

# Russian Business Practice: Issues of Corruption and Trust

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**Abstract** This study examines the dynamics and the ratio changes of different types of corruption practices in the relations between business and government in Russia. Corruption is regarded as a major barrier for the international business practice in Russia and the confidence of a foreign investment community in the Russian companies. It is especially relevant in terms of sanctioned Russian economy, its low competitiveness and innovativeness, deteriorating investment climate. Characteristic and peculiarities of a corruption process in Russia have been determined: (a) the high level of corruption in Russia in the system of international coordinates; (b) the crisis of confidence and trust between the Russian civil society and the government as an ideological foundation of corruption; (c) raw vs. innovation type of economics in Russia as an economical foundation and a precondition of corruption; (d) existence of a sustained corruptive relationship between government and business in Russia (in contrast to other countries, where it is revealed less obviously or has a random character of manifestation); (e) dominating significance and a latent character of the internal business corruption as opposed of its external manifestation in Russia; (f) formation of a social request for the effective anti-corruption policy.

**Keywords** Russian business • Trust • Corruption • Governance

## 1 Introduction and Methodological Framework

Corruption has been considered as a popular and conjunctural topic for the contemporary research both by scientific and business societies for a long period of time. Most of the research undertaken, however, is primarily focused on investigating the phenomenon of corruption in relation to the government sector. At the same time, the attempts to decode and analyze this phenomenon in its relation to the corporate sector (corporate corruption) and especially in the area of the

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government-business relationships (business corruption) are rare and associated with objective difficulties and barriers for the research.

The two main methodological approaches can be outlined for investigating corruption: economical (neoclassical) approach and economic-sociological approach. For revealing the phenomenon of corruption within the framework of the first approach named, it is useful to apply the theory of agents' relationships. According to neoclassic economists, corruption represents a rational tool of cost optimization, and the corruption relationships are based on the economic choices in a condition of scarce resources. For the corruption relations to be functional and effective, a mandatory participation of the three parties is needed: a principal or a warrantor (central government, legislative body, etc.), an agent or an executive (a governmental official, a representative of the executive authority), and a client or a "ward" (a company or an entrepreneur). In a situation when a corporate corruption occurs, a company's shareholders are acting as principals, hiring executive managers for the operational purposes who are acting as agents and who at the same time can implement their own goals when interacting with the other market actors in defiance of the shareholder's goals and interests.

Whereas the principal (government) establishes the framework and terms for the company's activity—formal regulations, governing activity of the clients (commercial organizations or individual entrepreneurs), and the principles of control functions—agents are responsible for the operations management. The rights and functions of control are delegated to the agents—executive authority representatives. It is presumed that agents are fully aware and informed about the content of these regulations, but do not have any opportunities for changing it, although suggestions with necessary changes in the regulations are permitted. At the same time, they must follow the rules of control, avoiding any discrimination toward to any of the clients, whose functioning is regulated by these formal rules, without affecting their interests. However, in practice the relations between the three mentioned parties can develop within different scenarios.

It is necessary to identify and outline the criteria for classifying and describing certain actions as corruptive ones. For identifying a corruption relation, Levin and Satarov (2012) consider its main elements:

1. Existence of formal regulations established by a principal
2. Entitlement of an agent with a monopoly authority of distributing resources and providing the services according to these regulations, which an agent is not entitled to change
3. Presence of a client as of an independent third party that is interested in obtaining the resources and services by means of breaching the formal regulations
4. Organization of an exchange of services and remuneration between the agent and the client that has been initially agreed by the parties
5. Breach of the regulations by the agent in favor of the client and his interests
6. Getting a private individual benefit by the agent and a public or a private benefit by the client

It should be noted that the client in a corruption relationship does not necessarily pursue his private benefits, whereas the presence of a private benefit for the agent is a mandatory sign of corruption. Thus, economical neoclassic approach considers corruption as an ability of a governmental official to impose a shade tax on a private business as a result of the monopoly of decision-making he possesses, which affects and influences significant terms and conditions for the business. Hence, according to this approach, corruption represents the usage of benefits given by an official position to an agent for the purpose of gaining a private benefit from the interested parties of the market by means of deliberate breaching of formal regulations for the sake of their interests.

However according to Barsukova (2008), the neoclassical approach is neglecting historical and cultural factors, dismissing the influence of such significant factors as moral, ethics, social pressure, and formal and informal social norms, as it ignores the “social implement” of economical parties, which is considered as a dissemination of an individual into the social environment. These limitations are mastered by the economic-social approach that focuses on corruption in a context of a historical retrospective and ethnocultural peculiarities. The determinants of a conscientious or unconscientious business action, including corruption, within this approach are such factors subtracted by economists as an ethnocultural specialty, confessional peculiarities, family values, network connections, corporate culture, professional ethics, ideology, and other generators of the social norms. For instance, the confessional attribute significantly influences a degree of corruption practice’s prevalence: it is fairly noticed in the Confucianism countries, such as Singapore and Japan, to have a very limited corruption practice, unlike their neighboring countries like Pakistan and India, where Confucianism historically has not been perceived as a code of “honest and wise behavior” of an official person (Barsukova 2008).

Corruption is a very complex, socially and culturally predetermined phenomenon that relies significantly on history, traditions, and customs of a country and that has multiple forms of manifestation. For example, giving a present to an official person or a person with a higher social rank on a special day (holiday or birthday) in some countries would be considered as a natural action, whereas in some it would be subjected to judgments. In Japan, for instance, it is of a particular importance to make presents on a permanent and mutual basis, including presents to superior persons. Moreover, the most typical present in Japan would be money, which is very common for the Japanese style of giving presents. According to the research carried out by Davis and Ikeno (2006), a typical top manager of a company in Japan spends up to 2300 US dollars annually for presents, which have about 43 types, according to the present ceremonial classification. However, at the base of this process is a theory of a social duty to respond in a similar way to an extended cooperation, a so-called *giri*, which is more important in Japan than personal feelings and interests, rather than a corruption motive. *Giri* carries a meaning of an obligatory social norm, moral commitment, and duty, which should be followed in a social interaction process. Therefore, whereas in the Western countries a practice of giving presents is considered mostly as an individual action, not oriented toward reciprocity, in Japan this process is as an essential element of a group culture

that is necessary for maintaining the contacts and supporting the balance of social relationships. Moreover, the “to take-to give” model in Japan exists even in an interaction of humans and gods, and this “balanced relationship” model is reflected in a practice of giving the presents. However, this practice imposes a fair question: how much of the governmental corruption (fuhay), bribing (vairo), and a common tradition to give presents are correlated and mutually preconditioned? Dominant social norms and ideological guidelines determine an actual legitimacy of existing laws and legal regulations and an actual scale of corruption in society and its acceptability and eligibility. It is especially true in regard of such countries as Russia.

A general definition of corruption as the abuse of public office for personal gain requires a clear separation of public and private spheres and of public and private interests. In the Russian context, this strict separation has not been achieved at the present because of an incomplete transition period in economics transformation and the weakness of the private property institution.

The global concept of corruption, laid at the foundation of modern international standards of governing, involves an unconditional completeness and maturity of the institutional system of business practice regulation, when a rationally legal order and the institutionalization of rules have acquired the status of a norm, and corruption is considered as a deviation from this norm. However, in Russia, such a “rational-legal order” is being developed at the moment, and the basis of management and decision-making is not only and not so much institutionalized by rules, as distorting and correcting their informal practices and interpersonal relationships. In regard to this, it is fairly noted by Ledeneva and Shekshnya (2011) that the informal practices in Russia should be viewed as indicators that point to defects in the formal procedures and should be considered as a key to understanding local peculiarities, and they should be used to investigate the relation to corruption rather than automatically identified with it.

For the abovementioned reasons, corruption mechanisms in Russia should be investigated in the context of a trust relationship, both institutional and interpersonal, as it is the element that compensates the failure and incompleteness of formal institutions. Particular mechanisms of corruption action realization are of a high importance as well. The interaction between the actors of the corruption process is either direct or mediated, being realized through intermediaries or agents. The presence or absence of such agent depends on the personality of a participant or participants of the corruption interaction process. For instance, as a rule, on the federal government level, the agents take part in a corruption interaction. Whereas at the level of small businesses and tax inspections there are no intermediaries, as the interaction is taken on the personal level. However, in all the cases, the backbone of the interaction in a corruption process is the establishment of trust between the parties within one of the schemes: either Participant 1-Trust-Participant 2 or Participant 1-Trust-Agent-Trust-Participant 2.

Indeed, the popular Russian informal practices are based on relationships of trust, mutual responsibility, and other informal norms or, conversely, are the result of abuse of trust by persons who use their official position for personal gain,

changing and breaching the formal regulations. Following this view and logic, we would like to refer to a position shared with Ledeneva and Shekshnya (2011), according to which, in a society where personal trust compensates the shortcomings of the functioning of formal institutions, it would be incorrect to use the term “corruption” in the same sense as it is used in developed societies. The traditional “from top to down” focus of research in calculating the ratings of corruption and the corruption perception index should also be considered inadequate for the study of corruption in Russia, as the focus of analysis should be shifted to understanding the phenomenon as a specific practice as adaptation strategies in a relation to a bigger scaled system.

## **2 Characteristic and Peculiarities of a Corruption Process in Russia**

### ***2.1 The Level of Corruption in Russia in the System of International Coordinates***

In 2014, in accordance with the generally accepted Corruption Perception Index (CPI), calculated annually and published by the Transparency International, Russia is ranked 136th among 174 countries, sharing with an index value of 27 points the group of countries including Nigeria, Lebanon, Iran, and Kyrgyzstan. The countries with the lowest index of perception of corruption are the North European countries, such as Denmark and Finland, whereas the USA has the 17th place (index value equal to 74), Japan the 15th place (with 76 points), and Germany the 12th place in the ranking. As for the interpersonal trust level index, according to the international survey World Values Survey carried out by the University of Aberdeen (2015), Russia is in the middle position (27.6%) in the group of developed economies above South Korea (28%), Poland (22%), Spain (19%), and Cyprus (7.5%) and among developing countries adjacent to India (32.1%), Belarus (32.6%), and Taiwan (30%). The least corrupted countries, however, demonstrate a significantly higher level of interpersonal trust compared to Russia: Sweden, 60%; the Netherlands, 66.1%; the USA, 34.8%; Japan, 35.9%; and Germany, 44.6%.

### ***2.2 The Crisis of Confidence and Trust Between the Russian Civil Society and the Government as an Ideological Foundation of Corruption***

A principal difference of the Russian domestic corruption phenomenon compared to the other countries is its fundamental basis, associated with the crisis of confidence and trust between the Russian civil society and the government, which serves

as an ideological foundation of corruption and provides a self-reproduction of a corrupted system of governance on a permanent basis. It is manifested in several ways. Firstly, the citizens perceive the government structure not as a necessary element of the production of public goods, ensuring social welfare, but as a completely extraneous bureaucratic structure, predominantly concerned about maximizing their own well-being by means of the authority given to it. Secondly and on the other hand, the lack of trust between the state and its citizens contributes to the reproduction of corruption in the executive branches of government. It is clear that in this case, we are primarily talking about the deficit of institutional trust and distrust of citizens to impersonal social institutions and the establishment of rules and regulations, when citizens do not rely on the performance and execution of the officials in accordance with the formal and publicly declared standards and regulations, and therefore, they are imposed to resort to corruption acts.

A decreasing level of institutional trust leads to disposition of the Russian citizens from governing on all levels (state, municipal, private business, and nonprofit sector), when the corruption practices and strategies of adapting to them are applied, as they are entitled to substitute the legal regulations when influencing the existing formal system of rules and norms. Moreover, the atmosphere of “alienation” and a decreasing power distance from the people lead to a lack of effective public control of corruption from the down to the top: citizens faced with corruption manifestations do not intend to report the incidents to the state authorities. Furthermore, people believe that every official takes a bribe, consider corruption as a norm, and attempt to resolve the issues with bribes on all levels, thus fueling the corruption. As a result, the most important principle of balances in a relationship of the society and the government is being violated, and favorable conditions of corruption relationships are being created and reproduced.

### ***2.3 Raw vs. Innovation Type of Economics in Russia as an Economical Foundation and a Precondition of Corruption***

At the moment, the necessity of shifting from a resource-based model of economy to an innovation-based model is being imperatively proved, as well as a fight against corruption on all levels is widely declared in Russia. However, neither at the level of theoretical understanding nor, especially, in the practice of political decisions, these major problems are not linked and are not related to each other. Moreover, it is a stable reproductive system of corruption relationships that significantly hinders the country’s transition to the innovative model of development. There are several reasons for this. First of all, the raw economic model provides the state income generated under the influence of independent factors of commodity markets’ trends and general external trends in the world economics, rather than by the business activity of the state’s citizens and the efficiency of its state apparatus

and structure. This is a fundamental cause of the government's reciprocal relationship with the citizens that is not oriented and focused on making decisions in the interest of the general public and, moreover, creates an alienation of the government from the citizens that are not seeking to influence the government in its decision. In these circumstances, an innovative type of behavior is not only discouraged but is also illogical and irrational.

In conditions when all-hands-on-deck work approach at the end of the year in order to meet the budget indicators is a standard, a motivation for innovations and its need decrease to a minimum level. Thus, practically none of the 22 state-owned companies in Russia that are members of the so-called first list and blue chips list (such as Gazprom, Rosneft, etc.) have reached the level of research and development costs comparable to the correspondent average indicator in the world practice. For instance, a coefficient that determines the ratio of R&D investments to a ton of fuel for Gazprom is equal to 0.29 and for Rosneft 0.06, while Shell has a coefficient of 5.67 and ExxonMobil 3.2. At the same time, 69 % of R&D expenditures in the year of 2010 were funded from the state budget and not the companies' own funds (Pozhidaev 2011). It is fairly noted by Romashkina (2015) that the public sector constraints the innovative development in the Russian regions.

The primary factors for the improvement of the investment climate and development of innovations in Russia are creating the conditions for fair competition and eradicating the corruption. Under this condition the development of innovation would become a natural process. Companies that do not offer new products and technologies for the market will be doomed. But at the present, it is of a much greater benefit for the Russian corporations' top management to split the annual budget for the technological lines maintenance and repair among numerous subcontractors with an established system of bribes from each of the subcontractors, rather than to implement high-cost and high-risk innovative technologies. For this reason, it is not surprising that top management in majority of industrial companies and plants in Russia get the most of revenues from the contracts on repair works.

Above that, the innovations' implementation activity requires significant investments. In case of the absence of trust between the government and the society, owners of investment resources become interested solely in a quick and painless export of their capital raised from the sale of the state's resources. It stands to reason that even the most innovative and developed part of the Russian oligarchs' companies are still far behind the leading world companies, both for the volume of R&D development and for the efficiency of pioneering and research. As majority of big corporations in Russia consider modernization is a process of purchasing and importing the Western technologies and equipments which are then being adapted and adopted to a harsh Russian reality. Twenty-two of the biggest Russian companies have got a bit more than 1000 patents in Russia over the year 2010. For comparison, during the same year, IBM solely had patented over 5000 of new technologies and products, whereas only 5 of these patents were international ones. In Russia the index of effectiveness of investment into R&D is at the same low level as the figures indicating the level of innovation activity: having spent 22 % of the total R&D funding provided by the Russian government, the companies with a state

ownership have got only 4 % of all the patents issued (Pozhidaev 2011). Thus, the “governmental-corporative” segment of the Russian businesses demonstrates a dramatically small innovation performance with a five times lower level of efficiency in costs spending. And one of the main reasons of R&D investment low efficiency among large corporations is corruption.

When it comes to the small and medium businesses, they have very limited possibilities for the innovative activity: provided the government is corrupted as in Russia, obtaining an additional authorization and licenses required for developing innovations becomes too expensive, as the bigger part of costs has to be spent on bribes. Moreover, these companies have a very limited access to credit funds and loan instruments having a high risk in innovation at the same time. Above that, when there is a very poor specification of innovations and the protection of property rights is at a very low level as the system is corrupted, most of the investment projects in Russia lose their economic efficiency and become short term. These factors demotivate an innovation activity by entrepreneurs and, at the same time, encourage a rent-seeking approach to projects and business in general. Thus, corruption has a negative impact on both investment and innovation activity by businesses, stimulates rent-seeking behavior, and leads to significant social losses. Considering the types of corruption, it should be noted that among numerous types of it, we would like to specifically focus on one type, the least studied but the most upfront and important to be investigated both for the Russian and international science and practice—business corruption.

#### ***2.4 Existence of a Sustained Corruptive Relationship Between Government and Business in Russia***

In Japan the analogue of such an underhanded alliance of capital and bureaucracy is a protectionist practice called *amakudari* which presumes appointing former governmental officials on the key positions in private corporations after their retirement. They help to provide confidential government information, permit for certain types of work, facilitate favorable conditions of contracts, and even participate in decisions on getting financial subsidies from the government. For instance, the research of Davis and Ikeno (2006) has shown the companies with about a quarter of top posts occupied by *amakudari* received exactly the same percentage of orders from the government, which indicates the presence of conspiracy and illegal actions. Dzen scandals, *dango* auctions which are free from any criticism (agreements on bids for obtaining construction contracts), and the vicious practice of formation of the former high-ranking officials of the commission on fair competition all clearly show the evidence of a need to establish a strict legal control over the corruption practice. This practice is equally peculiar for Russia as well, and it is not limited solely by the abovementioned strains. The danger, however, is not only in existence of such corruptive alliances between the business and the government and



the stability of these links, but it is even more of a danger to the society because this vast network of corruption connections is not only benefiting from their illegal activities but also investing and reinvesting in the development the corruption itself. This factor makes corruption a systematic factor specific to the Russian model. According to Levin and Satarov (2012), Russia is a country with a massive endemic corruption, where corruption from an occasional deviation from the moral and legal rules transforms into a load-bearing structure of authority and a standard of relations between the citizens and the government.

The business corruption in Russia has become the most significant and the most rapidly developing sector of the national economy, the volume of revenue in which has exceeded the same indicator in the oil and gas sector. This provided the basis of calling corruption the major sector of the Russian economy (Levin and Satarov 2012).

## ***2.5 Dominating Significance and a Latent Character of the Internal Business Corruption as Opposed of Its External Manifestation in Russia***

Unlike the public sector, in relation to business, the category of corruption splits into two parts: corruption as part of the relationships between business and the government and corruption within the firms as an indicator of their internal inefficiencies. There are no any accurate or valid statistical data in Russia on the second type of corruption. The in-house corruption in a private business is caused by the following factors: confusion and conflicts of ownership relationship and management in corporate systems, lack of transparency and privacy of companies, and old methods and forms of financial and other reporting used by them in order to follow the government regulations and to avoid the use of the statements by the competitors (both in business and in government) for their hostile business acquisition strategies realized by means of illegal methods.

Corruption in the private business in its relation with the government can be divided into two parts. The first of it can be interpreted as a special form of tribute payments to officials for the right to do the business. The second one represents corruption as an instrument of competition. Both forms of corruption are associated with partial immersion of the business into the gray area of the economy. And while the first form of corruption knowingly represses a particular business and has a negative impact on its performance, the initiative use of the second form of corruption by business supposedly contributes to its competitive advantages and, therefore, its effectiveness. The most efficient and effective corruption strategies for the Russian companies basing on the successful performance of the business are the corruption interaction with the governmental authorities and acquisitions of the business undertaken by the governmental officials (or with their assistance) for the rent gaining purpose.

## ***2.6 Dynamics and the Ratio Changes of Different Types of Corruption Practices in the Relations Between Business and Government in Russia***

According to Ledeneva and Shekshnya (2011), who carried out surveys of 110 - Russian and foreign companies operating in different regions of the country, the most common corruption schemes currently applied are based on the extortion of money from businesses by state control authorities: customs services, fire inspection, and law enforcement service. This practice has become systematic and often voluntary (preventive) by businesses. An internal corporate corruption demonstrates an increasing trend associated primarily with the use of company's resources for personal gain: the use of company's funds for purchasing expensive cars, organizing personal trips, receiving commissions and expensive gifts from vendors and customers, etc. In actual business practice, the common forms of corruption are also based on friendship and other interpersonal relations reflecting the phenomenon of trust: favoritism in the selection of suppliers based on the friendship or family ties, the practice of nepotism when hiring employees of the corporation on the same base, and others. Moreover, these cases are not regarded by top managers as corruption, neither are the cases of pressuring and blackmailing business partners or employees by means of collecting confidential and compromising information on them. At the same time, researchers outline the following corruption practices that are currently losing its prevalence and economic significance in Russia: leasing of corporate office space or equipment for personal purposes, paying inflated remunerations to particular board members, paying commissions in monetary or nonmonetary forms for employment or career promotion, etc. Above that, the prevalence of a primitive "black cash" business gives way to more advanced forms of long-term corruption interactions.

## ***2.7 Formation of a Social Request for the Effective Anti-corruption Policy***

According to the Public Opinion Foundation (2011), the vast majority of Russians (84 %) in 2011 believed that the level of corruption in Russia was dramatically high. Almost half of respondents (46 %) believed that corruption had been growing. Every third respondent reckoned that within a year, the number of bribe takers would increase together with the scale of bribes taken. Moreover, 76 % of citizens believed that the published income declarations of government officials did not correspond to reality, and only 1 % of respondents trusted them. This is a testament of the formation of a large-scale social demand for a disclosure, assessment, and prevention of corruption in Russia. According to Gudkov (2014), corruption is an inevitable consequence of the notorious "vertical of power" and the concentration of resources in the hands of a small group of government officials. And numerous

studies and research undertaken within the last several years only prove that the scope and the scale of corruption grow in a direct proportion with a degree of centralization of the power and management (Aklyarinskaya and Ilyichev 2011).

### 3 Conclusion

Corruption as a barrier for the activity of international companies and investors in Russia is indicated and outlined by the vast majority of foreign top managers making business in Russia. This fact is also confirmed by the joint study of the National Council on Corporate Governance and Russo-British Chamber of Commerce conducted in Russia in the year 2010. The results of the survey showed a striking contrast of the Western business culture as opposed to the Russian one in terms of its openness, honesty, and transparency. For instance, as noted by one of the respondents, “big business in Russia is based on power, political connections and corruption. Business ethics is present only to the extent when it contributes to the promotion of business interests, but doesn’t lie beyond these borders”. Above that, experts outlined a huge influence of the state and government officials, who are guided by “unclear objectives and motives” on the business and stressed that the impact of authorities (especially by the tax inspections and licensing authorities) had increased dramatically. The red tape and high levels of corruption were named as the factors causing the greatest discontent of the businessmen. Above that, the foreign respondents assessed the current state of Russia’s legal and regulatory systems and environment in relation to the business as being at a mediocre level, ranking a three-point mark on a ten-point scale. One of the experts described this issue in general terms in the following way: “The cult of secrecy, up to the point of paranoia, is strongly expressed in the Russian business culture. However, it is clear how this phenomenon came into being: the fear of the government, fear of competition, weak legal and regulatory systems and highly uncertain regulatory rights. All of this significantly hinders a constructive business practice in the country”.

The most significant factors related to the credibility of the Russian companies outlined by the investment community abroad on a 10-point scale were a high level of transparency (an average of 9 points), confidence in property rights (8.3 points), the overall quality of corporate governance and business ethics and commitment (8.1 points), and a stable regulatory environment (7.9 points)—thus, all the factors essential not only for building up the confidence for the international business practice but also for preventing the corruption.

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