

Covid-19 Pandemic Risks and Opportunities For Business at the Regional Level

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ABSTRACT

Small and medium businesses play a significant role in social and economic development. There are several mechanisms of such influence. Modern economic growth is impossible without the renewal of corporate forms, technologies, business practices, and the elimination of inflexible and obsolete ones. The creation of barriers to "creative destruction" may reduce social risks, but it also reduces the economy's growth rate in the future. Entrepreneurship is considered as one of the commercialization mechanisms of scientific research and development. And regions with high scientific research and development potential may have a low level of economic development due to poor entrepreneurship development and low density of startups. In other words, this refers to entrepreneurial capital concentrated in a country or region. In a large investment project execution, the return on investment will be higher in the region where the density of SMEs is higher. Small businesses provide additional services and related products. In addition, small businesses often exempt large enterprises from incidental functions, which allows them to improve their efficiency through outsourcing. The study's purpose was to form a range of proposals to reduce the negative consequences and opportunities associated with the Covid-19 pandemic consequences for business. The research identifies the risks, opportunities, and analyzed measures to support business and employment, implemented by regional executive authorities of all subjects of the Russian Federation in response to the limitations and challenges posed by the spread of new Covid-19 infection.

Keywords: *small and medium business, entrepreneurship, risks, opportunities*

1. INTRODUCTION

Developed small and medium businesses help reduce unemployment amid redundancies in large enterprises and the public sector. Within this framework, small and medium businesses perform social functions but also have a positive impact on economic growth [3]. It fulfills not only an economic function but also an important social function, contributing to the formation of a middle class and self-employment [11].

Entrepreneurship in developing countries and regions is often seen as a tool for poverty reduction and inclusive economic growth [4]. Fast-growing small and medium companies can create more than half the workspaces in developed countries [1] and more than a third in Russia [8]. Small businesses help to group new markets. Small enterprises appear where entrepreneurs feel an unmet need for some kind of benefit from their customers or see an opportunity to create a new need. For example, launching a cafe, concession stand or repair service leads to a new kind of service. In modern conditions it is impossible to achieve high efficiency of the state policy of small business (SB) development without a deep knowledge of

its types, instruments of financing (programs, credit conditions, and credit guarantees), the specifics of the subjects themselves (small and medium enterprises) to which it is directed [9].

Thus, the local economy is diversified and its sustainability is increased. The high density and diversity of specializations of companies contribute to the economy's adaptation to permanent changes. New entries in the market increase competition, scope of proposal, which leads to lower prices. As a result, the financial resources of the population, that can be used to consume other benefits, are released, which in turn puts upward pressure on aggregate output. The formation of a middle class by increasing the number and share of entrepreneurs in the population can contribute to the spread of common progressive norms and rules across the community and ultimately to the development of inclusive institutions [2]. Analysis of these mechanisms suggests that the development of small and medium businesses in a region can have a direct and indirect impact on the level of economic development. It was proved that a more

favorable institutional environment is conducive to attracting investment, expanding the credit field, and developing small and medium businesses. This, in turn, may lead to higher levels of regional development. It is important that in the period after 2009, regions with low risks for investors and high activity of entrepreneurs gain an advantage, that is, the role of favorable conditions for the development of entrepreneurship increases. On the 2020-2030 horizon period, several global trends will determine the increasing role of entrepreneurship and private initiative in the social and economic development of Russia.

At a time when Covid-19 infection is spreading and, as a consequence, self-isolation and social distance are being introduced in all regions of the Russian Federation, regional business faces new challenges. The difficulty in adapting to "new realities", along with other factors, is the inability to quickly reformat lines of production, business processes and value-added formation lines.

2. RESEARCH METHODS

The work contains the results of a survey of over 1500 entrepreneurs from all over Russia on the impact of the Covid-19 pandemic on Russian business. The research design contains theoretical and empirical parts, survey methods, descriptions and are supported by tabular and graphical methods of data illustration.

3. RESEARCH RESULTS

According to the data obtained in the survey of representatives of small and medium businesses from different regions of Russia, which was conducted by the Agency for Strategic Initiatives in the framework of the Smarteka project, the consequences of COVID-19 had an impact on more than 80% of respondents. More than a third of the respondents claim that revenue in March 2020 fell by more than 80% compared to the same period in 2020. More than half of small and medium businesses have frozen their operations. And one-fifth of all interrogated entrepreneurs say that they had to reduce or send the main part of their staff to unpaid leave.

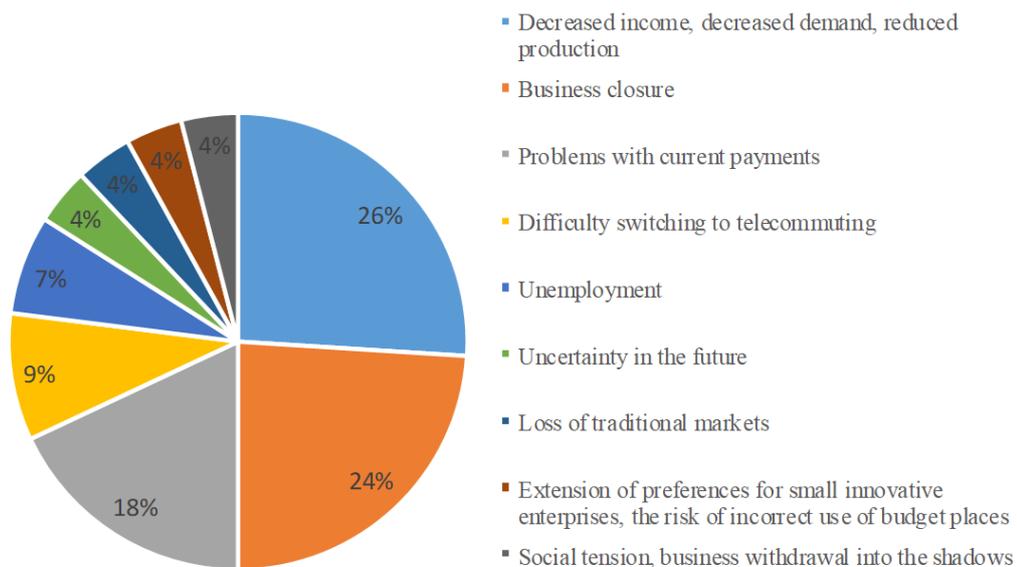


Figure 1: Risks to Business "Identifying Risks and Opportunities for Consequences of the COVID-19 Pandemic for Russia" Project Report

Risks to business:

1. The risk of business closure and related complications: For example, it was mentioned that the rainy day fund (who has it) is not infinite, and in addition, business closure can occur due to cash deficiencies, the obligation to pay for non-working days, the disadvantage of keeping an IE open in quarantine, the general decline in income

and demand. The risks of the closure of business related to traditional markets that cannot be transferred online (services, film distribution, tourism) were mentioned separately.

2. Inability to make current payments on loans, rent, utility bills due to general decline in income, cash deficiencies, significant losses in the most affected industries. In addition, these were noted:
 – an increase in unemployment due to lower production volumes and lower revenues, possible bankruptcies;

- the impossibility of strategic planning due to the situation uncertainty and the possibility of new "black swan events";
- underdeveloped electronic document flow systems, technical problems with communication channels and the inability of employees to work remotely;
- general decline in economic indicators against the background of the introduced regime of self-isolation and increased readiness, reduced purchasing power of the population, the chain effect of non-payments.
- forced to drop off the radar due to business obligations to pay non-working days and lack of real support measures;

- increased social tension caused by the reduction of employees and a decrease in their income.

3. Risks of business in the education sphere were separately noted. Within the issue framework, the experts reported that the applicants will seek to enter the state-financed openings to the maximum extent possible, not for reasons of further professional development, but for reasons of lack of applicants competing for one place; experts also proposed to extend the preferences for small innovative enterprises at universities.

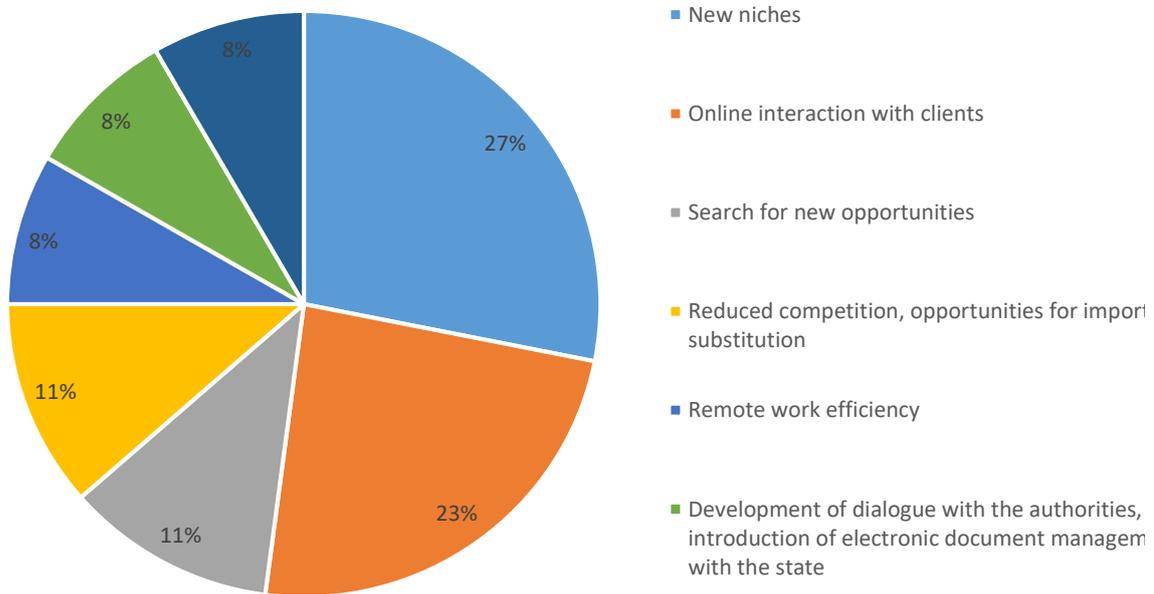


Figure 2: Business Opportunities
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Business opportunities:

1. New niches. Under this topic, experts reported on the possible development of the following industries: alternative energy, sanitary goods, cyber-risks insurance, manufacturing of meals ready to eat.
2. Online interaction with clients. Under this topic, experts reported on the opened opportunities for the reorientation of all processes to online interaction (sales, delivery, services) and possible benefits of this in the future.
3. Search for new options. Under this topic, experts reported on the pandemic situation that is an excellent incentive to audit existing costs and optimize them, to find new ways of development.
4. Decline in competition, the room for import-substitution. Under this topic, experts reported on:

- decline in competition as a result of closing companies that are unable to overcome the crisis, general economic rehabilitation and improvement;
 - the fact that discontinuation of supplies from other countries opens wide opportunities for import-substitution.
5. It was also noted:
- forced transition to remote work can bring many benefits in the future;
 - the condition of compulsory receipt of online educational services by state companies will allow educational non-profit organizations to participate in procurement tenders;
 - the need to develop a constructive dialogue with the authorities;
 - introduction of electronic document flow for all state services;

– possibility of agriculture to use super incomes for development.

Table 1: Problem Industries

Industry	Percentage of citations
Tourism	21%
Events organizers	11%
Catering	11%
Small and medium business	11%
Consumer goods	7%
Cosmetology	7%
Extended education	4%
Personal services	4%
Cinemas	4%
Hotels	4%
Housing and public utilities	3%

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The most affected ones were catering establishments, hotel business and other tourism industry organizations, institutions providing personal services (repair, laundry, dry cleaning, hairdressers services, and beauty salons), providers of passenger transportation, as well as retail and wholesale trade enterprises (mainly nonfood goods).

In fact, the demand for services of these industries under quarantine has fallen by several times. Accordingly, revenues also fell, while mandatory costs remained unchanged: loan payments, rent payments, salaries, taxes, and social contributions. The resulting cash deficiency is likely to result in massive bankruptcies.

The share of potentially most affected industries is about 11% of the total number of SMEs, or about 2.6% of SME turnover, which seems insignificant (see table). But if we take into account the industries that will be affected by the closure of these businesses, it turns out that the COVID-19 epidemic may close down an additional 64.2% of small and medium firms, i.e., about 3.4 million companies.

Table 2: Number of SME in the Industries Most Affected by the Crisis

Activity category	Number of SME entities in 2018	In % of the total
Total number of enterprises in the SME sector	5,304,409	100%
The most affected industries, among them:	591,478	11.2
Hotels and public catering	135,177	2.5
Education	26,290	0.5
Enterprises from the culture, sport, leisure	206,546	3.9

and entertainment spheres		
Other services	223,465	4.2
Industries that may be affected by the multiplier effect, among them:	3,403,121	64.2
Wholesale and retail trade; repair of motor vehicles and motorcycles	2,081,011	39.2
Construction	458,895	8.7
Real estate operations	356,686	6.7
Transportation and storage	493,383	9.3
Electric energy, gas and steam supply; air conditioning	13,146	0.2

4. DISCUSSION OF FINDINGS

Already now it is possible to preliminarily assess the damage from the current crisis, including its impact on revenue, employment, lending, and the number of firms in the SME sector.

All types of businesses that have not had time to switch to online provision of goods and services, or whose business model requires the only personal provision of services, are now at risk of bankruptcy. Sberbank analysts noted strong growth in spending on telecommunications equipment (+50.37%), drugs and medical products (+22.19%), household appliances, and electronics (+21.2%), as well as alcohol (+8.9%) in March-April. Consumer demand fell in all other categories of spending, and in some of them - by more than 90%: travel agencies, jewelry, airline tickets, clothes, shoes and accessories, beauty salons/massage/spa, sports, education.

The volume of daily expenses of Russians in the first week of the lockdown fell almost twice. Therefore, the average weekly turnover of small and medium businesses decreased for three weeks by 21% compared to February and March levels. In the second half of March 2020, customers' accounts of Moe Delo online accounting service received 31% fewer funds than in the same period in 2019.

The leaves made in the country due to the Covid-19 pandemic from March 30, 2020, with the full pay increase the cash deficiency of enterprises. According to estimates of the FinExpertiza accounting and consulting firm, salary payments will amount to more than 0.5 trillion rubles. Not all companies have accumulated the necessary funds in the pre-crisis period.

Due to these and other difficulties, the business may withdraw into the shadows, as the accounting and consulting firm warns. Competition among young specialists in the labor market will increase, and the cost of

labor resources will decrease. That means that for the same skills and the same job ones will be paid less than before quarantine.

Due to lower incomes and effectual demand, some EPs may simply close down, at least for the quarantine duration, and the real level of unemployment will be higher. Especially because it is impossible to transfer the enterprises providing "physical" services, like film distribution and tourism, to the online sphere.

Because of the same cash deficiencies and losses in the most affected industries, many companies will not be able to make current payments on loans, utility bills, and rent. We recall, that entrepreneurs of Novaya Tura also told about the rental problem to Realnoe Vremya online newspaper. The general decline of the population purchasing power and quarantine itself will lead to a chain effect of non-payments, as the accounting and consulting firm experts warned. The domino effect will eventually affect the growth of social tension caused by the reduction of workers and their income. Obviously, this will further reduce consumer demand and lead to an increase in unemployment again. Lower incomes and higher unemployment may lead to an increase in crime [6].

In an effort to reduce costs, entrepreneurs also seek to withdraw into the shadows, to transfer their employees into informal employment or self-employment status. The number and proportion of people employed in the informal sector is expected to increase by several million in 2020, similar to previous crises. At the end of 2020, the unemployment rate can be expected to be 8%, at worst 10% of the economically active population, which is from 6 to 9 million people.

It is expected that the damage will be caused to the whole industries, where the demand has sharply decreased. These are air transportation, leisure, and entertainment, sports and fitness activities, tourism and hotel business, catering, further or additional education establishment, non-governmental educational institutions, consumer services to the population: repair, laundry, dry cleaning, hairdressers services, and beauty salons, etc., as well as trade-in nonfood goods.

The reduction of turnover in some industries has a multiplier effect on the accompanying industries. Thus, calculations made by the staff of the Laboratory of Entrepreneurship Problems Studies of IPEA RANEPA show that the optimistic scenario assumes the reduction of SME sector turnover by only 1.9 trillion rubles, or 2.6% of the turnover of the whole sector, in the sectors that will be directly affected by the crisis. However, the closure of enterprises with a turnover of 1 million rubles in the most affected sector may result in the closure of enterprises in related industries by 2.9 million rubles (on average), and the total damage, in this case, will exceed 5.7 trillion rubles or 7.5% of the SME sector. The industries that may be affected by the multiplier effect account for almost 77% of the SME sector turnover. Therefore, maintenance of quarantine measures for several months may lead to catastrophic consequences for the sector.

According to Rosstat estimates, about 20% of GDP in Russia is created by small and medium enterprises. Thus, a

catastrophic scenario of turnover reduction by 50-60% in the SME sector may lead to a reduction of GDP by about 10% in the second quarter of 2020.

According to earlier estimates, a 1% reduction in the number of small and medium firms may lead to a decrease in GDP from 0.06% to 0.17%, depending on other conditions. Then, the closure of 50-60% of firms in 2020 in the most pessimistic scenario would lead to a 3-10% drop in GDP for the year.

While the Russian government was developing an anti-crisis program to help businesses at the federal level, regional authorities were preparing similar measures. Some regions managed to play ahead of Moscow, but some of the constituent territories of the federation hoped for help from the federal center and hesitated [7].

Considering the importance of maintaining stability in the social and economic spheres, entrepreneurship support, and employment preservation, in addition to federal measures, regional support packages are being adopted in the constituent territories of the Russian Federation.

These include the following categories:

- tax advantages;
- preferential lease of regional and municipal property;
- loan support;
- direct financial backing for business;
- public employment support;
- reducing the regulatory load. *Tax Advantages*

To reduce the taxation burden on entrepreneurs during the pandemic, regional authorities are taking the following measures:

- reducing (up to two times) and postponing payments of corporate property tax;
- providing privileges for paying land tax;
- deferral and reduction of the transport tax rate, as well as exemption from advance payments;
- reducing tax rates for entrepreneurs who use the simplified tax system (in most regions, up to 5-7% under the revenue less scheme and 1-3% under the income scheme) or are UTII taxpayers;
- reduction of potential income for users of the taxation patent system.

Preferential Lease of Regional and Municipal Property

Most regions have introduced preferential lease of regional and municipal property as business support measures. Among approaches to solving the problems of tenants who have suspended their activities for a lockdown period, one can single out:

- repayment deferral of lease payments;
- reducing the amount of lease payments;
- exemption from repayment of lease payments.

Loan Support

The regional authorities of most Russian Federation regions have decided to provide support from regional business support funds and microlending companies, as well as their recapitalization. This is a necessary measure to expand the capacity of SMEs to obtain soft loans for wages, eliminate cash deficiencies and cover operating expenses. The most widespread measures are:

- refinancing and restructuring of previously issued microloans;
- providing deferrals on previously granted microloans;
- introduction of special microfinancing loans.

Direct Financial Backing for Business

Due to limited budget resources, most regions are unable to provide direct financial backing for businesses. At the same time, a number of Russian regions have decided to allocate subsidies to SME, including for the preservation of jobs.

These measures include:

- reimbursement of expenses for promotion of goods and services on online markets;
- compensation of expenses related to the export of products;
- recharge of costs of purchasing equipment;
- subsidies to agribusiness, tourism and transport companies (regular road passenger transportation on urban and intermunicipal routes);
- reimbursement of expenses under leasing agreements, lumpsum payments, royalty, etc.

Public Employment Support

In the current situation, when there is not only a decline in demand for manufactured goods and services but also a supply "shock", support for jobs and employers is a priority.

Despite the fact that most business support measures are in one way or another aimed at preserving jobs, a number of regions have introduced special measures to preserve existing jobs, as well as to support the employment of citizens who lost their jobs during the spread of a new coronavirus infection.

Reducing the Regulatory Load

In order to reduce the load on small and medium businesses during the COVID-19 pandemic, many Russian regions decided to suspend the current and appointments of new field inspections of SME by regional regulatory authorities [5].

5. CONCLUSION

Despite the general similarity of the solutions proposed by regional governments, there are different degrees of regional activity, as well as significant gaps in the complexity of measures taken.

The nature of the support measures taken largely depends on the specifics of a particular region, but in most regions of the Russian Federation, the main focus is on supporting businesses and industries, while decisions aimed at providing employment are implemented in a limited number of territories. At the same time, the existing lack of horizontal communications between regions hinders the spread of best practices and the development of new solutions.

Besides, it is important to mention that about 60% of the interrogated businessmen stated about difficulties in getting support. This was due to the lack of sufficient information about the necessary actions and problems that

arose in the registration process. This indicates the need for organizations to expand information about regional SME support infrastructure and to simplify procedures for obtaining support [10]. However, the data of the entrepreneurs' survey [10] show that almost one fifth (18%) of existing small and medium business organizations cannot use the proposed measures because the list does not contain the solutions they need.

At the same time, the regions continue to introduce new support measures, and some Russian regions have unique, financially unsustainable solutions that need to be replicated. Negative changes in the existing social and economic situation caused by the COVID-19 pandemic cannot be quickly overcome, the consequences will be visible for a long period of time, and all institutions will be tested. In this situation, it is especially important to rely not only on momentary (quick) decisions aimed at ensuring the current social and economic stability, but also to go beyond meeting immediate needs and set up a long-term policy of energetic and sustainable economic recovery considering new challenges in the Russian regions.

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