

### The development of small innovative enterprises through harmonising economic interests

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Veröffentlichungsversion / Published Version

Zeitschriftenartikel / journal article

#### Empfohlene Zitierung / Suggested Citation:

Duplenko, N. G. (2012). The development of small innovative enterprises through harmonising economic interests. *Baltic Region*, 3, 25-34. <https://doi.org/10.5922/2079-8555-2012-3-2>

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THE DEVELOPMENT  
OF SMALL INNOVATIVE  
ENTERPRISES  
THROUGH HARMONISING  
ECONOMIC INTERESTS

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*The harmonisation of economic interests is one of the essential preconditions for the development of enterprises, including small ones. As practice shows, the harmonisation of major interests of small innovative business requires not only market instruments, but also state regulation, which demands the development of a corresponding mechanism. This study sets out to develop and justify the macroeconomic mechanism of development of small innovative enterprises on the basis of harmonisation of basic economic interests of their agents. The research significance of the results presented in the article consists in the fact that, for the first time, the problem of economic interest harmonisation has been considered in relation to the agents of small innovative business. The author juxtaposes the major economic interests of these agents and identifies their compatibility and conflict areas. The article offers a mechanism for the development of small innovative businesses, including two sets of instruments — those aimed at combining the agents' efforts on the basis of their common economic interests and prevention of conflicts resulting from their incompatibility. The recommendations on the application of instruments for harmonising economic interests can be used in drawing up programmes for the development of small innovative business at the federal, regional, and municipal levels.*

**Key words:** small innovative business, harmonisation of economic interests

Transition to an innovative development model in Russia is not just a way to increase economic efficiency, but a challenge to survive in global competition for the right to occupy a dignified place in the world economy. One of the most important challenges on this path is the development of small innovative entrepreneurship (SIE) as a key player in the national innovative system [1, p. 69].

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Received on June 12, 2012.

doi: 10.5922/2079-8555-2012-3-2

Currently small business does not play a significant role in the innovation process in Russia, with its 0.8% share of SIE in the total number of small enterprises. It can hardly compare with France where it amounts to 38%, Norway with 49%, or Germany with 62% [2, p. 105]. Numerous publications offer analysis of the situation and proposals for its improvement; however, those are usually reduced to the assessment of entrepreneurship potential and business climate in the country. Moreover, those works largely disregard the fact that the harmonization of major economic interests of their subject is a most important prerequisite for the development of any type of business.

Thus the problem is that the issues of theory and methodology of SIE regulation are treated without proper evidence-based integration of economic interests.

The aim of our study was to develop a mechanism for the development of small innovative enterprises through matching the principal economic interests of their subjects.

To that end, we have refined the definition of the 'business entity'; carried out a comparative analysis of the economic interests of SIE; identified the regularities of common interests and their clashes; studied forms of subjects' responses to conflict of interests; substantiated the necessity to use two sets of tools designed to bring together stakeholders around common economic interests and to prevent conflicts. In addition, we have also developed recommendations as to how to implement the proposed mechanism.

Methodologically, the worst hurdle consisted in identifying the range of SIE subjects. The reason for that is the existence of two approaches to defining entrepreneurship — legal and economic.

Within the legal approach, the subject of entrepreneurship is understood as a business entity that is the one involved in economic activity. According to this definition, small businesses are viewed as legal entities and individual entrepreneurs meeting a number of relevant statutory criteria, such as: a marginal number of employees, marginal annual revenue, etc. This definition, featuring in the law *On the development of small and medium entrepreneurship in the Russian Federation* is preceded by the phrase that it is used only for the purposes of this federal law; however, such a tight legal interpretation has become quite common in the economic and scientific literature.

Within the economic approach the business entity is traditionally viewed as an individual actor, a consolidated group of people, or part of society and the state in general, as opposed to the entrepreneurial process. Since small innovative business is a special case of entrepreneurship, its actors could be viewed as a special case of the subjects of the latter.

In the scientific literature, entrepreneurs, their business partners, customers, employees and the state are usually regarded as economic entities. "The entrepreneur is not the only subject of entrepreneurship: consumers and the state also belong to the category of business subjects, as well as the *employee* (unless the entrepreneur is self-employed), and business partners... However, the entrepreneur's main contractor is the *consumer*, alongside *the state*, which in different situations can act either as the entrepreneur's assistant or opponent"[3, p. 181].

Among business subjects, along with the state, one can also find administrative-territorial units (municipalities and regions) that affect the business process by changing the local tax levy rates, targeted programs' implementation, etc. This approach is supported by V. Bilchak, M. Gornovich [4; O. Biyakov, N. Kolomarova [5]; M. Zhuk [6]; G. Fetisov and V. Oreshin [7].

Thus, we define SIE subjects through their ability to regulate, direct and implement entrepreneurial processes. Within this approach the concept of business subject embraces such entities as SIE, their owners, investors and donor organizations, labour groups, as well as municipalities, regions and the state.

It should be noted that the issue of small business development based on the harmonization of interests of its subjects has been raised in the world literature and Russian publications; however, so far the attention it was given is insufficient; moreover, so far SIE have not been studied in this respect.

Among the Russian scientists involved in research on the harmonization of economic interests are: O. Biyakov and N. Kolomarova [5] M. Zhuk [6] P. Kanapukhin [8] N. Klimova [9] I. Kokueva [10], N. Rasskazova [11, 12], D. Shulgin [13]; the overseas authors whose work must be acknowledged are: S. Laske [14], W. Clemens [15], and H.-J. Krämer [16]. The analysis of publications shows that they consider either individual aspects of small business' economic interests, or general theoretical issues concerning joint interests of all business organizations, with no particular focus on specific innovative small businesses. This situation ensures the scientific novelty of this research.

To begin with, SIE's major economic interests consist in increasing the rate of income generation and strengthening market positions, which is fundamentally similar to the pursuit of other self-supporting enterprises.

The economic interests of SIE founders are much more diverse. They can be divided into groups as follows (Table 1).

#### Founder grouping according to SIE objectives

| SIE founders   | Main objective of setting up a SIE   |
|--|--|
| Creative entrepreneurial researchers and developers            | Joining forces for the implementation of the results of intellectual activity aimed at gaining profits and raising one's scientific status |
| Entrepreneurs  | Profiting through creating and disseminating innovations   |
| Research and educational establishments                        | Implementation of results of intellectual activity   |
| Large-size and manufacturing associations and research centres | Creating ready-for-sale innovative products and services on the basis of 'parent' organization's research                                  |
| Specialized research institutions and industrial enterprises   | Market duplication of laboratories and departments by way of producing and trading science-intensive products                              |

Among investors, the most important ones are private equity funds, venture capital funds, and "business angels" [17, p. 241]. The chief economic interest of direct investors is to make profit. To that end, they acquire company stakes; together with the management they do their best to increase their value, after which they sell their share of the business [18, p. 68].

Donor organizations include government agencies, private companies, foundations, and individual actors investing into innovative projects, usually on a competitive and non-profit basis. As follows from the gratis principle of such investments, the economic interests of donors do not consist in gaining revenues, but in stimulating business activity in a given area, development of high-tech production, support of small entrepreneurship, etc. [19].

SEI employees find their economic interests in stable salaries they deem appropriate with regard to their qualification and contribution to the company.

In this aspect, the economic interests of municipalities, regions and the state have, in our view, no fundamental differences. Development of small business contributes to the realization of the economic potential of the territory, enhances competition, increases tax revenues, promotes involvement in the social reproduction of additional labour resources, and assists in attracting private investment and personal savings to real economy [20, p. 94].

The development of small innovative enterprises is a priority, because, apart from the above said, it increases the rate of innovation, thereby increasing competitiveness of business organizations, as well as of the territory as a whole [4, p. 47].

In a simplified form, basic economic interests of small business innovation are presented in figure 1. It should be emphasized that in this case we consider only major economic interests. The interlocking of indirect interests is, of course, much more complicated.

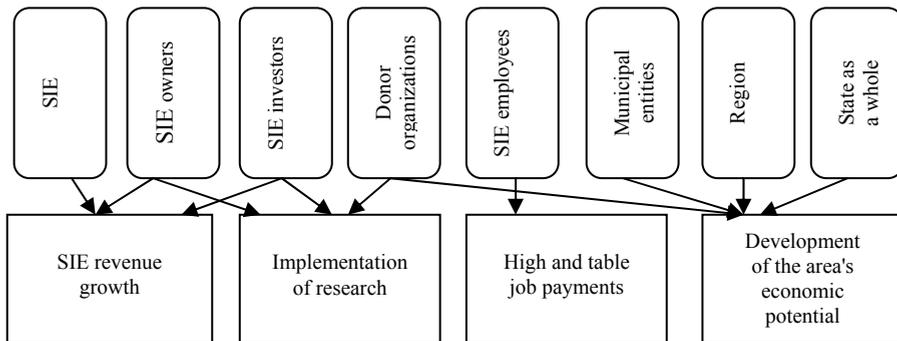


Fig. 1. The interlocking of major economic interests of SIE subjects

The analysis of the economic interests of SIE subjects shows that they are characterized by a higher degree of consistency and harmonization than, for example, joint ventures with foreign participation. Thus, the desire of SIEs, their founders and investors to increase profitability and revenues, along with consolidating their market positions, does not go contrary to the desire of donor organizations, municipalities, regions, and the state as a whole to develop the economic potential of the territories and increase their



competitiveness. The interest of the founders — researchers and developers — to increase their scientific status does not contradict the desire of scientific and educational institutions to implement the results of intellectual activity, nor does it contradict research institutes' motivation for creating ready-to-trade innovative products and services.

Indeed, there are certain differences between the economic interests of small innovative business. The most important of those, in our opinion, are as follows.

Firstly, it is a contradiction between the desire to increase the net profit of the companies, their founders and investors, and the interest of municipal entities, the region and the state to raise tax revenues from SIEs.

Secondly, it is a contradiction between the desire of SIE employees to get higher salaries and the desire of enterprises to speed up profit growth. In this case the company is supported by other SIE subjects directly interested in increasing their profitability.

Thirdly, the conflict of interest shows in the competition between the SIE, municipalities and regions for the allocated financial resources to support small innovative enterprises. Unlike other controversies, this one occurs between same-kind subjects.

These three contradictions between the economic interests of SIEs are nonspecific by nature and are common for other types of enterprises. However, there are specific differences too.

They are a number of controversies related to the commercialization of intellectual property. They can occur between SIEs and innovation developers; between SIEs and their founders, and between SIEs and investors. Such conflicts may centre on the size of the material remuneration to the SIE owner and innovation developer, exclusive ownership rights, legal relations arising from confidentiality restrictions, unfair competition, and so on. [21, p. 40].

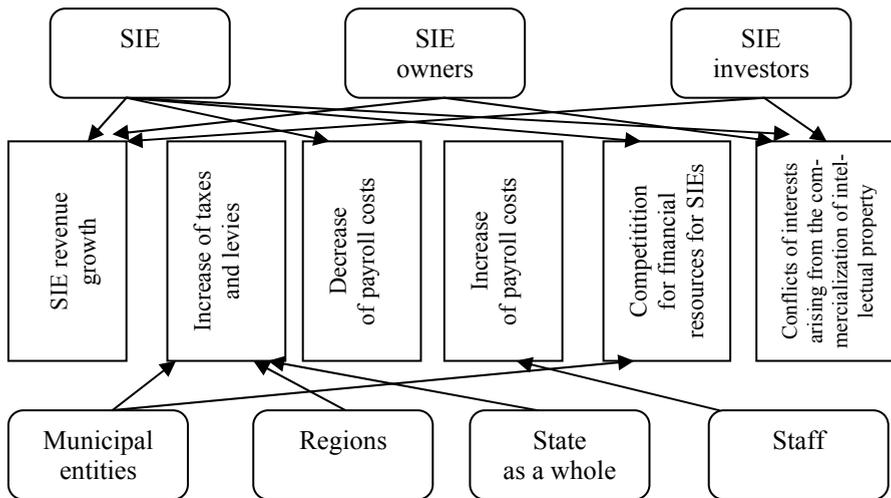


Fig. 2. Contradictions of basic economic interests of SIE subjects

The reaction of economic agents to the contradictions in their interests could manifest itself in avoiding interaction, suppression of a weaker entity, adaptation, compromise and cooperation. In contemporary Russia, almost all forms of reaction can be found:

- Suppression (compelling to pay high taxes) on the part of the state, with SIE dodging the interaction by "going quiet" as a result;
- Suppression (compelling to work for lower-than-expected wages) on the part of the enterprises;
- Adaptation and, less often, compromise between agents of the same level as regards the distribution of resources allocated to support innovative small businesses;
- The controversies related to the commercialization of intellectual property (due to the fact that the character of interaction between the actors involved in this kind of conflict may be very different); almost all kinds of reactions could be expected, from suppression to cooperation.

Aligning the economic interests, should have as its aim the creation of conditions for SIEs to be able to resolve their differences through compromise and cooperation.

To that end, two sets of instruments are available, one of which aims to bring together subjects' efforts on the basis of their common interests; and the second one should be aimed at the prevention of conflicts. A brief description of the developed mechanism is presented in Table 2.

Table 2

**The mechanism of SIE development on the basis of alignment of their subjects' interests**

| Subjects   | Shared interests                                   | Implementation tools   |
|--|--|--|
| <i>Joining subjects' efforts on the basis of common economic interests</i> |  |  |
| SIE, their founders and investors  | Increase of earning power                          | Promotion of SIE and their production by joining their owners' and investors' forces in various public organizations |
| Conveners of SIE and donor organizations                                   | Implementation of scientific research              | Support funds for SIE development in scientific-technological sphere and similar institutions                        |
| Donor organizations, municipal entities; regions and the state as a whole  | Development of economic potential of the territory | Targeted development programmes for SIE  |

End of Table 2

| Subjects  | Shared interests                             | Implementation tools   |
|---|--|--|
| <i>Prevention of conflicts arising from contradicting interests</i>   |  |  |
| On the one hand, SIE and their founders and investors; on the other — municipal entities regions and the state as a whole | SIE taxation rates                           | Scientifically justified correction of tax rates for SIE with due attention to state priorities in innovative development                      |
| SIE on the one hand; SIE employees on the other   | Share resources allocated for labour payment | Using the employees' participation in revenues schemes   |
| SIE; municipal entities; regions  | Competition for resources for SIE support    | Competitive distribution of funds; competition for development programmes between municipal entities and regions; project bidding between SIEs |
| SIE; their owners and investors   | Commercialization of intellectual property   | Creation of legal support centres for innovative activities  |

In order to bring together the efforts of SIE's, their owners and investors, with the aim to increase the enterprise's profitability, it would make sense to set up associations charged with the task to protect the interests of small innovative enterprises at the municipal, regional and national levels, and to promote SIE's innovative production to other markets, regions and countries. Foreign investors create such organizations fairly often. If even large companies find it useful to work together to protect their interests, it is all the more important to do so for small businesses, each of which individually exercises much less influence.

Institutions like the Russian Foundation for Assistance to Small Innovative Enterprises in the scientific and technical field function as a tool for bringing together SIE owners and the donor organizations for the implementation of research. In the framework of such organizations, platforms for interaction with small innovative companies are created, with the aim to effectively spread technological information, to accelerate the implementation of innovation and speed up the commercialization of the latter.

Combining efforts of donor organizations, municipal formations, regions and the state, based on shared interests in developing the economic potential of the area, is only made possible with the help of such a tool as joint participation in the development and implementation of targeted programs for the development of small innovative business.

Contradictions arise from the fact that SIEs, their founders and investors are interested in reducing the tax burden, while the municipal entities, regions and the state are more interested in the growth of taxes and levies. The conflict can be resolved through science-based correction of SIE tax levels

with respect to state priorities in innovation. Optimal tax policy for small innovative enterprises must envisage the application of tax rates and local levies capable of promoting the growth of taxpayers numbers and increase of taxable base, without encouraging companies to escape into the shadow economy.

Using the schemes of employee participation in profits, bonus systems encouraging SIE profit growth alongside the increase of labour remuneration on the basis of the principle of optimal combination of individual and collective interest could work as an effective tool to reduce conflicts of interest between SIE and its employees regarding the share of labour costs.

Competitive distribution of funds could be an effective instrument for resolving the contradictions resulting from competition among SIEs, municipal entities and regions for SIE support resources. Given this, regions and municipalities compete for regional and municipal programs of small innovative enterprises, while SIEs bid at the municipal level for individual innovation projects.

Conflicts among SIEs, their owners and investors arising from the commercialization of intellectual property can be prevented through the creation of a legal support centre for innovation. It will provide services on signing legally competent agreements between members of innovation process (confidentiality agreement, letter of intent, licensing agreements, etc.), and hold seminars on legal aspects of SIE intellectual property commercialization. These centres are appropriate at the regional level, working along with SIE support structures; they are also viable in large municipalities.

For the practical implementation of the developed mechanism at regional and local levels the potential of targeted programs for innovative development or small business can be used.

The stage of pre-project analysis requires the evaluation of all SIE subjects' major economic interests according to a number of criteria, through matching them to standard values. Unfortunately, the framework of this article does not permit us to consider this important, if under-researched issue. It is worth noting that to assess the coordination of SIE interests it is advisable to calculate such indicators as average returns on sales by the industry; the coefficient of payroll rate, calculated as the ratio of monthly remuneration in SIE to average monthly one by the industry; the share of the SIE receiving financial support in the framework of a particular program; the correlation coefficient between innovative products sales revenues and the amount of received subsidies, etc. These indicators can count among the target indicators of the program.

Thus, it can be concluded that SIE subjects can have both common and conflicting economic interests. The suggested mechanism of small innovative entrepreneurship development includes two sets of instruments. The first one is meant to bring together stakeholders' efforts to achieve their common goals, while the second one is aimed at preventing conflicts that may arise as a result of contradictions. The harmonization of interests in the course of implementation of this mechanism occurs at four levels — the enterprise, mu-

nicipality, region and state. The proposed tools can help to achieve the interaction of these levels in pursuit of maximum effect for all SIE subjects; which constitutes one of crucial preconditions for the Russian regional economies's transition to innovative development.

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