 2011).

Satirical works during the Brezhnev era, as before, played on the use of connections to gain access to goods. In one poem, which appeared in *Krokodil*, the protagonist attempts to buy cigarettes, only to find that the door to the store is locked. A woman inside yells at him that the salesman is busy distributing shortage goods (*defitsit*) to his friends. The salesman, meanwhile, protects the *defitsit* with his body and cries that he is doing "a responsible deed." The narrator concludes that he is better off, as he no

longer goes to the store and has quit smoking. But, he says, his neighbor is not so lucky – he has quit eating (Poluian, 1976). This poem demonstrates the combination of shame and defiance related to using *blat*. It also highlights the winners and losers of *blat* transactions – while the salesman’s friends are benefitting, the protagonist, and especially his neighbor, are unable to buy necessary goods that are in shortage.

The government, for its part, did little to slow the growth in activity in the shadow economy. *Blat* transactions during this period were tolerated, or even “winked at” by the regime, in what James Millar refers to as the “Little Deal” (1985). The Little Deal was essentially a tacit agreement between the authorities and the population that allowed the second economy to flourish. Under the Little Deal, Soviet citizens were able to gain access to various goods and services without any real threat of punishment by the regime. Whereas large-scale transactions of this sort were clearly illegal and could result in significant consequences, petty exchanges within circles of personal connections were mostly ignored. This is most likely because *blat* actually eased many of the problems associated with shortage, and the government had an interest in letting the system of connections continue to operate (O’Hearn, 1980). Thus, *blat* was used to obtain such diverse goods and services as cold cuts and other delicacies, hairdressing, tutoring, medical services, and housekeeping. During this time, *blat* connections were used extensively and obviously, suggesting that there was no real punishment for such infractions.

### Characteristics of *blat* networks

Given that *blat* is a phenomenon that relies on connections, it is important to understand the networks that allow it to operate. *Blat* networks can be broken down into two main categories: horizontal and vertical. Horizontal networks are those that are made up of people of similar status, while vertical networks are composed of people of different social strata interested in each other's connections (Ledeneva, 1998). Imagine a horizontal network as a group of friends or family members that are all of roughly equivalent socioeconomic status. Exchanges between members of such a network are a regular occurrence, and there is no appearance of impropriety. Most people would agree that it is acceptable, if not encouraged, for friends and family members to share items with each other or perform tasks for each other in an ongoing exchange. This sort of horizontal reciprocity is seen in almost all societies. However, it was much more pronounced in the Soviet Union because it was one of the only methods of procuring necessary goods and services.

Vertical networks, meanwhile, were used much less frequently. An example of a vertical network would include a worker, or someone on a lower social stratum, and a party boss, who has access to various goods and services that others do not. The connection between these two actors becomes essential to the worker, and the party boss may provide him with various favors that others do not have access to. All of these favors are given, however, with the expectation of an exchange, and the worker will eventually need to reciprocate by helping the party boss in whatever way he can. It is the use of these vertical networks, rather than horizontal ones, that accounts for much of the negative association with *blat*. The main difference between these two types of *blat*

relations is that while horizontal networks were used on a regular basis, vertical networks were used less often. Furthermore, *blat* ties among family and friends (horizontal) were more commonly accepted, whereas the use of connections for profit or explicit exchange (vertical) was often looked upon with resentment, because they were seen as unethical and less personal than horizontal exchanges.

It should be noted that, although similar in many respects, *blat* is not the same thing as bribery. While the two phenomena certainly overlap, *blat* differs from bribery in the sense that there is always a personal basis for the exchange. Bribery also implies immediate payment, whereas reciprocation in a *blat* transaction can take time and occur in various forms (Berliner, 1957). The line, however, between bribery and *blat*, can sometimes be difficult to make out. One case that demonstrates the ambiguity of the distinction is that of Yuri Sokolov, the director of the Eliseevsky Gastronom in Moscow (Faitelberg, 2004).

During the Brezhnev period, the Eliseevsky Gastronom was known as the best grocery store for buying items that were almost impossible to find elsewhere. Because of this, many members of high society, including diplomats, generals, and actors, attempted to cultivate a relationship with the director of the store, Yuri Sokolov. In exchange for access to the store's shortage items, these high-powered people were able to offer Sokolov various services. For example, Sokolov's friendship with the Minister of Internal Affairs, Nikolai Shchelokov, allowed him to avoid problems with law enforcement. The actors, artists, and musicians, meanwhile, gave Sokolov access to tickets for various shows, and even performed an annual concert at the store itself. These were all classic examples of *blat* exchanges – continuous interactions based on friendship.

However, in order to obtain those coveted goods that made his store so attractive, Sokolov needed money. Therefore, in addition to various favors, Sokolov also took bribes, which he then passed on to members of the Gortorg, which determined the allocation of goods for grocery stores. By bribing these officials, Sokolov was able to guarantee access to luxury grocery items, and therefore able to hold up his end of the relationships he had cultivated with Moscow high society. In the case of the Eliseevsky Gastronom, *blat* and bribery were intimately interconnected.

Despite the hazy distinction between *blat* and bribery that can appear in practice, however, the two phenomena can be distinguished from one another in theory. *Blat* consists of multiple favors given over time within personal networks; a bribe, by contrast, is a specific, immediate deal outside of those networks (Humphrey, 2002). Thus, this paper is not simply an investigation of bribery or corruption, but of a specific cultural phenomenon that occurs based on personal relationships.

These personal relationships were fundamental to the day-to-day working of Soviet society. They created a sort of social capital, a currency in which practically everyone had something they could share with others, with the expectation of eventual reciprocation (Utekhin, 2007). Although *blat* went against the Soviet social and economic order, the system could not have functioned without it. *Blat* became the primary way of getting things done in a non-market society in which money had little value. The relationship between the Soviet system and *blat* had two sides to it. On the one hand, the conditions created by a command economy made *blat* necessary and allowed it to operate. On the other hand, the structure of the system and the rules enforced by Soviet authorities limited *blat* practices to small-scale transactions, and kept the entire

phenomenon of *blat* from spiraling out of control. Once the Soviet system disappeared, however, the nature of *blat* changed dramatically.

## **II. *Blat* and the transition to a market economy**

In the late 1980s and early 1990s, as Russia was transformed from a command economy into a market economy, *blat* played a crucial role in the way the business environment developed. For many entrepreneurs during this period, one's connections were the main determinant of whether or not one was to succeed in business. The use of *blat* during the transition to a market economy created a small group of insiders that succeeded in business, while the vast majority of those who lacked connections were less successful. A brief history of the process of privatization and the transition to a capitalist economy will explain how *blat* contributed to the creation of an insider/outsider dynamic – a dynamic that still exists in the Russian market today.

Beginning in 1987, as part of Gorbachev's attempt to reform the Soviet system, the state allowed new autonomous businesses, known as "cooperatives," to form. The cooperative movement was initially limited to small sections of the economy, but by the time the Law on Cooperatives was adopted in 1988, many of these quasi-private businesses had already formed. As the movement took hold, it became clear that success depended on knowing the right people. Connections were important in establishing a cooperative for several reasons. First, one could not simply start a cooperative; it was necessary to obtain permission from the government. Not surprisingly, many of those who received permission to start cooperatives in the early years were already well connected with those in power.

Second, many goods remained difficult to find during the transition, and connections were essential for obtaining the necessary supplies to operate a business.

Despite the fact that cooperatives represented a significant step away from the planned economy, they were still operating in an environment of scarcity. Thus, only those who had connections to suppliers could truly benefit from the opportunities of the cooperative movement. As journalist David E. Hoffman points out in his book on the transition, “the first private entrepreneurs had to rely on their wits—on *blat* and *svyazi*, on theft, bribes and bargaining—to get supplies” (2002, p. 42).

Third, ties to the government allowed many cooperatives to acquire the necessary liquidity to develop their business, especially as many cooperatives attempted to enter the banking industry. This is because most banks would have been unable to survive without cheap credit from the state. Indeed, “big industries, regional governments, and the Communist Party and its many affiliates were the driving force in the explosion of the new banking sector, and their political clout and money dwarfed the more independent young cooperatives” (Hoffman, 2002, p. 46). Thus, those entrepreneurs who had connections to state resources were much better positioned to establish successful, lucrative banking operations.

One of those who benefitted hugely from this system was Mikhail Khodorkovsky, a young Komsomol member who went on to become the richest man in Russia. Over a very short period of time, Khodorkovsky was able to make huge amounts of money through various business operations, eventually establishing Bank Menatep and acquiring the oil company Yukos. His success was in large part thanks to his various connections and friendships, and to his affiliation with the Komsomol, which provided him with legitimacy and access (Hoffman, 2002). As Khodorkovsky himself acknowledged, “All the ventures that were started at this time succeeded only if they were sponsored by or

had strong connections with high-ranking people. It wasn't the money but the patronage. At the time, you had to have political sponsorship" (Khodorkovsky qtd. in Hoffman, 2002, p. 101). And Khodorkovsky was not alone. In fact, his is just one example of "a movement that would gain momentum as the Soviet Union fell apart: party, government, militia, and KGB officials on all levels went into business, using their contacts as starting capital" (Brady, 1999, p. 56). In many cases, these contacts were the determinant of success.

Another entrepreneur who took advantage of his connections in order to succeed in business was Vladimir Gusinsky, the former media magnate. Like Khodorkovsky, Gusinsky recognized the importance of friendships and connections with people in high places. Regardless of one's personal feelings toward a particular official, it was essential to develop good relations with anyone who could be of use. Even more important, Gusinsky believed, was to offer that official something that he needed to advance his own career: "So it was always important for me to understand, what does this boss need?" (Gusinsky qtd. in Hoffman, 2002, p. 160). Gusinsky's observations demonstrate how *blat* had become a system that allowed officials and businessmen to pursue their own self-interest under a veneer of friendly relations.

*Blat* also proved instrumental in determining who would control those businesses that already existed prior to the collapse. In many cases, those who already knew the ins and outs of the business and had established connections in the industry were able to retain control in the face of market reforms. Newcomers, even with an education in business and free markets, were at a disadvantage. This was particularly apparent in the battle for the position of general director of the Vladimir Tractor Factory. The Factory,

which was the main employer in the town of Vladimir, had made tractors and diesel engines since 1945. In the face of Yeltsin's reforms, the question emerged of who would take control of the factory when the state sold its shares.

On one side was the factory's general director, Anatoly Grishin. Grishin was well versed in the central planning system, and knew how to succeed within it. He had mastered the art of using personal ties and "managing within the old boys' network" (Brady, 1999, p. 82). He had close relationships with customers as well as suppliers, and also maintained contacts within government. However, Grishin was challenged for ownership by Josef Bakaleynik, the deputy director of the factory. Bakaleynik was the quintessential new Russian businessman with a passion for markets, having even studied at Harvard Business School through a scholarship program for Soviet managers.

In order to gain control of the factory, one of the men would have to gain control of the shares, which meant winning over the shareholders, mainly factory workers. Bakaleynik attempted to do this by offering the shareholders a dividend, but Grishin was able to gain far more support by having his foremen ask workers to hand over their voting rights to worker representatives (Brady, 1999). At the shareholders meeting, Bakaleynik attempted to appeal to market values and the new business environment, but received little support. One worker declared, "I think a Harvard education will not help you. Today you need personal contacts, deep personal contacts" (Brady, 1999, p. 89). Another worker expressed his confidence in Grishin based on the length of their relationship, declaring, "I trust him because I know him for eighteen years" (Brady, 1999, p. 91). The reactions of the workers demonstrated that even in the transition, business knowledge was secondary to connections. This was made clear in the voting as well, which Grishin

won by a whopping 82 percent. When it came to knowing the right people, Grishin clearly came out ahead, and was thus able to retain control of the factory through the reforms.

As the transition from the command economy to the market economy moved forward, connections with those in power continued to be an important determinant of who succeeded in Russian business. As part of the effort to privatize state-owned assets, the state held so-called “loans-for-shares” auctions. These auctions, which were part of the post-voucher “cash phase” of privatization, were intended to help the government finance the federal budget deficit. Under the program, the government offered shares in major companies as collateral for loans from large banks. Given the government's deplorable financial situation, the program practically guaranteed the banks a stake in the companies in question. The ability to participate in the program was therefore crucial, as it was a stepping stone to ownership in large state companies. However, participation in the loans-for-shares auctions was limited to a small number of banks. The new owners of the former state companies were selected not by market forces, but by politicians (Hoffman, 2002). Indeed, all the banks that were allowed to participate in the auctions had close ties to political power brokers (Colloudon, 1998). Thus, it was important to have friends in high places, and to use those connections for a chance to participate in the loans-for-shares auctions.

One case in which connections to the government proved particularly lucrative was in the auction for Norilsk Nickel in 1995. In November of that year, an auction was held for control of 38% of Norilsk Nickel, which was the world's largest producer of nickel, platinum, and cobalt. Uneximbank, the firm that was ultimately victorious in the

auction, had close ties to President Yeltsin's former security chief and drinking buddy, Alexander Karzhakov. This connection gave the firm a distinct advantage, especially since Uneximbank itself was charged with managing the auction. In this role, Uneximbank was able to award itself control of Norilsk Nickel at a laughably low price – only half that offered by a competitor. Furthermore, with a price tag of \$170 million, the shares of Norilsk Nickel were sold at only \$100,000 above the minimum bid level, which, not surprisingly, was set by Uneximbank (Frydman et al, 1998). Thus, Uneximbank was able to capitalize on its connections within the government to gain the position of auctioneer, thereby ensuring that the firm would be able to buy the shares of Norilsk Nickel at a cut-rate price.

The importance of connections in establishing a cooperative or participating in the loans-for-shares auctions ensured that only a small group of people would significantly profit from the process of privatization. As a result of the reforms of this period, a close-knit, clannish economic elite formed in Russia. By the the mid-1990s, it had become clear that privatization in Russia was not the domain of self-made entrepreneurs, but instead of the politically and economically well-connected (Karklins, 2005). Olga Kryshtanovskaya, a Russian sociologist, was one of the first to take note of and study the emerging clan structure of what she called “the financial oligarchy” (qtd. in Hoffman, 2002). The group she observed, generally referred to simply as “the oligarchs”, formed a network of connections that married the interests of wealth and power. Glenn Waller, an Australian diplomat who was in Russia at the time, called the relationship between business and government “incestuous”, claiming that even the new business elite was a product of the old Soviet system:

Most (if not all) of the private financial groups made their first capital through their privileged access to party and Komsomol funds or through political contacts (in Russian: *blat*) in government ministries. Today, they continue to rely on government favors.... Big Business in Russia continues to coalesce around powerful political leaders. (Waller qtd. in Hoffman, 2002, p. 322)

As Waller notes, the *blat* connections between political leaders and businesspeople in Russia determined who was part of the elite group of oligarchs, and thus, who succeeded in business. Indeed, “each oligarch needed to cultivate a good relationship with a senior government official or his relatives. Intrigue, connections and payoffs count for more than talent” (Goldman, 2003, p. 154). Without such connections, a newcomer to Russian business would be at a severe disadvantage. This dynamic of insiders and outsiders would continue to determine the course of the Russian economy for years after the end of privatization.

It is clear that *blat* played a significant role in the formation of the Russian market economy in the post-Soviet era. It is true that *blat* was in many ways a tool for coping with the rigidities of the Soviet command economy. However, it appears that the phenomenon was so “deeply embedded in social relations, including kinship, neighborhood, ethnicity, and common religion,” that it continued to shape market interactions throughout the post-Soviet transition (Humphrey, 2002, p. 138). This is not to say that the nature of *blat* did not change during this time period – it was certainly adapted and molded to fit the needs of the new economy and the new actors on the post-Soviet stage. However, the essence of the phenomenon remained the same: the use of personal connections to obtain hard-to-find goods and services.

### III. Blat lived, lives, and will live: The use of connections in modern Russia

The collapse of the Soviet Union meant the end of many of the conditions that made *blat* necessary, and the process of transition to a market economy certainly transformed the phenomenon. But does this mean that *blat* has disappeared entirely? Or has it simply evolved in the context of the post-Soviet economy?

The word “*blat*” itself is still in use, although a generational gap seems to have developed in terms of its understanding. Whereas older generations associate the term “*blat*” with the use of connections, younger generations associate it more with its original, pre-Soviet meaning, which refers to petty criminal activity. Although this generational difference indicates that the term has lost its central significance, it does not mean that *blat* no longer exists. Indeed, Ledeneva argues that *blat* has assumed new forms that go beyond the areas in which the term was traditionally used (1998). Thus, although *blat* has changed, and may no longer be consistently referred to by the same name, it should be analyzed as a continuous – though evolving – phenomenon.

In her most recent analysis of *blat* in the post-Soviet environment, Ledeneva explains the changes that the phenomenon has undergone in the past two decades. First, *blat* has become monetized. This is because, in general, goods are now widely available. Money, on the other hand, is in short supply. Whereas *blat* was once a means of obtaining goods and services in a society in which money had little value, it is now used to obtain the money itself (Ledeneva, 1998). The driving force behind *blat* connections has therefore been reoriented toward obtaining money. The scale of *blat* exchange has also changed. *Blat* is now used for a wider variety of needs in the newly formed private

sector, such as establishing a personal business or rerouting state funds into the private sector. However, the number of people to whom *blat* is available as a means of transaction has shrunk. *Blat* in the Soviet system was available to virtually everyone as a method of obtaining necessary goods. Now, however, *blat* is only available to a select few in the business sphere. Therefore, *blat* practices are larger in scale, but less pervasive, primarily serving the needs of the business sector (Ledeneva, 2008).

Given the new importance of *blat* in the business sector, this area deserves special attention. The use of *blat* is often cited as one of the reasons for the corruption that continues to afflict Russian business. In business, *blat* is used to access bureaucratic decision-making and information, connections that can in turn result in increased monetary income. In fact, many now consider business to be one of the realms in which *blat* remains most useful today (Puffer & McCarthy, 2011). Part of the continued use of *blat* can be explained by history – the use of personal connections has become deeply embedded in Russian culture. However, there is also a practical explanation for the phenomenon's continued importance. The Russian business environment is characterized by an inadequate legal system that fails to guarantee businesses protection through any formal needs. Therefore, the formation of close personal relationships and informal networks is used to replace the formal protections that are present in more developed business environments (Butler & Purchase, 2004; Kuznetsov & Kuznetsova, 2005). As in Soviet times, *blat* serves as grease for a machine that might not otherwise function, supplementing for the system's deficiencies and failures.

As a response to these shortcomings, businesspeople in Russia have resorted to a particular form of *blat* adapted for the market economy. Like in Soviet *blat* networks, the

connections in Russian business are based on personal contacts in what is referred to as “network capitalism” (Puffer & McCarthy, 2007; Hunter, 2003). Despite its impersonal name, network capitalism is a system in which “virtually all important business alliances are embedded in personal ties between business people who know and trust one another” (Hunter, 2003, p. 115). Thus, network capitalism is simply a different name for a more modern manifestation of *blat* – one that has adapted to the needs of Russian businesspeople in the market economy.

The use of network capitalism as a business tool is widespread in post-Soviet Russia. In a survey conducted in the late 1990s, Russian managers ranked connections as one of the two most important factors for success in business<sup>1</sup> (Taylor & Kazakov, 1997). In another study of twenty-two Russian domestic firms, fifteen firms attested to using connections to do business, and nine of those firms specifically used the term *blat* to describe their business practices (Hunter, 2003). Furthermore, network capitalism has been shown to be an effective tool for those firms and businesspeople who use it. In a study based on interviews with seventy-five Russian entrepreneurs, political scientist Bat Batjargal (2003) found that personal network ties directly improve entrepreneurial performance. This is because, according to Batjargal, “having many weak ties and being able to mobilize financial resources from rich and powerful contacts enables entrepreneurs to increase their revenues and profits” (p. 551). Network capitalism, then, is both a widely used and effective tool in Russian business.

For businesses in contemporary Russia, network capitalism, or *blat*, is especially necessary in relation to tax authorities, customs officers, the banking sector, and regional

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<sup>1</sup> The other most important factor that the surveyed managers listed was dishonesty.

administration (Michailova & Worm, 2003). *Blat* is a helpful tool for businesses looking to gain preferential bank financing, export licenses, tax exemptions, special terms in contracts, or access to influential customers (Butler & Purchase, 2004; Ledeneva, 2008). In order to establish a business and keep it running, “entrepreneurs must routinely offer favors to public officials, ranging from local police and fire authorities to politicians in local and federal governments” (Puffer et al., 2010, p. 448). Interestingly, the use of *blat* connections both substitutes and complements the use of money when dealing with officials. Connections allow certain businesspeople within a network to obtain a good or service for which others would have to pay a bribe, or at least reduces the amount of the bribe that is required (Gehlbach, 2001).

As in the Soviet era, the use of *blat* is reflected in contemporary literature. In Oksana Robski’s novel *Casual*, the main character is attempting to start a buttermilk business. The protagonist explains the plight of looking for someone to sell her product: “Now I had to find a network of dealers. If I talked to Wimm-Bill-Dann, the biggest packagers of juices in Russia, they would start selling buttermilk themselves. I had to talk to a friend, who would be bound by his word” (Robski, 2006, p. 63). The importance of obligation in *blat* connections is key here. The narrator feels that she cannot trust anyone with whom she would communicate through official channels, and therefore seeks out someone on whom she can rely on a personal basis, and who feels compelled to help her.

The connections that businesspeople like Robski’s character use can be long-standing, but some *blat* connections have been formed more recently. The success of the new economic elite “is often built on networks of access to goods, information and contacts either dating back to their professional position in Soviet times or due to their

‘family background’” (Bruno, 1997, p. 57). Indeed, connections formed under the Soviet system remain prevalent in modern Russian business. However, newly founded enterprises are building new networks of their own (Huber & Wörgötter, 1998). Thus, it would seem that the use of *blat* in business is not simply a holdover from the command economy, but a phenomenon that is continuing to perpetuate itself in market conditions as well.

Although *blat* has continued to be a useful business tool for those who are part of a network, it disadvantages those who are outside of the web of connections. As pointed out earlier, *blat* connections reduce the costs of dealing with officials by substituting for, or at least complementing bribery. However, those entrepreneurs outside the network face higher costs than they would in the absence of a network, because without connections, they are forced to pay the full bribe (Gehlbach, 2001). Thus, *blat* networks decrease costs for members of the in-group, who are able to circumvent the need to pay bribes. Those same networks, on the other hand, increase costs for those who are outsiders, and must pay for necessary favors from officials.

This theory of *blat* networks is corroborated by evidence indicating that the Russian business environment favors insiders. In an analysis of Russian entrepreneurship, Aidis et al. (2008) found that entrepreneurs who are already in the business sector dominate entrepreneurial entry in Russia more than in other countries. The entrepreneurs’ connections in the business sector were most likely key in creating this advantage, and in discouraging entry of new business actors. Thus, network capitalism, or business *blat*, is a system that favors insiders, with little opportunity for entry by newcomers to the business sector.

#### **IV. Strangers in a Strange Land: How *blat* affects foreign businesspeople**

It is widely agreed that Russia is not an easy market for foreign companies to enter. Indeed, Russia places 120<sup>th</sup> out of 183 countries on the World Bank's ease of doing business rankings, receiving a worse rating than countries such as Yemen, Pakistan, and Kosovo (World Bank, 2012). It is also no secret that corruption in the country is rampant, and Russia ranks 143<sup>rd</sup> out of 182 countries on Transparency International's Corruption Perceptions Index (Transparency International, 2011). Given that international perceptions of the Russian business environment are so poor, it is not surprising that levels of Foreign Direct Investment in the country have remained relatively low. In the period from 1992 to 2010, the average foreign direct investment as a percentage of GDP was only 1.7%. China's, meanwhile, was over 4% (World Bank, 2011). While it is impossible to determine to what extent, *blat* and similar practices undoubtedly contribute significantly to these abysmally low rankings and investment figures. As already discussed, *blat* is still a very important reality of the business environment in Russia. But what specific effect does the phenomenon have on foreign companies trying to do business in Russia? Do foreigners encounter *blat* in their dealings with Russians, and if so, how does it affect their own business success?

Given that Russia has only been a part of the global marketplace for about twenty years, it can be difficult to draw lasting conclusions about the various difficulties and advantages of foreign investment in the country. This is especially true with respect to the challenges posed to a foreign investor by *blat*, since the phenomenon itself is not well documented. However, by piecing together various observations made over the past

twenty years regarding foreign companies doing business in Russia, we can better understand the nature of *blat*'s effects on foreign investors.

The first question that arises with respect to *blat* and foreign companies is whether the phenomenon is relevant to non-Russian businesses at all. *Blat* is, after all, a uniquely Soviet (and now Russian) concept, and it seems to only occur within established networks. However, *blat* networks do not exist in a vacuum. In fact, foreign companies will often encounter *blat* networks, and many times have no choice but to deal with them. In their overview of the differences in business ethics between Russians and Americans, Sheila Puffer and Daniel McCarthy note that American businesspeople are likely to encounter *blat* quite often in Russia. In fact, they claim *blat* is “the most frequently encountered questionable behavior in Russia” (Puffer & McCarthy, 1995). Thus, *blat* is not just a nebulous, outdated Soviet concept, but a modern reality that foreign businesspeople continue to encounter. But the question remains: how exactly does *blat* affect the experiences of foreign companies in the Russian market?

In some cases, when used effectively, *blat* practices can actually provide foreign firms with certain advantages when entering the Russian market. Indeed, networking capabilities and the use of connections have played a major role in determining foreign firms' effectiveness. A survey of 179 foreign firms operating in Russia, for example, found that adaptability to network conditions and involvement within networks were the most important determinants of effectiveness in the Russian market (Fey & Denison, 2003). Another study of West European companies investing in Russia found that it was very important to have a partner with political influence, especially in the context of Russia's fluid legal environment. Having such a partner was particularly helpful for

obtaining approval to set up a new office, or in registration, custodial, and settlement procedures (Ariño et al., 1997). It is clear then, that adapting to networks and using connections to one's advantage can help foreign firms in their entry into the Russian market. However, the *blat* system has many drawbacks for foreign entrants as well – hindrances that often outweigh the advantage that the system can provide.

One way in which *blat* has proven difficult for foreigners is that it is simply very different from business practices in other countries. With the possible exception of Chinese *guanxi*<sup>2</sup>, there are no real analogues to *blat* in other cultures. Although it may be tempting to compare *blat* to the networking that is often used in the West, the two phenomena are actually quite different. Personal networking in the West is based primarily on individualism and is characterized by non-personal exchanges that are discrete in time and take place outside the workplace. *Blat*, on the other hand, is based on collectivism, and is characterized by highly frequent exchanges that are usually personal, but also take place at the workplace (Michailova & Worm, 2003). Because of these differences, Western businesspeople will not be predisposed to understanding how *blat* networks function.

Foreign investors are likely to have a difficult time navigating the peculiarities of a business environment in which an unfamiliar concept plays such a large role. Scholars have cited a noticeable variance between Russian national business culture and international business culture as a challenge and deterrent to foreign firms doing business

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<sup>2</sup> *Guanxi* involves “the exchange of gifts, favors, and banquets; the cultivation of personal relationships and networks of mutual dependence; and the creation of obligation and indebtedness” (Ledeneva, 2008). The many differences between *blat* and *guanxi* are not within the purview of this paper, but it is important to recognize that, although the two phenomena are often compared, they are not the same.

in Russia (Kuznetsov & Kuznetsova, 2005). Undoubtedly, *blat* plays a role in this variance, widening the gap in business practices between Russia and the rest of the world.

Specifically, foreign investors may encounter blurred boundaries between formal and informal spheres when engaging in business. This stands in sharp contrast to practices in the West, where business relationships are generally impersonal, and business interactions take place in a formal setting (Jansson et al., 2007). This difference can often be a source of confusion for Western investors in Russia. The importance of the personal dimension of Russian business relationships means that foreign investors may need to spend a good deal of time on relationships with Russian business partners. Often this means getting to know each other's families, drinking vodka, or going on hunting trips. This, of course, would be unfamiliar territory for Western businesspeople, who are accustomed to formal negotiations and straightforward agreements (Brady, 1999). Indeed, Westerners often underestimate the amount of time and effort necessary to build a relationship and secure an initial agreement with a Russian business partner (Barnes et al., 1997).

A second obstacle that foreigners will likely encounter is that *blat* is, by its very nature, an exclusive arrangement. No matter how hard a foreign businessperson tries to understand and engage in *blat*, the system will favor insiders. We have already discussed how, during the transition from a command economy to a market economy, *blat* connections created a clear dichotomy between insiders and outsiders. Those with ties to government and friends in high places were much better positioned to succeed in the new Russia than those who were less well connected. Connections to people in power were then, and remain now, an essential part of doing business in Russia.

Because of the strong ties between businesses and the state, the Russian economy still provides greater opportunities to so-called “entrepreneurial insiders” than to less connected newcomers to the market (Aidis, 2007). Furthermore, connections continue to play an important role long after a business is established. This is partially to facilitate the process of getting supplies or finding customers. But it is also indicative of a larger cultural mistrust of outsiders, which leads to a lack of transparency and a dependency on networks (Puffer & McCarthy, 2011). It is not difficult to see then, how a system that so favors insiders would be especially difficult for a foreign investor to navigate. Indeed, Russian networks “are closed and opaque to outsider firms” (Jansson et al., 2007). A foreign businessperson will be unlikely to know the necessary authorities in Russian government, and even less likely to be able to trust them to the extent a well-connected Russian businessperson could. Foreign businesspeople, as outsiders, are thus limited in their ability to participate in the system of exchange and *blat* relations (Bruno, 1997). Language and cultural barriers aside, the system of *blat* is a closed-off one, and even the most well-financed, talented foreign businesspeople will have difficulty penetrating it.

But there is a third problem associated with *blat*, one that foreigners are unlikely to overcome, even with considerable time and effort. Specifically, foreign firms will face the challenge of operating under international ethical standards, which often don’t correspond with Russian business practices. *Blat* itself is not technically illegal. But *blat* networks are often used for questionable practices from which many foreign companies would shrink. Since *blat* often involves using connections with state authorities to benefit one’s business, it can easily run afoul of foreigners’ concept of ethical business practices (Puffer and McCarthy, 1995). Indeed, practices that are legal in Russia may still cause

problems for foreign companies because they face legal sanctions from their home country.<sup>3</sup> This can discourage multinationals from engaging in any practice that could be seen as corruptive, since they risk facing significant legal consequences at home (Venard, 2009). Even setting these legal issues aside, most foreign companies are held to account by consumers in countries with a different understanding of business ethics than that found in Russia. What may be looked upon as an everyday business practice in Russia could be seen as bribery by observers abroad. Therefore, foreign companies are put in the awkward position of trying to integrate themselves into a system of practices that would not necessarily be considered ethical by their consumers.

In sum, I propose that *blat* disadvantages foreign businesses in Russia in three distinct ways. (1) It is unique to Russian culture and difficult for non-Russian businesspeople to understand. Because there is no analogue to *blat* in other countries' business cultures, foreign businesspeople have difficulty learning how to navigate the system. (2) *Blat* is, by nature, a system that favors insiders. Having longstanding connections with the right people is key, and foreign companies, as the ultimate outsiders, are at a significant disadvantage. (3) The practices associated with *blat* are sometimes of questionable ethical nature to outside observers, and even foreign firms that are able to integrate themselves effectively into the Russian market may face pressure from consumers or legal sanctions from their own governments for engaging in *blat* practices.

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<sup>3</sup> The Foreign Corrupt Practices Act, for example, prohibits the bribery of foreign government officials by U.S. persons. (U.S. Department of Justice, 1998)

## **The case of IKEA**

In order to assess this theory of how *blat* affects multinational companies operating in Russia, it is useful to examine the experience of the Swedish furniture retailer IKEA in entering the Russian market. I have chosen IKEA because it is one of the few Western multinationals whose experiences in Russia have been well documented. Thus, using this company's experience as a qualitative case study gives us the most information with which to test the hypothesis above about *blat*'s effect on foreign firms.

IKEA opened its first Russian store in Moscow in 2000, and now has fourteen stores in eleven Russian cities ("Richer Russians," 2012). Russia quickly became a very important market for the company, accounting for 5 percent of their business worldwide. Prior to the economic crisis, IKEA's business in Russia was growing 20 percent per year (Kramer, 2009b). The company has repeatedly cited Russia as a key market, with significant business potential in retailing, purchasing, and production (IKEA Group, 2010). However, the company has also encountered various obstacles in Russia. This section will explore the business practices that allowed IKEA to succeed in Russia, the difficulties that have plagued the company more recently, and the role of *blat* practices in determining the nature of the company's experience in the Russian market.

One reason that IKEA was able to achieve relatively rapid growth and success in Russia was its effective use of connections when initially entering the market. As with many firms, *blat* seems to have helped IKEA deal with the challenges of the Russian market. In their study of IKEA's entry into the Russian market, Elg, Ghauri, and Tarnovskaya (2008) found that the company was successful because of its use of network capitalism and its cultivation of close personal relationships with key people. IKEA made

a concerted effort to build trust with network insiders. By building this trust and becoming part of the network, IKEA became less of an outsider. Indeed, building trust with network insiders was critical, as it facilitated “the growth of the network and the development of business contacts to those network actors who are in control of critical activities and resources” (Elg et al., 2008, p. 689). As the trust between IKEA staff and their Russian contacts grew, both parties became more open in sharing information. IKEA, then, was itself able to become somewhat of an insider, which in turn gave it a competitive advantage in relation to other retailers, who had not cultivated the same type of personal relationships.

Networking activities were critical because contacts with officials aided IKEA in acquiring necessary permissions and land or managing construction of their large store complexes. IKEA made an effort to establish personal contacts with authorities at all levels of government, as well as with suppliers, journalists, and other influential actors. IKEA’s initial success was facilitated by the fact that the company worked on establishing supplier relationships well in advance of opening stores in the country. A close personal rapport with key Russian actors was essential. Even the highest levels of management and government were involved: IKEA’s founder, Ingvar Kamprad, met personally with President Putin to discuss Russian customs rules and IKEA’s plans for future investment (Elg et al., 2008).

These relationships ensured that IKEA would have an established business network in Russia. They also helped provide IKEA with a preliminary understanding of the culture and the consumers it would be dealing with. In general, “the exchange of mutual benefits and relationships with political and social actors also gave IKEA

representatives an increasing understanding of the culture as well as of how the bureaucratic system worked” (Elg et al., 2008, p. 690). Thus, the connections that IKEA made early on in the establishment of its Russian venture helped make the company more fluent in the language of *blat*, giving its executives a better understanding of how Russian networks functioned. It also guaranteed that the company had friends in powerful positions. These relationships, both by teaching IKEA managers about *blat* and by providing the benefits associated with network capitalism, proved instrumental in ensuring that IKEA’s entry into the Russian market was a success.

IKEA also brought its own creative business approach to its operations in Russia, which helped the company overcome some of the problems it encountered. Although IKEA had made a concerted effort to cultivate good relationships and *blat* connections with Russian officials, it also wanted to ensure that it would not be completely dependent on them. This often meant resorting to new and creative methods of ensuring the company’s independence and ability to operate. For example, when officials cut off the electricity supply prior to the opening of one of IKEA’s Moscow stores, IKEA brought in generators to ensure that the store could operate as planned. In fact, after this incident, the company made it a general practice to have a generator in every one of its Russian stores (Loshak, 2010). Thus, while IKEA attempted to use connections and networks to its advantage, it also recognized the unreliability of Russian officials and the necessity of creating an independent contingency plan.

It seems, then, that IKEA was able to overcome many of the obstacles of *blat*, first by working to gain a better understanding of the system, then by further building trust and becoming an insider in the exclusive *blat* networks. Indeed, Elg et al. argue that

it was these very activities that determined IKEA's success in entering the Russian market (2008). Furthermore, IKEA endeavored to guard itself against the uncertainty of the Russian market by attempting to maintain a certain level of independence. In addition to cultivating close relationships with officials, IKEA took measures to ensure that it could continue to operate even without the support of local officials. This strategy, which was a creative and unique combination of the use of business networks and the maintenance of relative independence, contributed to IKEA's initial success in the Russian market.

More recent evidence, however, would suggest that not all is well. IKEA has run into several difficulties that have led it to reevaluate its approach to the Russian market. One case that proved particularly frustrating to IKEA executives was the opening of a store in Samara. Despite years of preparation and consultation with local officials, the opening of IKEA's new store in Samara was postponed nine times. The most recent reason that Russian officials cited for delaying the opening was that the building for the store was not adequately built to withstand hurricanes – a prospect that seems rather unlikely in the Volga region (Loshak, 2010). Frustrated, IKEA announced a halting of investment in Russia “due to the unpredictability of the administrative processes in some regions” (Toohey, 2011). Outside observers have interpreted this statement as code for IKEA's exasperation with the rampant corruption in Russia (Kramer, 2009a). The Samara store only opened in September 2011 after a four-year delay, undoubtedly costing IKEA millions of dollars in lost revenue.

The Samara case closely resembles an earlier incident in Nizhnii Novgorod. In 2006, an IKEA store in Nizhnii Novgorod was forced to close for a period of thirty days

when authorities determined the store did not comply fully with fire safety regulations. The forced closure, which occurred just before the holiday season, was estimated to have cost the company up to 50 million dollars (Miliaev, Chichurina, Savel'ev & Morozova, 2006). In both of these cases, it is reasonable to assume that the delays and closures were not based on actual safety concerns, but instead on an attempt to extort money from the company in exchange for permission to operate the stores. These incidents persuasively demonstrate that even the most creative business practices are subject to setbacks due to corruption. Despite IKEA's concerted effort at establishing useful connections while simultaneously maintaining a significant degree of independence, it was still subject to the whims of local authorities. Had IKEA been able to establish more reliable *blat* connections with the authorities in question, they might not have experienced such delays and difficulties.

IKEA has also run into problems with executives within its own ranks. In 2010, IKEA founder Ingvar Kamprad learned that a Russian executive at IKEA was reportedly taking kickbacks from the company that provided IKEA with its prized generators. In exchange, the executive convinced top IKEA leadership to overpay for the use of the generators. As a result, IKEA had overpaid by about 200 million dollars. Adding insult to injury, IKEA terminated the contract with the generator company, only to be slapped with a five million euro fine by Russian courts for breaking the terms of the contract (Loshak, 2010). In December 2011, Russian authorities accused another IKEA manager of attempting to extort a bribe from a local businessman who wanted to rent space at one of the company's Moscow shopping centers (Mauldin, 2011).

In February of 2010, IKEA fired the director of its operations in Central and Eastern Europe, Per Kaufman, and the director of its operations in Russia, Stefan Gross. The two executives were fired for giving bribes to an energy company in St. Petersburg, in order to ensure that the IKEA store there would have power. At the time, Russian newspapers seemed puzzled by the firings – after all, the officials were *giving* bribes to advance the interests of their company, not taking them for their own self-interest (Taranov, 2010). This attitude demonstrates the difference in approach to ethics in the two countries. Whereas American business ethics would condemn bribery as unequivocally corrupt, the Russian mindset sees it as an acceptable – and perhaps necessary – measure to ensure a company's survival.

Regardless of what Russian standards might dictate when it comes to business ethics, this pattern of corruption is particularly damning for IKEA. The company has spoken out forcefully against corruption in the past. In a statement on its website, the company emphasizes that it “works proactively to prevent corruption and illegal activities and disassociates itself from corruption in any form, whether direct or indirect” (IKEA Group, 2011). Indeed, from the very beginning of its entry into the Russian market, IKEA made it clear that it intended to follow its own rules and ethical principles (Loshak, 2010), and the company has been one of the most outspoken Western corporate critics of Russian corruption since opening its first store in the country in 2000 (Kramer, 2009b).

IKEA’s 2009 decision to halt investment also indicates the extent of the corruption problem in Russia, given that IKEA runs many international outlets and is “hardly thin-skinned when it comes to dealing with bureaucracies” (Kramer, 2009a). The problem, most likely, lies in the incompatibility of IKEA’s corporate values and the

measures that are often necessary to run a successful business in Russia. Even though IKEA was able to adjust to the Russian market and make the necessary connections there, it is still held to the standards of Western businesses, and is therefore unable to justify corrupt business tactics. Although *blat* does not necessarily entail bribery or extortion, it can facilitate it. It appears that IKEA managers in Russia had difficulty toeing the line between cultivating useful business connections and engaging in corruption. The accusations and admissions of corruption indicate that IKEA's market entry strategy of using *blat* connections may have backfired as they are forced to face international ethics standards.

Indeed, IKEA executives appear to have been caught off guard by the problems that the Russia branch of the company encountered. The founder of the company, Ingvar Kamprad, expressed his dismay in a 2010 press release: "The documented general disorder inside our Russian shopping center company is totally unacceptable. I have been over-optimistic. It is shocking and sad that our organization got carried away" (IKEA Group, 2010). The same press release announced that the company had undertaken multiple reviews of its operations in Russia, and that these reviews showed "large deficiencies in several areas." With regards to the problems surrounding bribery, IKEA admitted in the statement that "there are indications that within IKEA MOS there has been a culture of accepting third parties who have engaged in unethical business practices." The company committed itself to "strengthening its compliance and control mechanisms in this area" (IKEA Group, 2010). It is unclear, however, whether these efforts will be successful, and whether IKEA will be able to continue its growth and expansion in the unpredictable Russian market.

No matter what the future may hold for IKEA's Russian operations, the problems encountered in the country clearly and persuasively demonstrate that even the most resourceful, creative business practices, implemented by a company with extensive international experience, are subject to the uncertainties of the Russian market. Corruption, and *blat* practices in particular, remains a deterrent to international companies who would otherwise find significant success in Russia. For IKEA, despite extensive efforts to adapt to the Russian market, the ultimate determinant of success or failure was the incompatibility of Russian business practices with international ethics standards. By trying to bridge this gap and engage in *blat* practices, IKEA found itself embroiled in practices that, while acceptable in the Russian business environment, ran entirely counter to the spirit of the company's commitment to anti-corruption. IKEA, even as one of the most experienced corporations in international market entry, was unable to reconcile this conflict, and it ultimately led to the firing of top officials, the suspension of investment in Russia, and the loss of significant amounts of potential revenue. IKEA's experience suggests that, at least for the time being, Western companies will be unlikely to succeed in the Russian market because of the ethical problems associated with *blat*. Even those companies, that, like IKEA, spend significant time and effort learning about and participating in *blat* networks will eventually encounter ethical problems.

IKEA's experience with *blat* in the Russian business environment can be instructive for other Western multinationals that are interested in investing there. While the current state of the Russian business environment is not encouraging, there are some tentative recommendations that can be drawn from knowledge of *blat* practices. IKEA's

experience indicates that while the use of *blat* and network capitalism may initially provide Western corporations with multiple business advantages, it can ultimately lead to ethical problems that can completely derail the company's activity in Russia. Thus, the recommendations of many scholars familiar with the Russian market, who advise that Westerners avoid engaging in *blat*, seem most prudent (Barnes et al., 1997; Michailova & Worm, 2003). Avoidance of *blat* may decrease the level of success of Western businesses entering the Russian market, or prevent them from doing business there altogether. However, this option is far preferable to the public relations and legal problems associated with accusations of corruption.

If Western companies do shy away from investment in Russia, of course, it will certainly be detrimental to the country's integration into the world economy. Therefore, Russia has a clear interest in discouraging the use of *blat* practices in business. Although President Medvedev has announced his intent to combat corruption, little improvement has actually been noted over the course of his four years as president. Furthermore, the Russian government has only shown inclination to fight corruption when it surfaces publicly. Instead, it should focus on discouraging those practices, including *blat*, that create the conditions for corruption to occur. In the meantime, *blat* will continue to deter Western corporations from investing in Russia, and to cause problems for those who do choose to do business there.

## Conclusion

This paper has shown how a peculiar social phenomenon, deeply rooted in the idiosyncrasies of the Soviet system, continues to affect business in contemporary Russia. The use of connections and personal favors to do business is particularly detrimental to foreign investors, who are often excluded from the Russian networks that have formed. Furthermore, attempts to participate in the *blat* system of Russian capitalism often lead foreign companies into ethical quagmires and, consequently, public relations difficulties. As demonstrated by IKEA's experience in Russia, even the most well-prepared, cautious, and creative companies will struggle with the challenges of *blat*. However, much research remains to be done in order to fully understand the effect that *blat* practices have on Western companies investing in Russia.

While the case of IKEA's entry into the Russian market is instructive, it is just one well-publicized example of the problems faced by foreign companies in Russia. In order to perform a more conclusive assessment of *blat*'s effect on foreign investors, we would need to examine the experiences of other foreign companies as well. A more comprehensive survey of managers of Western multinationals who have invested in Russia would provide much more information on the various problems foreign companies encounter. Furthermore, it would allow us to trace the commonalities in various companies' experiences in order to determine more conclusively how *blat* disadvantages Western firms. Although the case of IKEA was helpful in testing the hypothesis that *blat* is detrimental to foreign companies, much more research remains to be done to support these initial findings.

The question that remains to be addressed is whether the trends observed in this paper are likely to continue in the long term. Many observers of the Russian business scene have predicted that as Russia becomes more integrated into the global economy, the idiosyncrasies that have plagued its development in the past will begin to disappear, and it will conform more to international norms. This would mean that foreign firms would eventually find it easier to invest in Russia, as the barriers to entry – *blat* included – disappear. However, as this paper has shown, *blat* is a deeply embedded cultural phenomenon that has endured momentous political and economic transitions. It seems unlikely, therefore, that the practice will disappear any time soon. In any case, it is clear that *blat* is currently one of the main obstacles to investment, and therefore development, in Russia. This paper serves as a cautionary tale both to foreign firms and to the Russian government. For Western multinationals, the prevalence of *blat* practices and the difficulties experienced by IKEA indicate that particular care is necessary when making the decision to enter the Russian market. For the Russian government, the findings outlined here demonstrate the importance of pursuing real reform that discourages *blat*. Otherwise, Russian development will continue to stall, leaving it further and further behind the rest of the global economy.

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