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Corporate Governance in Transition Economies
Part 1: The Case of Russia

Edited by
Shuichi Ikemoto and Ichiro Iwasaki

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Corporate Governance in Transition Economies
Part I: The Case of Russia

Edited by Shuichi Ikemoto & Ichiro Iwasaki

The Institute of Economic Research
Hitotsubashi University
Tokyo, Japan
January 2004
Preface

As a result of substantial efforts by the governments and citizens in the former socialist countries, the shift to a market economy is now entering its second phase. If the first phase of the transition was to constitute the social and economic institutions that are vital for establishing a ‘minimum’ system of market economy, then the present aim should be to enhance these hastily introduced institutions for further development of capitalism.

This is also the case with the corporate system. There is no country in the former Soviet Union or Central and Eastern Europe that does not have secured legal freedom of private ownership, labor contracts, profit distribution and business competition. Despite being in the early stages of developing a market economy, most of these countries have laid the groundwork for their banking system, securities markets, accounting systems and bankruptcy procedures. Moreover, according to EBRD’s Transition Report 2002, the position of private capital in these countries has been almost stabilized, judging from the fact that the private sector share of GDP by the middle of 2002 reached 61.7%, using a simple national average of 27 countries in the region. Thus, in a number of countries where the formal institutional framework has been established and private businesses have begun to lead production activities, the focus of policy debate has shifted from ‘traditional’ measures for the economic transformation such as privatization of state-owned enterprises to how to shape the existing business firms including their organizational architecture and the governance mechanism.

From this point of view, we are now conducting investigation into corporate governance issues in the former Soviet Union and Central and Eastern Europe together with foreign scholars in the framework of a joint research project supported by the Institute of Economic Research of Hitotsubashi University. This book represents one of outcomes from the project. We wish it could expand knowledge of readers in the field of corporate governance in transition economies and make a contribution to the development of so-called ‘Economics of Transition’ as whole.

Shuichi Ikemoto
Ichiro Iwasaki
January 2004
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Abstracts

Chapter 1
The Governance Mechanism of Russian Firms: Its Self-enforcing Nature and Limitations
Ichiro IWASAKI

The legal form of business enterprises in contemporary Russia is diversified to almost the same extent as those in major advanced countries. Joint-stock companies are now the most common form of incorporation among leading industrial enterprises. The law on joint-stock companies in Russia provides for the governance mechanism of joint-stock companies, in order to implement the concept of a ‘self-enforcing’ organization in which the legal code of business management should be observed voluntarily by managers and large stockholders. This fundamental idea is embodied in many aspects of the current system, including the mechanism of management and supervision characterized as ‘diarchial leadership’, the balance of power between stockholders and corporate officers, and the internal audit system. However, the self-enforcing nature of the Russian enterprises has been undermined by a number of factors, including the overwhelming expansion of closed joint-stock companies, the predominance of insider ownership, the short history of internal auditing and the lack of legal enforcement power. As a result, breaches of company law are rampant in Russia today. This raises serious problems for the Russian corporate system, along with the legal peculiarity of privatized firms and people’s enterprises, which complicates the system of joint-stock companies and deprives it of transparency.

JEL Classification Numbers: G34, K22, P31, P51

Chapter 2
Corporate Ownership and Control in the Russian Companies after the Decade of Reforms: As Reflected by Statistical and Sample Surveys
Tatiana Dolgopyatova

The main sources of joint-stock companies in Russian economy are as follows: privatization,
creation of new private business, restructuring of enterprises. Voucher privatization played a special role in the development of corporate ownership and control. Ownership redistribution trends of the last decade have been identified: as capital concentration grew, shares moved from the government and employees over to managers and outside shareholders, representatives of large private business. Most companies feature corporate control based on a dominating owner who either is head of the company himself or strictly controls managers appointed by him. The main source of funding is equity capital or owners’ money. Joint-stock companies are closed for potential outside investors, their capital structure and performance indicators are not transparent. Internal corporate control mechanisms are defined by dominating owners, the role of the stock market is minor. The analysis given in this paper is based on statistics and surveys of joint-stock companies carried out by HSE and other analytical organizations in 1999-2003.

JEL Classification Numbers: G32, G34, P31

Chapter 3
Corporate Governance in Russia: Formal Rules and Real Incentives of Economic Agents
Andrei Yakovlev

This paper is devoted to analyzing the evolution of corporate governance mechanisms in Russia. Special attention is paid to the causes of dramatic discrepancies between the expected outputs of institutional reforms implemented by the Russian government with the World Bank and IMF support and the actual behavior of Russian companies. Why was the model of interaction between enterprises and investors, owners and managers which, had been successful in other countries actually rejected by Russian business in the 1990’s? And how can we evaluate certain positive change that has occurred recently in corporate policies of major Russian companies? The answer to these questions is given based on analysis of economic agents’ motivation at different stages of development of corporate structures in Russia. The paper argues that the need of comprehensive organizational and technological restructuring of enterprises caused the need to have a concentrated ownership structure. The formation of such a structure in the late 1990’s (which occurred, in fact, contrary to the government’s activities) created preconditions for extending the horizon of interests of dominating owners and managers and for positive qualitative changes in the relations between major Russian companies and their shareholders and investors.

JEL Classification Numbers: G34, G38, P31
Biographies


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Chapter 1
The Governance Mechanism of Russian Firms
- Its Self-enforcing Nature and Limitations -

Ichiro IWASAKI*

1.1 Introduction

As a result of substantial efforts by the governments and citizens in the former socialist countries, the shift to a market economy is now entering its second phase. If the first phase of the transition was to constitute the social and economic institutions that are vital for establishing a ‘minimum’ system of market economy, then the present aim should be to enhance these hastily introduced institutions for further development of capitalism.

This is also the case with the corporate system. There is no country in the former Soviet Union or Central and Eastern Europe that does not have secured legal freedom of private ownership, labor contracts, profit distribution and business competition. Despite being in the early stages of developing a market economy, most of these countries have laid the groundwork for their banking system, securities markets, accounting systems and bankruptcy procedures. Moreover, the position of private capital in these countries has been almost stabilized, judging from the fact that the private sector share of GDP by the middle of 2002 reached 61.7%, using a simple national average of 27 countries in the region (EBRD, 2002, p. 20). Thus, in a number of countries where the formal institutional framework has been established and private businesses have begun to lead production activities, the focus of policy debate has shifted from ‘traditional’ measures for the economic transformation such as

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privatization of state-owned enterprises to how to shape the existing business firms including their organizational architecture and the governance mechanism.

For Russia, understanding of the formal corporate structure and the legal rights of stakeholders is needed when examining the problems of corporate governance. Recent enhancements to the legal system have helped to alleviate the conflict between ownership and management, and the situation is improving. There is, however, a lack of economic studies on the legal structure of Russian firms, and this paper aims to illuminate the legislative framework, with special attention to the governance mechanism of the joint-stock companies.

The paper is organized as follows: Section 1.2 examines the present forms of business firms and the prevalence of joint-stock companies in the industrial sector. Section 1.3 clarifies the formal structure of joint-stock companies, and Section 1.4 explains the legal specificity of privatized enterprises and workers’ joint-stock companies (people’s enterprises). The concluding section summarizes the major implications of the findings.

1.2 Business Organization in Contemporary Russia

The current legislative structure of the Russian commercial organization are shown in Figure 1.1 It is clear that the legal forms of incorporation in contemporary Russia are not substantially different from those in advanced countries. If there are any notable characteristics of Russian firms, they would be the followings:

1) There is a category of ‘unitary enterprises’, which are commercial organizations whose assets cannot be divided in ownership and under which only state and municipal enterprises fall (Civil Code, Art. 113).

2) Joint-stock companies are classified as of either ‘open’ or ‘closed’ type depending on how company stock is assigned. Closed joint-stock companies also include a special form known as ‘workers’ joint-stock companies (people’s enterprises)’.

3) ‘Companies with subsidiary liability’ may be established as a type of limited liability company (Civil Code, Art. 95). ‘Companies with subsidiary liability’ are a form of organization that requires the members (investors) of each company to assume additional

1 This is mainly based on federal laws concerning various types of enterprises, including the Civil Code, Part I, Chapter 4 (Art. 48-115), the Law on Joint-stock Companies and the Law on the Specificity of the Legal Status of Workers’ Joint-Stock Companies (People’s Enterprises), dated 19 July 1998. The term ‘current laws’ means laws effective on 1 January 2003.
liability for the company’s debts in excess of its assets in proportion to their participatory shares. This form of organization has been introduced into some former socialist countries, including Russia and Hungary (Oda, 2002, pp. 93-94).

Official Russian statistics disclose only extremely limited information on the form of incorporation. According to Table 1, the number of registered commercial organizations on 1 October 2002 was approximately 3 million, but the share of joint-stock companies in the total is no more than 14.8% (about 440,000 companies). In numerical terms, limited liability companies represent the most common form of enterprise. However, if discussion is limited to leading industrial enterprises, the situation seems substantially different. Here, we present two studies as empirical evidence.

Table 2 shows the results of the social survey that the Higher School of Economics in Moscow conducted on 356 industrial enterprises located in 39 regions across the country in the second half of 1999. The prevalence of joint-stock companies is as high as 87.8%. In terms of employment, the average size of the joint-stock companies is 1.6 times larger than unitary enterprises and 3.9 times larger than limited liability companies.

To obtain a more detailed picture of the actual composition of Russian joint-stock companies, we attempted to calculate descriptive statistics on the number of employees as well as the amount of share capital (уставный капитал) of 1,336 industrial joint-stock companies by using an enterprise database, which is originally based on the report on securities (AK&M List, 2002). The results are listed in Table 3. While this classification confirms that the sample group represents only 0.9% of all industrial enterprises, it comprises no less than 34.2% of all workers when compared with official statistics (See Table 4). From these figures it becomes clear that joint-stock companies are extremely common in almost all industrial sectors. In addition, this trend is most notable among a group of industrial enterprises classified under the Russian statistical standards as ‘large enterprises’ (those with 500 employees or more) and ‘superlarge enterprises’ (those with 1,000 employees or more).

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2 ‘Share capital’ denotes total amount of nominal value of shares acquired by shareholders that is specified in the articles of incorporation (устав).
3 For the details of the database, see http://www.disclosure.ru/rus/akmlist/sys-akm-list.stm.
4 According to official statistics, the total number of industrial enterprises (organizations) is 155,000 entities in 2001 (Goskomstat, 2002c, p. 20).
Chapter 1

The above-mentioned survey results strongly suggest that most leading Russian industrial enterprises are managed as joint-stock companies. This fact is not, as it would seem at first glance, the result of a voluntary decision by investors and managers. Rather, it is the result of an almost compulsory conversion of state and municipal enterprises to joint-stock companies, which the federal government promoted as part of its privatization policy before the enactment of the current Law on Joint-stock Companies. As discussed later, this factor has complicated the present state of Russian joint-stock companies. In the following section we will discuss the legislative structure of joint-stock companies in Russia, while taking into consideration the background factors outlined above and the history of the Russian company law (see Box 1.1).

Box 1.1 A Short History of the Russian Law on Joint-stock Companies

The history of the Russian Law on Joint-Stock Companies can be traced back to the middle of the eighteenth century. The first Russian joint-stock company was the ‘Constantinople Russia Trading Company’ founded in February 1757. Its articles of incorporation were approved by the Tsar and are the starting point for Russian joint-stock company legislation. Subsequently, a decree of the Tsar in 1782 stipulated the limited liability of shareholders in view of the spread of joint-stock companies throughout Europe, and the Imperial edict in 1807 provided the mechanism of management for such companies.

The legal system for regulating joint-stock companies was gradually developed. A typical example of a law passed at this time was the Provisions for Joint-Stock Companies, approved by the Imperial parliament in December 1836. In the second half of the nineteenth century, as these provisions became increasingly out of step with the times, the government and parliament attempted, without success, to drastically reform the legal system. Nevertheless, joint-stock companies rapidly became widespread in Russia. For instance, at the beginning of the twentieth century, 68% of industrial capital, 61% of assets of financial institutions, and 35% of railway networks were held as joint-stock companies. The number of such companies established had reached 2,956 by 1916 and their total capital amounted to almost 5.5 billion rubles (Iontsev, 2002, pp. 7-9; Meteleva, 1999, pp. 21-23).

When enterprises were nationalized or expropriated after the October Revolution of 1917, the joint-stock companies of the Imperial era were virtually abolished. However, joint-stock companies, as a form of incorporation, became popular again when the New Economic Policy (NEP) was adopted in 1921. The All-Russian Central Executive Committee passed a
resolution in May 1922 that the Soviet people were entitled to set up joint-stock companies. The Civil Code, which included the latest provisions of the law on joint-stock companies that had been adopted by various other countries, was enforced in January 1923. The Provisions for Joint-Stock Companies were approved at a meeting of the Sovnarkom (Council of People’s Commissars) in August 1927. All these developments resulted from the vigorous legislative activities of the Soviet government, which wanted to spread this type of company.

However, the legislative framework of joint-stock companies in the Soviet Union went into a long period of disuse with the rise of Stalin and his thorough enforcement of the ‘one factory in one country’ policy. As discussed later in this article, Anglo-American company law has exerted a significant influence on the process of restructuring the joint-stock company system from the last stages of the former USSR to the present time. This fact is deeply related to the half-century of suspension of Russian company law, which originally came from continental European legal models.

The precursor to the Law on Joint-Stock Companies (which came into force on 1 January 1996) was the Provisions for Joint-Stock Companies approved by a resolution of the Republican Cabinet of Ministers of Russia in December 1990. The provisions were adopted in the course of the mass conversion from state enterprises to joint-stock companies, including the Kamaz Corporation, one of Russia’s leading truck manufacturers, which was part of economic reforms promoted by the Gorbachev administration. Although, at the time, this legislative action was regarded as revolutionary, it provided only for the most basic rules on joint-stock companies. As a result, a large amount of fraud related to incorporation and stock issue, and frequent breaches of trust by executive officers occurred in the political chaos that ensued after the collapse of the Soviet Union (Khokhrov et al., 1995, p. 81; Burkov & Sklyarov, 1995, p.103).

However, the new Russia, facing a build-up of more pressing legislation, could not drastically revise those provisions in a climate of serious political confrontation between the Federal government and parliament. The El’tsin administration therefore bypassed the parliament by issuing presidential decrees and governmental resolutions. Among other things, the government issued a great number of ordinances to regulate former state enterprises that

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5 For instance, the provisions for joint-stock companies in the Civil Code were deleted in the beginning of the 1930s, and the Provisions for Joint-stock Companies of 1927 were abolished in 1962 (Meteleva, 1999, p. 4).
were transformed to joint-stock companies, as part of the move towards privatization.

The Russian company law was substantially improved when the parliament approved the Civil Code, Part I, in October 1994 and the Law on Joint-stock Companies in December 1995. Nevertheless, it was impossible for these new laws to completely supersede a number of ordinances that were regulating privatized enterprises at the time. As a result, the present legal system for joint-stock companies is composed of two pillars: (1) the Civil Code and the Law on Joint-Stock Companies, and (2) laws and ordinances concerning privatization. Of course, other laws and ordinances, including the Labor Code and the Accounting Law, have a critical role in regulating business activities of joint-stock companies and legal rights of stakeholders. The most important laws and ordinances are listed at the end of this article. In the following sections the formal corporatestructure of the Russian joint-stock company will be examined, with reference to these relevant laws and ordinances.

1.3 Legislative Structure of Joint-stock Company

This section will discuss the fundamental framework of joint-stock companies under the Civil Code and the Law on Joint-Stock Companies (hereinafter Law on JSC), including (1) the organizational form, (2) the mechanism of management and supervision, (3) the division of power among shareholders, directors and executive officers, and (4) the internal audit system. Workers’ joint-stock companies (people’s enterprises), which are a special type of joint-stock company along with privatized enterprises, will be discussed separately in the following section.

1.3.1 Open and Closed Joint-stock Companies

As stated earlier, joint-stock companies in Russia are legally classified as either ‘open’ or ‘closed’ (Civil Code, Art. 97 and Law on JSC, Art. 7). Whereas the former are allowed to transfer their shares to a third party and offer their shares to the public, the latter are only allowed allocating or transferring shares only among founders and other specific investors. In addition, there are certain differences between them in terms of (1) minimum capital, (2) number of shareholders and (3) obligations of disclosure. First, the nominal capital of open joint-stock companies must be not less than 1,000 times the official minimum monthly wage

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6 For the process of enacting the Law on Joint-Stock Companies, see Burkkov & Sklyarov (1995).
in effect at the time of their registration as a juridical person,\textsuperscript{7} while that of closed ones has only to be not less than 100 times (Law on JSC, Art. 26).\textsuperscript{8} Second, there must be no more than 50 shareholders in a closed joint-stock company. If a company exceeds the limit, it must be converted to an open joint-stock company or dissolved within one year of the exceeding this limit (Art. 7(3)).\textsuperscript{9} Third, open companies are obliged to publish their annual reports and financial statements and other information required by laws and ordinances and government agencies, such as the Federal Committee for Securities Market (Art. 92).

It has been reported that the number of closed companies is extremely high, at more than 370,000 entities, compared with about 60,000 open companies as of 1 July 2001 (Shapkina, 2002, p.5). Moreover, in spite of the restriction on the number of shareholders, many large companies are of the closed type, as shown in Table 2. This is largely the result of a special measure that Article 7(3) above will not apply to closed companies founded before the Law on Joint-stock Companies came into force (Law on JSC, Art. 94(4)). For example, ZAO Izumrud (Timashev Sugar Plant), established in 1991, remains a closed company despite having had over 1,000 shareholders while the law has been in effect (Sukhanov, 1997, p. 94). There are numerous cases like this.

Furthermore, there are also a significant number of former state and municipal enterprises converted to closed companies in the relatively early stages of privatization. For these closed companies, the Presidential Decree of 18 August 1996 directed that they should be converted to open companies by the end of 1996 if the government has a share of 25% or more in ownership. But this provision was regarded merely as a recommendation from the government because it did not specify effective penalties or disciplinary measures for breaches of the provision (\textit{Ekonomika i Zhizn’}, No. 36, 1996, p. 43). Still today, large

\textsuperscript{7} The official minimum monthly wage is stipulated by the Law on Minimum Wages. According to the revised law dated 29 April 2002, it is 450 rubles per month with effect from 1 May 2002.

\textsuperscript{8} Before the Law on Joint-stock Companies came into force, the minimum of 1,000 times was uniformly applied to both types of company (Tikhomirov, 2001, p. 138).

\textsuperscript{9} According to ‘the Resolution of the Board of Officers of the Federal Supreme Court and the Board of Officers of the Federal Supreme Tribunal on Problems in Applying the Federal Law on Joint-stock Companies’ dated 2 April 1997, conversion from closed to open companies and vice versa is not equal to reorganization (reorganizatsiya) as Article 15 of the law initially assumed. Accordingly, conversion cannot be completed by re-entry in the register of juridical persons, but requires a resolution of the general shareholders’ meeting to amend the articles of incorporation and the subsequent entry of the resolution in the register.
companies often remain closed despite being former state enterprises. Evidently the management of such companies did not observe the provisions of the decree or obtain support from private shareholders. At any rate, the overwhelming spread of the organizational form that shuts out external investors probably complements the prevalence of insider ownership. However, this is an extremely distorted form of organization if the intrinsic functions of joint-stock companies are taken into consideration. Also, there are a number of critical issues related to developing capital markets and improving the transparency of corporate management.

1.3.2 Management and Supervision Bodies

Five organs within a joint-stock company are legally prescribed for supervising and making decisions on a business’s affairs: (1) the general shareholders’ meeting (obshchee sobranie aktionerov), (2) the board of directors (sovet direktorov) or the supervisory board (nabludatel’nyi sovet), (3) the single executive organ (edinolichnyi ispolnitel’nyi organ), (4) the collective executive organ (kollegial’nyi ispolnitel’nyi organ) and (5) the audit committee (auditor) (revizionnaya komissiya, revizor). The board of directors is responsible for general leadership in corporate management, with the exclusion of the competence granted to the general shareholders’ meeting. The single executive organ (the general manager or president) and the collective executive organ (the management and administration division) are responsible for performing ordinary tasks (Law on JSC, Art. 64 and 69). In the statute, the term ‘board of directors’ is always referred to with ‘supervisory board’ in brackets. This is the result of having transplanted the concepts of Anglo-American company law into Russia, which has historically been influenced by continental European law. In assessing the main functions of this body, some people argue that it is not proper to use the name ‘board of directors’ solely. (Torkanovsky, 1997, p. 27). The audit committee (auditor) inspects financial and managerial activities jointly with the general shareholders’ meeting (Art. 85).

Joint-stock companies are not always required to have all five organs. When less than 50 people are holders of voting shares, the general shareholders’ meeting may substitute for the function of the board of directors (Law on JSC, Art. 64(1)). It is left to the discretion of the company whether a collective executive organ will be set up or not. Moreover, the minimum number of directors varies with the number of voting shareholders (Art. 66(3)). Accordingly, if the workers’ joint-stock companies (people’s enterprises) are included, there are a number of possible combinations of organizational forms and corporate bodies for joint-stock companies (See Table 5).
Chapter 1

The interrelationships between the executive and the supervisory bodies are illustrated in Figure 2. To secure the independence of the latter from the former, the Law on Joint-stock Companies imposes relatively tight restrictions on holding several posts concurrently. For instance, the single executive organ may not assume the chairmanship of the board of directors, and the members of the collective executive organ may not account for more than one-quarter of all directors (Art. 66(2)). Also, the members of the audit committee may not serve as directors or as any other officers (Art. 89(6)). Prior to the revision of the Law on Joint-stock Companies in January 2002, members of the executive bodies were permitted to assume the directorship, unless they held the majority on the board. As this case suggests, the shift from the Provisions of 1990 to the Law on Joint-Stock Companies, and subsequent revisions of the law are apparently intended to reinforce the supervisory power over corporate management. Russian researchers have responded favorably to these legislative controls (Shitkina, 2002, pp. 74-75; Ignatov & Filimoshin, 2002, p. 4).

However, it has already been pointed out that the restriction against executive officers assuming directorship can be easily eluded to by refusing the adoption of a collective executive organ (Economica i Zhizn’, No. 9, 1996, p. 38). According to Aukutsionek & Kapeliushnikov (2001), who have scrutinized the ownership structure of industrial enterprises, management's share of company ownership was remarkably increased from 1995 to 2001, while employees’ shares were distributed widely in small amounts (See Table 6). This may have occurred because managers could buy shares from their employees by taking advantage of the pre-emption rights accorded them by closed companies.

Adaptation of a collective executive organ requires amendment of the company’s articles. The resolution of the general shareholders’ meeting on this matter has to be adapted by a qualified majority. Such a resolution comes into effect when holders of a majority of issued voting shares are present and not less than three-quarters of all votes are affirmative. Thus, it is not uncommon for management to conspire with affiliated companies and their employees to prevent external investors from demanding the enforcement of control over corporate management. It is also possible that an executive officer as a major shareholder might appoint a person under their influence to the position of chairman of the board of directors. There have been some interesting opinions raised in this respect. For example, Torkanovsky (1997, p. 38) pointed out that the directors of privatized enterprises are in reality subordinates under the direct influence of the president. Ionsev (2002, pp. 102-103) noted that the most common form of management system in Russia is currently the general shareholders’ meeting - the board of directors - the single executive organ model, and that
even at companies with a collective executive organ, the purpose of setting up this body is not clearly recognized in many cases.

In major industrialized countries, the systems of corporate governance can be divided into two types: ‘a two tier system’ where the executive function is separated from the supervisory function and ‘a single tier system’ where a single organ assumes both these functions (Oda, 2002, p. 121). In the case of Russia, the governance system can be characterized as a kind of ‘hybrid’ (Polkovnikov, 2002, p. 141): it is not as independent as supervisory organs in German joint-stock companies, but it is more independent than those found in Anglo-American joint-stock companies. However, if the aforementioned legal loopholes and the insider-controlled ownership structure remain in their current state, it is very doubtful that this ‘hybrid’ system will effectively prevent executive officers from opportunistic management.

1.3.3 Shareholders’ Rights and their Scope

A notable improvement in the Law on Joint-stock Companies compared with the Provisions of 1990 is that clear lines were drawn around corporate organs in terms of competence (Torkanovsky, 1997, p. 28). Subjects of resolutions adapted by the general shareholders’ meeting are limited to legal matters and any other matters specified in the articles of incorporation. In addition, it is prohibited to delegate exclusive competence to the board of directors, not to mention the executive organs, although there are some legal exceptions (Law on JSC, Art. 48(2)). However, the board of directors and the executive organs are also given a great deal of authority. The allocation of power to these corporate bodies is summarized in Table 7. Because of limited space, we will now move on to the scope of exclusive competence of shareholders, an issue that is especially important for the governance design of joint-stock companies, and specifically, (1) the election and remuneration of corporate officers, (2) managerial decisions, (3) the restrictions on the transfer of shares and voting right of individual shareholders, (4) the rights of minority shareholders, and (5) the right of litigation against defective resolutions by the general meeting of shareholders.

The election of directors and the early termination of their power are the exclusive competence of the general shareholders’ meeting and items of resolution to be adapted by a simple majority (Art. 48(1), para. 4 and Art. 49(4)). The relationship between the company

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10 The number of directors may be fixed in the articles of incorporation or resolved by the general shareholders’ meeting. Their term is one year, or to be more accurate, until the date of the next general shareholders’ meeting. Directors must be natural persons (not juridical persons) but do
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and its directors is regulated on a private-law basis. This means that directors may be dismissed at any time by a simple majority at the general shareholders’ meeting, regardless of justifiable reason, and remuneration paid to directors based on the resolution of the general shareholders’ meeting shall not be considered as wages (Tikhomirov, 2001, pp. 278-279). On the other hand, the competence to elect executive officers and terminate their power may be transferred to the board of directors in accordance with the articles of incorporation (Art. 48(1), para. 8). Such delegation often takes place in the case of large companies. Therefore, this matter will be discussed in the following section, along with the issue of the balance of power between the board of directors and executive organs.

Managerial decisions may be specified in the articles of incorporation as matters to be resolved by the general shareholders’ meeting, as is the case in the United States and Japan. In addition to this, the general shareholders’ meeting is initially empowered to make several important decisions on a company's affairs, including increasing its capital by issuing new shares, approving transactions with interested parties (sdelki, v sovershenii kotorykh imeetsya zainteresovannost’) and major transactions (krupnye sdelki) involving the acquisition or disposition of assets equivalent to not less than 25% of the company’s total assets, and deciding on the purchase of the company’s own stock, as shown in Table 7. Moreover, as already mentioned, the exclusive competence of the general shareholders’ meeting may not be delegated to the executive body. Essentially, shareholders in Russia have relatively extensive voting rights on managerial decisions.

In restricting the transfer of shares, there is a large variance between open and closed joint-stock companies. Open companies are prohibited by Article 7(2) of the Law on Joint-stock Companies from specifying in the articles of incorporation that the company and shareholders have the right to pre-empt transferred shares. On the other hand, any shareholder of a closed company that intends to assign his/her own shares must notify in writing the company and all other shareholders involved of his/her intention at his/her own cost, and ask whether the other shareholders wish to exercise their right of pre-emption. If the assigning shareholder fails to do so, the company and other shareholders may file a complaint against

not need to be shareholders (Law on JSC, Art. 66). The chairman of the board of directors shall be elected by a single majority of directors (Art. 67(1)).

11 However, one who serves as both employee and director shall be remunerated for his/her performance as an employee under the labor contract. Therefore, that part of remuneration is not necessarily subject to the approval of the general shareholders’ meeting and is beyond its control.
the shareholder to make that transfer invalid (Art. 7(3)). With regard to restrictions on the voting rights, however, the Law on Joint-stock companies is generous. For instance, regardless of organizational form, the company is empowered to set ceilings for the number and total nominal value of shares per holder in the articles of incorporation (Art. 11(3)). In practice, many cases of employing such measures have been reported. OAO Nizhneenergo, for example, limits the maximum number of shares per holder to 0.5% of the nominal capital, while AO Sverdlovenergo and AO Samarenergo limit it to 1%. The articles of incorporation of OAO Surgutneftegaz contain the provision that the number of voting shares per holder shall be limited to at most 1% (Shitkina, No. 12, 1998, p. 85).

Provisions for protecting minority shareholders and filing complaints against the general shareholders’ meeting for defective resolutions, which are almost taken for granted in major industrialized countries, were actually introduced into Russia when the Law on Joint-stock Companies was enacted in 1996. The current law provides for the following rights to be accorded to minority shareholders, with stipulated requirements of holding shares: a requirement of holding 10% shares applies to the right to demand the convocation of an extraordinary shareholders’ meeting (Art. 55(1)) and the right to demand an audit on corporate management (Art. 85(3)). A 2% requirement applies to the right to make a proposal for the general shareholders’ meeting and the right to nominate a candidate for the executive (Art. 53(1)). A 1% requirement applies to the right to file a suit on behalf of shareholders (Art. 71(5))\(^\text{12}\) and the right to inspect the list of shareholders qualified to attend the general meeting (Art. 51(4)). Regardless of the number of shares held, shareholders are also entitled to file a suit before the court within six months to revoke a resolution passed at a general shareholders’ meeting or declare the meeting null and void (Art. 49(7)). Moreover, the following measures were introduced in part to protect minority shareholders:

1) The cumulative voting system to elect members of the board of directors, which is a compulsory measure that applies to companies with not less than 1,000 holders of voting shares (Art. 66(4)).

\(^{12}\) Although a shareholders’ representative suit is an important means of internal control, the explanation of such litigation is omitted from this article because of its limited space. For details, see *Ekonomika i Zhizn’* (No. 13, 1996, p. 38); Yarkov (1997); Meteleva (1999, pp. 153-176). For legal proceedings and costs, see *Ekonomika i Zhizn’* (No. 16, 2001, pp. 2-3).
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2) The obligation to propose the unlimited purchase of shares and convertible bonds held by existing shareholders, which is applicable to those who intend to obtain not less than 30% of the issued common shares (Art. 80).

These rights have been expanded and reinforced by revising the Law on Joint-stock companies step by step. This process is also regarded as an active reaction from the legislature to society’s need for effective countervailing power against management (Shitkina, No.12, 1998, p. 81; Tikhomirov, 2001, pp. 330-332; Shapkina, 2002, pp. 6-7).

1.3.4 Division of Power between the Board of Directors and the Executive Organs

As previously stated, the Law on Joint-stock Companies adapts the governance model described as ‘diarchial leadership,’ which prohibits one person from serving as both the chairman of the board of directors and the single executive organ at the same time. It goes without saying that the general shareholders’ meeting is the supreme entity of the company. Moreover, the general shareholders’ meeting in Russia has a relatively robust legal status by international standards, which has been secured by the extensive rights to vote on managerial decisions. Nevertheless, as in many other advanced countries, the general shareholders’ meeting in Russia has been gradually losing substantial power (Torkanovsky, 1997, p. 28).

Hence, when controlling the conduct of business affairs in practice, the following two factors are particularly essential: (1) the allocation of authority to the board of directors and the executive organs, and (2) the contract relationship between the company and its executive officers.

As Table 7 shows, the Law on Joint-stock Companies empowers the board of directors to make many important managerial decisions. Moreover, their decision-making rights may not be delegated to the executive organs (Art. 65(2)). This provision ensures that the board of directors may take ‘general leadership in corporate management’ (Art. 64(1)). However, it is illegal for all business affairs of the company to be added to the competence of the board of directors in the articles of incorporation, as the executive body plays a leading role in

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13 For example, the revision in January 2002 included the provisions for: (1) abolition of the limitation on the number of proposals on the agenda of the general shareholders’ meeting, (2) addition of the right to nominate a candidate for the executive organs, and (c) relaxation of the requirement of holding shares for inspecting the list of shareholders qualified to attend the general shareholders’ meeting from 10% to 1%.
corporate management (Karabel’nikov, 2001, p. 24). Therefore, the main functions of the board of directors are limited to (1) the personnel management of executive officers, (2) supervision over and advice on business affairs, and (c) decisions on management strategies (Torkanovsky, 1997, p. 36). With respect to the competence and functions of the executive organs in terms of ‘leadership in daily corporate management’ (Art. 69) on the other hand, the current law contains no specific provisions other than the provision that when both single and collective executive organs are simultaneously set up, the authority of the latter must be specified in the articles of incorporation (Art. 69(1)). As a result, the Law on Joint-stock Companies substantially leaves this matter to the discretion of the company.

The above-mentioned allocation of power is likely to bring about a conflict between the board of directors and the executive organs with regard to the business affairs of the company. In fact, it has already surfaced as a problem. For instance, Ignatov & Filimoshin (2002, p. 170) reported that boards of directors have been unable to obtain sufficient and reliable information on corporate management owing to conflicts with their respective company presidents. As a result, these directors could not make a proper judgment on matters under their competence. To cope with this situation, which was not foreseen at the time of the Law on Joint-stock Companies was enacted, the legislative authorities emphasize the explicit accountability of the executive organs to report any problems to the general shareholders’ meeting and the board of directors (Art. 69(1)). However, this is not a sufficient solution. Hence, as pointed out by many Russian researchers, it is vital when designing governance systems to specify in the articles of incorporation and the company’s internal documents the division of authority between the board of directors and the executive organs.

Another situation that the drafters of the Law on Joint-stock Companies did not initially foresee is the contract relationship between the company and its executive officers. According to the Law on Joint-stock Companies, this relationship can be treated like an entrustment between the company and its executive officers, which is underlined by the right of arbitrary dismissal of executive officers given to the general shareholders’ meeting and the board of directors (Art. 69(4)). This idea is also emphasized by the limited application of the labor law to the relationships between the company and its executive officers without prejudice to the Law on Joint-stock Companies (Art. 69(3)).

Nevertheless, the company’s unilateral cancellation of the contract on the grounds of these provisions is neither supported by precedent nor does it have widespread support in
Russia, a country where labor rights have been traditionally respected. From a Russian perspective, the relationships between the company and its executive officers are essentially labor relations. Thereof, an officer who complains about the company’s decision on his/her dismissal is entitled to claim the protection of labor rights before the court (Bakshinskas et al., 1999, p. 193). In practice, when the former president of a company claims that his/her dismissal while in office should be nullified, the hearing is concluded in almost all cases by the company ‘purchasing an agreement on voluntary resignation’ from the plaintiff (Karabel’nikov, 2001, pp. 21-23). Hence, the company must enter into a labor contract with executive officers. If the company annuls the contract on grounds that contain neither an illegal action nor an illegal inaction by that officer, the company is obliged to pay a certain amount of compensation to the officer (Labor Code, Art. 279). In this way, the principle of the Law on Joint-stock Companies, which places the general shareholders’ meeting and the board of directors above the executive organs in the hierarchy, seems to be partially in conflict with labor law.

Whomever the right of election belongs to, the contract between the company and its executive officers must be signed by the chairman of the board of directors (Law on JSC, Art. 69(3)). The period of contract shall be no longer than five years (Labor Code, Art. 58). The board of directors is empowered to determine the remuneration of executive officers on the basis of the right to sign the contract. Although there is no legal ceiling, the remuneration of executive officers is actually determined to be several times as high as that of general employees in many companies (Glazyrin, 1999b, pp. 26-27). It is also reported that similar provisions to ‘golden parachutes’ in the United States are often written into the labor contract between large enterprises and their managers in Russia (Karabel’nikov, 2001, p. 24). This applies, unless the remuneration of executive officers is not subject to the approval of the general shareholders’ meeting. That is why the responsibility of the board of directors is critically important. From the angle of corporate governance, it raises the major issue of how

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14 For more details, see Kondratov (No. 10, 1998, pp. 90-92); Glazyrin (1999b, pp. 24-25); Karabel’nikov (2001, pp. 5-12, pp. 36-42).

15 As a result of the revision to the Law on Joint-stock Companies in January 2002, the item of remuneration for the service of executive officers was deleted from Article 65(1), which itemizes the authority of the board of directors. However, even after the revision, the right to sign the contract still belongs to the chairman of the board of directors and, therefore, the issue of remuneration is supposed to be a matter under the competence of the board of directors (Shitkina, 2002, p. 77).
to secure incentives for external directors to control the remuneration of executive officers along with the aforesaid issue of how to coordinate the balance of power between the board of directors and the executive organs through the articles of incorporation and internal documents.

1.3.5 Internal Control over Corporate Management

The audit committee (auditors) and external auditor (auditor) are legally required to continuously check corporate management by executive organs together with the board of directors (supervisory board). The audit committee carries out a preliminary review of financial statements submitted to the general shareholders’ meeting. It also undertakes extraordinary inspections of financial and managerial activities at the request of the general shareholders’ meeting, the board of directors, and shareholders who hold no less than 10% of voting shares (Law on JSC, Art. 88(3) and Art. 85(3)). The audit committee is also entitled to convene an extraordinary shareholders’ meeting or a meeting of the board of directors (Art. 55(1) and Art. 68(1)). The election and remuneration of auditors are exclusively under the competence of the general shareholders’ meeting. By law, the number of auditors and the rules for their activities must be specified in internal documents to be determined by the general shareholders’ meeting (Art. 85(1) and (2)). Moreover, in order to secure the independence of the audit committee, auditors are prohibited from holding the post of director or any other officer of the company, and from exercising the right of voting of shares held by executive officers of the company on the election of auditors (Art. 85(6)).

Thus the audit committee, as a subordinate agency of the general shareholders’ meeting, is expected to play a leading role in internal audits. However, according to observations made by Russian jurists and legal practitioners, the role of the audit committee in any company is ‘obsequiously small’ (Dunaevskii et al., 2001, p. 317) and it is ‘extremely rare to find such an audit committee able to act in an effective way.’ Rather, in reality, an ordinary auditor usually appears suddenly on the eve of the regular general shareholders’ meeting and ‘will be never seen by anyone else for one year after reading the audit report at the meeting’ (Iontsev, 2002, p. 203).

In relation to this situation, the following factors should be pointed out: (1) insider ownership is dominant; (2) the internal audit system only has a short history; and (3) the number of auditors falls short of what is required. Since these problems cannot be easily solved, companies have little choice but to depend on external auditors selected by the

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16 For more details on the duties of the audit committee, see Tikhomirov (2001, pp. 346-350).
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general shareholders’ meeting from among the licensed auditors and audit organizations for much of the company’s internal audit, at least for the time being (Art 86(1)).

Article 7 of the Law on Accounting Audit Activities outlines the annual accounting audit requirements for open joint-stock companies, financial institutions, and enterprises/entrepreneurs whose annual sales are not less than 500,000 times as much as the official minimum monthly wage or whose balance of assets is not less than 200,000 times. Following the development of the private sector and the expansion of demand for approved accounting audit practices, the market of audit services grew at a rapid pace from about 8 billion rubles in 1999 to around 13-14 billion rubles in 2000 (Ekonomika i Zhizn’, No.11, 2000, p. 27; No.14, 2001, p. 27). In Table 8, we have aggregated the business performances of 150 largest audit firms, which comprise about 50% of the Russian market. The majority of these leading audit firms is based in Moscow, and has lately expanded their services to consulting. Also, foreign affiliates actively take part in this market and compete intensely with one another for large clients who wish to attract foreign investment or issue bonds overseas. Thus audit firms have steadily met the needs of domestic enterprises. Nevertheless, it is clear that, as the total number of professional staff in 150 large audit firms is no more than 7,600, the present pool of audit services is too small to supply the Russian corporate sector with a high-quality service. Also, unlike an audit committee that has direct control over financial and managerial activities, the functions of external auditors are limited to scrutinizing financial statements and expressing their technical opinions on the reliability of these statements (Dunaevskii et al., 2001, p. 317). Based on these factors, it can be said that the internal control of Russian joint-stock companies is still fragile and involves many problems in terms of corporate governance and the protection of minority shareholders. As a result, many people are asking whether the internal audit system for joint-stock companies in Russia is actually effective.

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17 The remuneration to external auditors shall be determined by the board of directors (Law on JSC, Art. 86(2)). Shareholders or officers of the company and those who have any relationship with or interest in the company shall not be qualified for this position (Iontsev, 2002, p. 204). External auditors, like the audit committee, are entitled to convene an extraordinary meeting of shareholders or a meeting of the board of directors (Art. 55(1) and Art. 68(1)).

18 Besides, the examination to qualify as an auditor in Russia is not particularly difficult. Almost all applicants can pass it ‘if they are practiced in accounting for three years or longer and take a course of about one month’ (Saito, 2003, p. 22). Hence the average auditor in Russia is generally less competent than licensed auditors in advanced countries.
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1.4. The Legal Specificity of Privatized Enterprises and Workers’ Joint-Stock Companies (People’s Enterprises)

The preceding section has described the standard type of the joint-stock company. In Russia, however, there are two groups of enterprises that deviate from the standard as a result of the country’s socialist past and its current transition to a market economy. They are privatized enterprises and workers’ joint-stock companies (people’s enterprises). This section will expound on the legal peculiarity of each of these groups and compare it with the governance structure of the standard model of joint-stock company.

1.4.1 Privatized Enterprises

By law, government agencies or local governments may not become the founder of a joint-stock company (Law on JSC, Art. 10(1)). The only exception to this rule is a joint-stock company founded on the basis of a state or municipal enterprise. In July 1992 the federal government determined as the first step to the privatization of national assets that state or municipal enterprises with 1,000 or more employees or with fixed capital greater than 50 million rubles on 1 January 1992 must be converted to open joint-stock companies.\(^\text{19}\) However, the presidential decree of 16 November 1992 reserved the right of fixed possession of voting shares, and the right to introduce ‘golden shares’ (zolotaya aktsiya) which accorded the government special management rights. The government aimed to maintain its political influence on leading enterprises, so the decree targeted privatized enterprises in specific industries, including the producers of energy, precious metals, munitions and alcoholic beverages. According to official statistics, 28,738 open joint-stock companies were created within the framework of privatization policy between 1993 and 2001 (See Table 9). Of them, 3,281 companies (11.4%) were subject to the Government’s fixed possession of shares and 1,695 companies (5.9%) were subject to golden shares.

According to the Law on Joint-stock Companies, laws and ordinances concerning privatization beyond the scope of the Law on Joint-stock companies apply to joint-stock companies where the government holds 25% or more of the shares or to which golden shares

\(^{19}\) See article 1 of the annex to the presidential decree dated 1 July 1992: ‘Provisions for the Commercialization of State Enterprises Involving Simultaneous Reorganization into Open Joint-stock Companies.’ Subsequently, in August 1998, it was made compulsory for all privatized enterprises with 25% or more of shares held by the government to convert to open joint-stock companies.
are applicable (Art. 1(5)). In other words, special attention should be paid to the legal status of joint-stock companies transformed from state or municipal enterprises, if the federal government or local administration still holds one-quarter or more of the company's shares or a golden share as a result of delayed privatization or political intention.

Normally, government representatives will be sent from the competent administrative authority to the managerial and supervisory organs of these privatized enterprises that are subject to the government’s fixed possession of shares. The post of government representative is usually assumed by the minister or a high-ranking official of the competent authority. The representative, who will attend a meeting of the board of directors, does not need to be appointed at the general shareholders’ meeting. Moreover, the government or the competent authority may replace the representative at its discretion (Iontsev, 2002, p. 32). The representative will also be sent to the general shareholders’ meeting and the audit committee. The exercise of his/her rights is conducted, as a rule, in accordance with the Law on Joint-stock Companies.

The use of golden shares can give the government more control than in the case of the fixed possession of shares mentioned above. According to the Law on Privatization of State and Municipal Assets enacted on 21 December 2001 (henceforth the Privatization Law), golden shares may be introduced when not less than 75% of shares are privatized. Adoption and abolition of golden shares are determined by the government or the competent authority (Privatization Law, Art. 38(5)). The federal government and the local administration may not apply golden shares concurrently to a specific privatized enterprise. Also, local governments are prohibited from introducing golden shares into an exclusively possessed enterprise under the jurisdiction of the federal government (Art. 38(1)).

Joint-stock companies into which golden shares are introduced have to secure a permanent post for the government representative on the board of directors and the audit committee. The representative is entitled to make proposals to the general shareholders’ meeting; convene an extraordinary shareholders’ meeting; and exercise the power of veto on the amendment of articles, reorganization, dissolution, change to share capital, and resolutions of the general shareholders’ meetings on major transactions and transactions with interested parties (Privatization Law, Art. 38(3)). Thus golden shares are a synonym for the above-mentioned special management right given to the government, but not for securities in
real terms. Accordingly, the government is not expected to secure dividends or convert these golden shares to common shares.\(^{20}\)

As we discussed above, it is obvious that whether the government possesses shares of not less than 25% or whether golden shares are introduced can provide a key explanatory variable for the governance performance of privatized enterprises. As some economists have noted, there is plenty of scope for questioning the constant monitoring capability of the government into question on the ground that the Ministry of National Assets is not particularly competent in clerical processing, and government representatives do not generally have sufficient knowledge or skills in corporate management (Torkanovsky, 1999, p. 68; Lyashchenko, 2001, p. 85). Nevertheless, the role of the government should not be disregarded in that the present institutional arrangements can directly reflect government interests in privatized enterprises and enable contingent governance (Aoki, 1994) to be considerably effective.

1.4.2 Workers’ Joint-stock Companies (People’s Enterprises)

There are still thousands of enterprises in Russia whose ownership and management are internally controlled by employees, continuing the tradition of ‘labor sovereignty’ cultivated in the socialist period. They include many industrial enterprises such as Novoryazansk Cogeneration Plant, Tatarstan Paper Manufacturing Kombinat, Vladimir Electric Cable Factory, and Starooskosk’ sk Metal Factory and so forth (Tarasov, 1998, p. 13).

The Law on the Specificity of the Legal Status of Workers’ Joint-Stock Companies (People’s Enterprises) (henceforth the Law on People’s Enterprises), which took effect on 1 October 1998, was introduced by 12 Russian deputies representing all political parties and groups of the State Duma (Lower House) of the Federal Assembly. This somewhat ideological law has been designed for the survival and spread of these worker-controlled enterprises, because these companies are run under a system that is substantially different from the standard closed joint-stock company. There are a number of differences, including (1) the incorporation to capital management rules, (2) the structure and power allocation of

\(^{20}\) When golden shares were introduced by the presidential decree dated 16 November 1992, they were incorporated as voting shares into the nominal capital specified in the articles of incorporation of privatized enterprises and initially made convertible to common shares after the expiration. Their status was revised after the Law on Privatization of State Assets and Principal of Privatization of Municipal Assets came into force in July 1997 (See Article 5 of this law).
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the supervisory and executive organs, and (3) the election and remuneration of corporate officers.

People’s enterprises may be established only by reorganizing an existing commercial organization (Law on People’s Enterprises, Art. 2(1)). They are legally required to complete a written agreement between investors and employees (Art. 2(3)). The minimum capital is subject to the same limited amount imposed on open companies (1,000 times as much as the official minimum monthly wage) (Art. 4(7)). The company may not use preference shares for capital procurement and the nominal value of shares is limited to not more than 20% of the official minimum monthly wage (Art. 4(1)). The number of shareholders is also limited to a ceiling of 5,000 persons (Art. 9(4)).

The ‘popular’ nature of people’s enterprises is especially embodied in the following provisions: a group of employees are required to obtain 75% of issued shares, which must be achieved within five to ten fiscal years of the establishment of the company depending on the share of external investors. However, the percentage of holding shares per employee may not exceed 5% (Art. 4(2)). New share issues intended to increase capital are to be distributed to all qualified employees in proportion to their annual wages. Recruits may also take part in new share issues after a certain period of service (Art. 5(2) & (3)). As for shares that are widely held by employees in small amounts, there are provisions for preventing their external diffusion (Art. 6): (1) the shares of people’s enterprises may not be assigned to a third person, (2) dismissed employees and the families of deceased employees are obliged to sell all their shares to the company and/or employees, and (3) creditors are prohibited from seizing shares held by employees (Zernin & Mikryukova, 1999, pp. 34-35).

The specific nature of people’s enterprises can be also found in the mechanism of management and supervision (See Table 5). First of all, almost all matters under the competence of the general shareholders’ meeting are resolved on the ‘one shareholder, one vote’ principle. They include important items concerning corporate management, such as the election and remuneration of corporate officers, amendment of articles, reorganization, salaries of employees, and internal stock distribution (Law on People’s Enterprises, Art. 5(4) & Art. 10(1)). Even employees who do not hold any shares are guaranteed the right to have

21 Moreover, it is stipulated that the general manager (president) of the people’s enterprise shall not be rewarded for his/her service in excess of 10 times the average salary of employees (Law on People’s Enterprises, Art. 13(3)).

22 Subjects to be resolved on the ‘one share, one vote’ principle are limited to the five items; namely, (1) auditors’ remuneration (Art. 10(1), para. 7); (2) approval of the method of
a voice at the general shareholders’ meeting (Art. 10(5)). Second, the Law on People’s Enterprises rejects the idea of ‘diarchial leadership’ by the board of directors and the single executive organ. The former is called only ‘the supervisory board’, which is, as a rule, chaired by the general manager (or president) (Art. 12(4)). In addition, when the percentage of non-shareholding employees exceeds 2% in people’s enterprises with a total of 1,000 employees or more, the general assembly of non-shareholding employees may send one representative to the supervisory board (Art. 12(7)). Third, the Law on People’s Enterprises does not provide for a collective executive organ to be set up – the executive organ is legally limited to a single individual. And finally, the audit committee of the people’s enterprise is responsible not only for inspecting financial and managerial activities but also supervising the protection of shareholders’ rights and the fulfillment of internal rules (Art. 14(1)). The members of the committee are limited to only shareholding employees, who are entitled to have a voice at the meeting of the supervisory board (Art. 14(3) & (6)). Thus, the audit committee of the people’s enterprise, as implied by its other name the ‘control committee’ (kontrol’naya komissiya), has much more power than that of the ordinary joint-stock company to enforce the direct monitoring system of corporate management by a labor collective (Glazyrin, 1999a, p. 30).

The above-mentioned provisions, especially the limitation on investment by non-employee shareholders and the ‘one shareholder, one vote’ principal, are excessively biased towards the protection of employees’ rights. As a result, it has been said of people’s enterprises that ‘its legal form of incorporation cannot be squeezed into that of joint-stock companies without distorting its essence’ (Zemin & Mikryukova, 1999, p. 36). Some people recognize that workers’ possession of shares ‘matches the mentality of Russians accustomed to the collective decision-making and behavior’ (Lyashchenko, 2001, p. 79) and claim the management efficiency of the enterprise belonging to workers surpasses traditional state and private enterprises (Glazyrin, 1999a, p. 26). From this point of view, the Law on People’s Enterprises embodies the belief of some politicians and intellectuals that the spread of this unique form of corporate organization will contribute to (1) mitigation of social tension between the management and the working class in Russia, (b) improvement in labor incentives for increasing productivity, and (c) resolution of negative problems brought about by privatization policies (Tarasov, 1998, p. 15).
Although we have reservations about this simplistic logic, the economic analysis of these beliefs is not the purpose of this article. Rather, we would like to stress two points here. First, that the legal specificity of people’s enterprises has heavily complicated the Russian corporate system, and second, that the institutional context of externally observable factors, such as ownership structure and directorship, are likely to be extremely different between the standard type of closed joint-stock company and the people’s enterprise.

1.5 Concluding Remarks

In conclusion, we would draw the attention of researchers to the diversity of managerial and supervisory mechanisms related to Russian joint-stock companies. This diversity strongly suggests the possibility of variations in performance among joint-stock companies, even if other conditions such as ownership structure are the same. It is well-known that numerous studies have focused on the structure of ownership after privatization in connection with the problem of corporate governance in Russia to date. Needless to say, insider-dominated ownership structure is still very problematic. However, the above examination underlines that the formal structure of corporate organization needs to be given just as much analytical consideration.

Furthermore, there are a number of other significant issues related to this subject. According to two American jurists involved in preparing a draft of the Russian Law on Joint-stock Companies, this law advocates the creation of ‘self-enforcing’ corporate organizations as a fundamental principle for institutional design. It aims to create a legal code on corporate management that will be voluntarily observed by managers and large shareholders (Black and Kraakman, 1996, p. 1917). That is why the drafters made the Russian Law on Joint-stock Companies more explicit and elaborate than the company laws of any other emerging economies in terms of procedural protections to control the internal decision-making process of the company. It is neither an ‘enabling statute’ which allows the wide discretion of the company nor a ‘prohibitive statute’ which strictly prohibits or limits various commercial acts in positive law.

Positive outcomes from their efforts appear in many aspects of the governance mechanism of Russian joint-stock companies, as outlined in this article. It should be noted that this type of law on joint-stock companies was adopted in Russia on the basis of a realistic view of unreliable and ineffective legal enforcement. Their judgment is quite right. However, as the aforementioned jurists themselves realize, it is even theoretically impossible to set out a completely self-enforcing joint-stock company legal framework, although it is
possible to reduce dependence on the courts to some extent (Black and Kraakman, 1996, p. 1918). Unfortunately, this has been proved by repeated breaches of the Russian company law in recent years, for example, (1) shareholders not being notified of the date and agenda of the general shareholders’ meeting, (2) directors not being re-elected at the general shareholders’ meeting, (3) external investors being refused attendance at meetings of the board of directors on various pretexts, (4) financial audits by external auditors being prevented by the company and (5) procedures for resolution not being followed at the general shareholders’ meeting (Starovoitov, 2001, p. 68).

As factors that inhibit Russian joint-stock companies’ ability to be sufficiently self-enforcing, it should be noted, together with a number of issues previously pointed out, that (1) legal enforcement is still weak even under the Putin administration, (2) organizations and institutions that complement the formal framework of the Law on Joint-stock Companies have not yet developed well, (3) directors and executive officers have a weak sense of morals in terms of business management, and (4) insider shareholders are not fully aware of their position as owners. Moreover, the presence of a formal option of closed joint-stock companies and people’s enterprises raises a serious problem for the Russian corporate system in that the government thereby is officially enabling domestic firms to turn inward. It seems that these factors will continue to exert a major negative effect on the governance and performance of Russian firms for some time to come.
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Federal’nii zakon ‘Ob auditorskoi deyatel’nosti’ ot 7.8.2001, No. 119-FZ.

Federal’nii zakon ‘Ob osobennostyakh pravovogo polozheniya aktsionernykh obshchestv rabotnikov (narodnykh predpriyatiy)’ ot 19.7.1998, No. 115-FZ.


Polozhenie o kommertsializatsiigosudarstvennykh predpriyatiy s odnovremennym preobrazovaniem v aktsionernye obshchestva otkrytogo tipa, utverzhdennoe Ukazom Prezidenta RF ot 1.7.1992, No. 721.


Ukaz Prezidenta RF ‘Ob organizatsionnykh merakh po preobrazovaniyu gosudarstvennykh predpriyatiy, dobrovol’nykh obedinenii gosudarstvennykh predpriyatiy v aktsionernye obshchestva’ ot 1.7.1992., No. 721.
Chapter 1

Figure 1. Legal Forms of Commercial Organization in Russia

Commercial organizations
(Kommercheskie organizatsii)

Unitary enterprises
(Unitarnye predpriyatiya)

State enterprises
(Gosudarstvennye Predpriyatiya)

Municipal enterprises
(Munitsipal'nye predpriyatiya)

Business partnerships
(Khozyaistvennye tovarishchества)

Unlimited partnerships
(Polnye tovarishchества)

Limited partnerships
(Tovarishchества na vere)

Business corporations
(Khozyaistvennye obshchestva)

Limited liability companies
(Obshchestva s ogranichennoi
otvetstvennoi)

Companies with subsidiary liability
(Obshchestva s dopolnitel'noi
otvetstvennoi)

Joint-stock companies
(Aktiionnye obshchestva: AO)

Open joint-stock companies
(Otkryte AO: OAO)

Closed joint-stock companies
(Zakryte AO: ZAO)

Production cooperatives
(Proizvodstvennye kooperativы)

Workers' joint-stock companies (People's enterprises)
(AO rabotnikov - Narodnye predpriyatiya)

Source: Illustrated by the author.
### Table 1. Composition of Commercial Organizations by Form (1 October 2002)

<table>
<thead>
<tr>
<th>Form of Incorporation</th>
<th>No. of Firms ('000s)</th>
<th>Share (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial organizations</td>
<td>3,001.1</td>
<td>100.0</td>
</tr>
<tr>
<td>Unitary enterprises</td>
<td>78.2</td>
<td>2.6</td>
</tr>
<tr>
<td>Business partnerships and companies</td>
<td>2,438.4</td>
<td>81.3</td>
</tr>
<tr>
<td>Joint-stock companies</td>
<td>442.8</td>
<td>14.8</td>
</tr>
<tr>
<td>Others</td>
<td>484.5</td>
<td>16.1</td>
</tr>
</tbody>
</table>


### Table 2. Composition of 356 Industrial Enterprises by Form and Descriptive Statistics on Number of Employees

<table>
<thead>
<tr>
<th>Number</th>
<th>Share (%)</th>
<th>Mean</th>
<th>Min.</th>
<th>Max.</th>
<th>Standard deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Joint-stock companies</td>
<td>316</td>
<td>87.8</td>
<td>3,313</td>
<td>25</td>
<td>113,944</td>
</tr>
<tr>
<td>Open joint-stock companies</td>
<td>268</td>
<td>75.3</td>
<td>3,634</td>
<td>25</td>
<td>113,944</td>
</tr>
<tr>
<td>Closed joint-stock companies</td>
<td>48</td>
<td>13.5</td>
<td>1,522</td>
<td>70</td>
<td>8,324</td>
</tr>
<tr>
<td>Unitary enterprises</td>
<td>31</td>
<td>8.7</td>
<td>2,011</td>
<td>13</td>
<td>9,873</td>
</tr>
<tr>
<td>Limited liability companies</td>
<td>6</td>
<td>1.7</td>
<td>844</td>
<td>142</td>
<td>2,351</td>
</tr>
<tr>
<td>Others</td>
<td>3</td>
<td>0.8</td>
<td>187</td>
<td>144</td>
<td>240</td>
</tr>
<tr>
<td>Total</td>
<td>356</td>
<td>100.0</td>
<td>3,132</td>
<td>13</td>
<td>113,944</td>
</tr>
</tbody>
</table>

*a At the time of survey.

*b At the end of 1998.

*Source*: Data provided from Dr. Tatiana Dolgopyatova, project leader involved in the social survey undertaken by the Higher School of Economics of National University in Moscow with the support of the Ministry of Economy of the Russian Federation, summer to autumn 1999. Her support is greatly acknowledged.
### Table 3. Composition of 1,336 Industrial Joint-stock Companies by Sector and Descriptive Statistics on Number of Employees and Share Capital

<table>
<thead>
<tr>
<th>Sector</th>
<th>No. of Enterprises</th>
<th>No. of Employees</th>
<th>Share Capital (million rubles)</th>
<th>Mean</th>
<th>Min</th>
<th>Max</th>
<th>Standard Deviation</th>
<th>Mean</th>
<th>Min</th>
<th>Max</th>
<th>Standard Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food industry</td>
<td>115</td>
<td>1,176.9</td>
<td>1.172.4</td>
<td>44.1</td>
<td>1.587</td>
<td>1.965</td>
<td>1</td>
<td>1.986</td>
<td>1.15</td>
<td>1.965</td>
<td>1.986</td>
</tr>
<tr>
<td>Light industry</td>
<td>165</td>
<td>1,212.1</td>
<td>1.191.4</td>
<td>6.9</td>
<td>1.176</td>
<td>1.266</td>
<td>1</td>
<td>1.363</td>
<td>1.15</td>
<td>1.266</td>
<td>1.363</td>
</tr>
<tr>
<td>Construction material</td>
<td>87</td>
<td>2.372.0</td>
<td>2.369.4</td>
<td>44.9</td>
<td>3.375</td>
<td>3.969</td>
<td>7</td>
<td>5.281</td>
<td>3.5</td>
<td>3.969</td>
<td>5.281</td>
</tr>
<tr>
<td>Wood, wood-working &amp; paper</td>
<td>23</td>
<td>2.720.0</td>
<td>2.518.5</td>
<td>5</td>
<td>2.72</td>
<td>2.72</td>
<td>1</td>
<td>2.7</td>
<td>5</td>
<td>2.72</td>
<td>2.72</td>
</tr>
<tr>
<td>Medical engineering &amp; medical</td>
<td>10</td>
<td>5.559</td>
<td>5.659</td>
<td>1.15</td>
<td>6.549</td>
<td>6.549</td>
<td>1</td>
<td>6.549</td>
<td>5</td>
<td>6.549</td>
<td>6.549</td>
</tr>
<tr>
<td>Chemical &amp; General industry</td>
<td>42</td>
<td>1.690</td>
<td>1.690</td>
<td>6</td>
<td>1.690</td>
<td>1.690</td>
<td>1</td>
<td>1.690</td>
<td>6</td>
<td>1.690</td>
<td>1.690</td>
</tr>
<tr>
<td>Non-ferrous metallurgy</td>
<td>6</td>
<td>4.133</td>
<td>4.133</td>
<td>1</td>
<td>4.133</td>
<td>4.133</td>
<td>1</td>
<td>4.133</td>
<td>6</td>
<td>4.133</td>
<td>4.133</td>
</tr>
<tr>
<td>Food industry</td>
<td>115</td>
<td>1,176.9</td>
<td>1.172.4</td>
<td>44.1</td>
<td>1.587</td>
<td>1.965</td>
<td>1</td>
<td>1.986</td>
<td>1.15</td>
<td>1.965</td>
<td>1.986</td>
</tr>
<tr>
<td>Light industry</td>
<td>165</td>
<td>1,212.1</td>
<td>1.191.4</td>
<td>6.9</td>
<td>1.176</td>
<td>1.266</td>
<td>1</td>
<td>1.363</td>
<td>1.15</td>
<td>1.266</td>
<td>1.363</td>
</tr>
<tr>
<td>Construction material</td>
<td>87</td>
<td>2.372.0</td>
<td>2.369.4</td>
<td>44.9</td>
<td>3.375</td>
<td>3.969</td>
<td>7</td>
<td>5.281</td>
<td>3.5</td>
<td>3.969</td>
<td>5.281</td>
</tr>
<tr>
<td>Wood, wood-working &amp; paper</td>
<td>23</td>
<td>2.720.0</td>
<td>2.518.5</td>
<td>5</td>
<td>2.72</td>
<td>2.72</td>
<td>1</td>
<td>2.7</td>
<td>5</td>
<td>2.72</td>
<td>2.72</td>
</tr>
<tr>
<td>Medical engineering &amp; medical</td>
<td>10</td>
<td>5.559</td>
<td>5.659</td>
<td>1.15</td>
<td>6.549</td>
<td>6.549</td>
<td>1</td>
<td>6.549</td>
<td>5</td>
<td>6.549</td>
<td>6.549</td>
</tr>
<tr>
<td>Chemical &amp; General industry</td>
<td>42</td>
<td>1.690</td>
<td>1.690</td>
<td>6</td>
<td>1.690</td>
<td>1.690</td>
<td>1</td>
<td>1.690</td>
<td>6</td>
<td>1.690</td>
<td>1.690</td>
</tr>
<tr>
<td>Non-ferrous metallurgy</td>
<td>6</td>
<td>4.133</td>
<td>4.133</td>
<td>1</td>
<td>4.133</td>
<td>4.133</td>
<td>1</td>
<td>4.133</td>
<td>6</td>
<td>4.133</td>
<td>4.133</td>
</tr>
</tbody>
</table>

Source: Author's calculation based on AK&M List (2002).

As of August 2002.

As of 1/1/2001.

A total of 1,336 companies are composed of 1,335 open joint-stock companies and 1 workers' joint-stock company (people's enterprise).

a As of 1/1/2002.

b As of 2001/2002.

c As of August 2002.

Source: Author's calculation based on AK&M List (2002).
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Table 4. Employees of 1,336 Industrial Joint-stock Companies by Sector

<table>
<thead>
<tr>
<th></th>
<th>Official statistics, 2001</th>
<th>1,336 industrial enterprises</th>
<th>Size of sample (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industry, total</td>
<td>13,282</td>
<td>4,539</td>
<td>34.2</td>
</tr>
<tr>
<td>Electric energy</td>
<td>942</td>
<td>566</td>
<td>60.0</td>
</tr>
<tr>
<td>Fuel</td>
<td>806</td>
<td>539</td>
<td>66.9</td>
</tr>
<tr>
<td>Steel</td>
<td>727</td>
<td>402</td>
<td>55.4</td>
</tr>
<tr>
<td>Non-ferrous metallurgy</td>
<td>582</td>
<td>355</td>
<td>61.0</td>
</tr>
<tr>
<td>Chemical &amp; petrochemical</td>
<td>877</td>
<td>487</td>
<td>55.5</td>
</tr>
<tr>
<td>Mechanical engineering &amp; metal-working</td>
<td>4,685</td>
<td>1,461</td>
<td>31.2</td>
</tr>
<tr>
<td>Wood, wood-working &amp; paper</td>
<td>1,054</td>
<td>181</td>
<td>17.2</td>
</tr>
<tr>
<td>Construction material</td>
<td>677</td>
<td>170</td>
<td>25.2</td>
</tr>
<tr>
<td>Light industry</td>
<td>814</td>
<td>225</td>
<td>27.6</td>
</tr>
<tr>
<td>Food industry</td>
<td>1,492</td>
<td>167</td>
<td>11.2</td>
</tr>
</tbody>
</table>

Source: Author’s calculation based on table 3 and Goskomstat RF (2002c, pp. 115-118).

(Table 5 is shown on next page.)


<table>
<thead>
<tr>
<th></th>
<th>1995</th>
<th>1997</th>
<th>1999</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insiders, total</td>
<td>54</td>
<td>52</td>
<td>50</td>
<td>50</td>
</tr>
<tr>
<td>Managers</td>
<td>11</td>
<td>15</td>
<td>15</td>
<td>19</td>
</tr>
<tr>
<td>Workers</td>
<td>43</td>
<td>37</td>
<td>34</td>
<td>28</td>
</tr>
<tr>
<td>Affiliated firms</td>
<td>-</td>
<td>-</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Outsiders, total</td>
<td>37</td>
<td>42</td>
<td>42</td>
<td>42</td>
</tr>
<tr>
<td>Outside individuals</td>
<td>11</td>
<td>15</td>
<td>20</td>
<td>22</td>
</tr>
<tr>
<td>Other enterprises</td>
<td>16</td>
<td>16</td>
<td>13</td>
<td>12</td>
</tr>
<tr>
<td>Commercial banks</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Investment funds</td>
<td>4</td>
<td>4</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Holding companies</td>
<td>4</td>
<td>4</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>Foreign investors</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>The state</td>
<td>9</td>
<td>7</td>
<td>7</td>
<td>7</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>No. of enterprises</td>
<td>136</td>
<td>135</td>
<td>156</td>
<td>154</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Number of Shareholders</th>
<th>50,000 persons or more</th>
<th>10,000 persons or more but fewer than 50,000 persons</th>
<th>50 persons or more but fewer than 10,000 persons</th>
<th>50 persons or more but fewer than 1,000 persons</th>
<th>50 persons or more but fewer than 50 persons</th>
<th>Less than 50 persons</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Control committee)</td>
<td>〇</td>
<td>▽</td>
<td>▽</td>
<td>▽</td>
<td>▽</td>
<td>▽</td>
</tr>
<tr>
<td>Supervisory Board</td>
<td>〇</td>
<td>▽</td>
<td>▽</td>
<td>▽</td>
<td>▽</td>
<td>▽</td>
</tr>
<tr>
<td>Single executive organ</td>
<td>〇</td>
<td>▽</td>
<td>▽</td>
<td>▽</td>
<td>▽</td>
<td>▽</td>
</tr>
<tr>
<td>Audit committee (Auditor)</td>
<td>〇</td>
<td>▽</td>
<td>▽</td>
<td>▽</td>
<td>▽</td>
<td>▽</td>
</tr>
</tbody>
</table>

Table 5. Variations of Organizational Form and Corporate Bodies of Joint-stock Companies

Source: Prepared by the author.

The symbols in this table mean as follows: - companies are required to set up an appropriate organ; ▽ - companies may set up or not set up an organ; ◯ - companies are not expected to set up an organ.

Closed joint-stock companies which were established prior to the enactment of the Law on Joint-stock Companies and have over 50 holders of voting shares are subject to the same provisions for management and supervision as open joint-stock companies.

The numbers in parentheses are the minimum numbers specified by Article 66 (3) of the Law on Joint-stock Companies.
Figure 2. Interrelationships between Corporate Bodies of Joint-stock Companies

- Chairman of board of directors
- Board of directors (Supervisory board)
- Single executive organ (General manager)
- Collective executive organ (Management/Administration division)
- General shareholders’ meeting
- Audit committee (Auditor)

a The case with the board of directors and collective executive organ.
b The members of executive organs shall be elected by the general shareholders’ meeting or the board of directors in accordance with the articles of incorporation (Law on JSC Art. 69(3)).

## Table 7. Division of Competence between Corporate Bodies stipulated by the Law on Joint-stock Companies

<table>
<thead>
<tr>
<th>Item of competence</th>
<th>Organ</th>
<th>Organ Item of competence (Applicable article)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amendment of articles following capital increase (Art. 12(2))*, Amendment of articles following capital decrease (Art. 12(3)), Merger (Art. 16(2))†, Absorption (Art. 17(2))†, New division (Art. 18(2))†, Branch offices (Art. 19(2))†, Amendment of articles of articles (Art. 48(1)), Reorganization (Para. 1), Reorganization by acquiring the nominal value of shares (Art. 49(2)), Reorganization of the annual report, balance sheet, and profit and loss report (Para. 7), Election of the board of directors and the early termination of their power (Para. 8), Election of the executive organs and the early termination of their power (Para. 9), Election of the audit committee (auditors) and the early termination of their power (Para. 10), Election of the executive organs and the early termination of their power (Para. 11), Determination of the value of assets involved in investment in kind at new issue of shares (Art. 34(3)), Determination of public subscription price for shares (Art. 36(1)), Determination of public subscription price for securities (Art. 38(1)), Proposal to the general shareholders' meeting on matters under Article 48(1), paras. 2, 6, &amp; 14 to 19 (Art. 49(3)), Selection of items on the agenda of the general shareholders' meeting (Art. 53(3)), Nominations of candidates for corporate organs (Art. 53(7)), General leadership in corporate management except for exclusive competence of the general shareholders' meeting (Art. 65(1), para. 1), Determination of price for assets and the early termination of their power (Art. 66(1)), Recommendation to the general shareholders' meeting on remuneration of the audit committee (auditors) members and the external auditor (Art. 69(1)), Recommendation to the general shareholders' meeting on dividend and way of allocation (Art. 71(1)), Utilization of proceeds from the sale of shares and securities (Art. 73(1)), Determination of the board of directors (Supervisory board)</td>
<td>General shareholders' meeting</td>
<td>Board of Directors (Supervisory board)</td>
</tr>
</tbody>
</table>

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**Amendment of articles following capital increase (Art. 12(2))**, **Amendment of articles following capital decrease (Art. 12(3))**, **Merger (Art. 16(2))**, **Absorption (Art. 17(2))**, **New division (Art. 18(2))**, **Branch offices (Art. 19(2))**, **Proposal on merger-related matters to the general shareholders' meeting (Art. 16(2))**, **Proposal on relevant matters to the general shareholders' meeting when absorbing any other companies (Art. 17(2))**, **Proposal on new-division-related matters to the general shareholders' meeting (Art. 18(2))**, **Proposal on branch-related matters to the general shareholders' meeting (Art. 19(2))**, **Proposal to the general shareholders' meeting on matters related to reorganization into limited liability company or production cooperative (Art. 20(2))**, **Proposal to the general shareholders' meeting on matters related to liquidation and appointment of the liquidation committee (Art. 21(2))**, **Proposal on matters under Article 48(1), paras. 2, 6, & 14 to 19 (Art. 49(3))**, **Selection of items on the agenda of the general shareholders' meeting (Art. 53(3))**, **Nominations of candidates for corporate organs (Art. 53(7))**, **General leadership in corporate management except for exclusive competence of the general shareholders' meeting (Art. 65(1), para. 1)**, **Determination of price for assets and the early termination of their power (Art. 66(1))**, **Recommendation to the general shareholders' meeting on remuneration of the audit committee (auditors) members and the external auditor (Art. 69(1))**, **Recommendation to the general shareholders' meeting on dividend and way of allocation (Art. 71(1))**, **Utilization of proceeds from the sale of shares and securities (Art. 73(1))**, **Determination of the board of directors (Supervisory board)**.
| Board of Directors (Supervisory board) | reserve funds and other funds (Para. 12), Approval of internal documents (Para. 13), Establishment of branches and affiliates (Para. 14), Approval of major transactions (Para. 15)*, Approval of transactions with interested parties (Para. 16)*, Approval of the roster administrator and conclusion/cancellation of contract with them (Para. 17), Election of the chairman of the board of directors (Art. 67(1)), Proposal to the general shareholders' meeting on external entrustment of authority of the single executive organ (Art. 69(1)), Signature of contract with executive officers (Art. 69(3)), Permission for executive officers to work for other companies concurrently (Art. 69(3)), Election of the extraordinary single executive organ and convocation of the extraordinary shareholders' meeting for election of the single executive organ (Art. 69(4)), Election of the extraordinary collective executive organ and convocation of the extraordinary shareholders' meeting for election of the collective executive organ (Art. 70(2)), Request for audit of financial and managerial activities (Art. 85(3))**, Prior approval of annual report (Art. 88(4)) |
| Executive Organ | Matters related to leadership in daily corporate management except for exclusive competence of the general shareholders' meeting and the board of directors (Art. 69(2)), Organization of the collective executive organ's meeting by the single executive organ (Art. 70(2)), Signature of documents resolved by the collective executive organ and the minutes of the collective executive organ's meeting by the single executive organ (Art. 70(2)) |

*a The items of competence are not strictly and completely translated from the Law on Joint-stock Companies.

b The symbols denote as follows: † - subject of resolution of the general shareholders' meeting to be adapted by a qualified majority; * - competence which may be delegated to the board of directors if the general shareholders' meeting resolves so, or the articles of incorporation specify so; and ** - matters under the competence of the general shareholders' meeting shared with the board of directors.

## Table 8. Performance of 150 Largest Audit Groups in Russia, 2000

<table>
<thead>
<tr>
<th>Rank</th>
<th>Group Name</th>
<th>Location</th>
<th>Gross sales ('000 rubles)</th>
<th>Sales increase (a)</th>
<th>No. of consultants</th>
<th>Share (%)</th>
<th>Locations of head offices</th>
<th>Cross sections</th>
<th>Business services</th>
<th>Location</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>PricewaterhouseCoopers Moscow</td>
<td>Moscow</td>
<td>2,652,826</td>
<td>18.8</td>
<td>708.0</td>
<td>47.3</td>
<td>Moscow</td>
<td>47.3</td>
<td>Business services</td>
<td>Moscow</td>
</tr>
<tr>
<td>2</td>
<td>Deloitte &amp; Touche CIS Moscow</td>
<td>St. Petersburg</td>
<td>843,000</td>
<td>36.8</td>
<td>250.0</td>
<td>11.3</td>
<td>Moscow</td>
<td>11.3</td>
<td>Business services</td>
<td>St. Petersburg</td>
</tr>
<tr>
<td>3</td>
<td>IUnikon/MS Moscow</td>
<td>Novosibirsk</td>
<td>360,105</td>
<td>49.5</td>
<td>420.0</td>
<td>3.3</td>
<td>Novosibirsk</td>
<td>3.3</td>
<td>Business services</td>
<td>Novosibirsk</td>
</tr>
<tr>
<td>4</td>
<td>FBK (PKF) Moscow</td>
<td>Perm</td>
<td>205,417</td>
<td>48.3</td>
<td>170.0</td>
<td>3.3</td>
<td>Perm</td>
<td>3.3</td>
<td>Business services</td>
<td>Perm</td>
</tr>
<tr>
<td>5</td>
<td>Rosekspertiza Moscow</td>
<td>Ufa</td>
<td>199,234</td>
<td>31.7</td>
<td>246.0</td>
<td>2.7</td>
<td>Ufa</td>
<td>2.7</td>
<td>Business services</td>
<td>Ufa</td>
</tr>
<tr>
<td>6</td>
<td>Top-Audit/Port-Audit Moscow/Tyumen</td>
<td>Kazan</td>
<td>135,933</td>
<td>n/a</td>
<td>157.3</td>
<td>2.7</td>
<td>Kazan</td>
<td>2.7</td>
<td>Business services</td>
<td>Kazan</td>
</tr>
<tr>
<td>7</td>
<td>Gorislavtsev &amp; K. Audit Moscow</td>
<td>Moscow</td>
<td>103,565</td>
<td>147.2</td>
<td>195.0</td>
<td>2.7</td>
<td>Moscow</td>
<td>2.7</td>
<td>Business services</td>
<td>Moscow</td>
</tr>
<tr>
<td>8</td>
<td>Sovremennye Biznes Tekhnologii Moscow</td>
<td>Moscow</td>
<td>99,106</td>
<td>232.7</td>
<td>105.0</td>
<td>2.0</td>
<td>Moscow</td>
<td>2.0</td>
<td>Business services</td>
<td>Moscow</td>
</tr>
<tr>
<td>9</td>
<td>Rusaudit Dornkhof, Evseev &amp; partners Moscow</td>
<td>Moscow</td>
<td>88,754</td>
<td>4.9</td>
<td>80.0</td>
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</tr>
<tr>
<td>10</td>
<td>Chto delat' Konsalt Moscow</td>
<td>Moscov</td>
<td>85,296</td>
<td>n/a</td>
<td>82.1</td>
<td>2.0</td>
<td>Moscow</td>
<td>2.0</td>
<td>Business services</td>
<td>Moscow</td>
</tr>
<tr>
<td>11</td>
<td>Institut problem predprinimatel'stva St. Petersburg</td>
<td>Moscow</td>
<td>84,988</td>
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<td>138.0</td>
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</tr>
<tr>
<td>12</td>
<td>Biznes-Audit Moscow</td>
<td>Moscow</td>
<td>76,316</td>
<td>45.9</td>
<td>144.0</td>
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<td>Moscow</td>
<td>2.0</td>
<td>Business services</td>
<td>Moscow</td>
</tr>
<tr>
<td>13</td>
<td>MKPTSN Moscow</td>
<td>Moscow</td>
<td>74,218</td>
<td>54.2</td>
<td>200.0</td>
<td>2.0</td>
<td>Moscow</td>
<td>2.0</td>
<td>Business services</td>
<td>Moscow</td>
</tr>
<tr>
<td>14</td>
<td>BDO Rufaudit Moscow</td>
<td>Moscow</td>
<td>67,160</td>
<td>2.9</td>
<td>237.0</td>
<td>2.0</td>
<td>Moscow</td>
<td>2.0</td>
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<tr>
<td>15</td>
<td>Marka Audit Moscow</td>
<td>Moscow</td>
<td>66,819</td>
<td>207.6</td>
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<tr>
<td>16</td>
<td>Moores Rowland International CIS St. Petersburg</td>
<td>Moscow</td>
<td>65,232</td>
<td>n/a</td>
<td>191.7</td>
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<td>2.0</td>
<td>Business services</td>
<td>St. Petersburg</td>
</tr>
<tr>
<td>17</td>
<td>Aval' Moscow</td>
<td>Moscow</td>
<td>63,764</td>
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<td>Moscow</td>
</tr>
<tr>
<td>18</td>
<td>PAKK-Univers-Audit Moscow</td>
<td>Moscow</td>
<td>61,927</td>
<td>n/a</td>
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<tr>
<td>19</td>
<td>Vneshaudit Moscow</td>
<td>Moscow</td>
<td>57,097</td>
<td>13.3</td>
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<tr>
<td>20</td>
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<td>Novgorod</td>
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<tr>
<td>21</td>
<td>MKD (PKF)</td>
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<tr>
<td>22</td>
<td>FinEskort Moscow</td>
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<td>45,307</td>
<td>38.0</td>
<td>139.0</td>
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<td>2.0</td>
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<td>Moscow</td>
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<tr>
<td>23</td>
<td>Soiuzaudit Moscow</td>
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<td>41,989</td>
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<td>24</td>
<td>Balt-audit-ekspert St. Petersburg</td>
<td>St. Petersburg</td>
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<tr>
<td>25</td>
<td>Bona Fide Finans Moscow</td>
<td>Moscow</td>
<td>38,259</td>
<td>122.7</td>
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<td>2.0</td>
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</tr>
<tr>
<td>26</td>
<td>Balans Ltd. Moscow</td>
<td>Moscow</td>
<td>35,644</td>
<td>37.4</td>
<td>152.0</td>
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<td>Moscow</td>
<td>2.0</td>
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<td>Moscow</td>
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<tr>
<td>27</td>
<td>EKFI Moscow</td>
<td>Moscow</td>
<td>35,352</td>
<td>45.7</td>
<td>165.7</td>
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<td>2.0</td>
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<td>Moscow</td>
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<tr>
<td>28</td>
<td>ARNI Moscow</td>
<td>Moscow</td>
<td>34,578</td>
<td>-16.0</td>
<td>51.0</td>
<td>2.0</td>
<td>Moscow</td>
<td>2.0</td>
<td>Business services</td>
<td>Moscow</td>
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<tr>
<td>29</td>
<td>ENPI Konsalt Moscow</td>
<td>Moscow</td>
<td>31,968</td>
<td>49.0</td>
<td>79.0</td>
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<td>Moscow</td>
<td>2.0</td>
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<tr>
<td>30</td>
<td>Natsional'noe agentstvo audita Moscow</td>
<td>Moscow</td>
<td>30,700</td>
<td>104.7</td>
<td>145.0</td>
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<td>Moscow</td>
<td>2.0</td>
<td>Business services</td>
<td>Moscow</td>
</tr>
</tbody>
</table>

(a) Compared with the previous year.

(b) The annual average value.

(c) Including business performances in other CIS countries.


Chapter 1: Accounting services to banks/insurance companies (a) Locations of head offices of top 30 groups and their business performances and number of consultants (b) Breakdown by location

### Chapter 1

#### Accounting services to banks/insurance companies

- Locations of head offices of top 30 groups and their business performances and number of consultants
- Breakdown by location

<table>
<thead>
<tr>
<th>Rank</th>
<th>Group Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>PricewaterhouseCoopers Moscow</td>
</tr>
<tr>
<td>2</td>
<td>Deloitte &amp; Touche CIS Moscow</td>
</tr>
<tr>
<td>3</td>
<td>IUnikon/MS Moscow</td>
</tr>
<tr>
<td>4</td>
<td>FBK (PKF) Moscow</td>
</tr>
<tr>
<td>5</td>
<td>Rosekspertiza Moscow</td>
</tr>
<tr>
<td>6</td>
<td>Top-Audit/Port-Audit Moscow/Tyumen</td>
</tr>
<tr>
<td>7</td>
<td>Gorislavtsev &amp; K. Audit Moscow</td>
</tr>
<tr>
<td>8</td>
<td>Sovremennye Biznes Tekhnologii</td>
</tr>
<tr>
<td>9</td>
<td>Rusaudit Dornkhof, Evseev &amp; partners Moscow</td>
</tr>
<tr>
<td>10</td>
<td>Chto delat' Konsalt Moscow</td>
</tr>
<tr>
<td>11</td>
<td>Institut problem predprinimatel'stva</td>
</tr>
<tr>
<td>12</td>
<td>Biznes-Audit Moscow</td>
</tr>
<tr>
<td>13</td>
<td>MKPTSN Moscow</td>
</tr>
<tr>
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<td>BDO Rufaudit Moscow</td>
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<td>15</td>
<td>Marka Audit Moscow</td>
</tr>
<tr>
<td>16</td>
<td>Moores Rowland International CIS</td>
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<td>PAKK-Univers-Audit Moscow</td>
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<td>Vneshaudit Moscow</td>
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<td>Soiuzaudit Moscow</td>
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<tr>
<td>24</td>
<td>Balt-audit-ekspert St. Petersburg</td>
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<td>Bona Fide Finans Moscow</td>
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<tr>
<td>27</td>
<td>EKFI Moscow</td>
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<td>ARNI Moscow</td>
</tr>
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<td>29</td>
<td>ENPI Konsalt Moscow</td>
</tr>
<tr>
<td>30</td>
<td>Natsional'noe agentstvo audita Moscow</td>
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<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
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<th></th>
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</thead>
<tbody>
<tr>
<td>Number of open joint-stock companies</td>
<td>13,547</td>
<td>9,814</td>
<td>2,816</td>
<td>1,123</td>
<td>496</td>
<td>360</td>
<td>258</td>
<td>199</td>
<td>125</td>
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<tr>
<td></td>
<td>(3,979)</td>
<td>(1,054)</td>
<td>(412)</td>
<td>(176)</td>
<td>(109)</td>
<td>(68)</td>
<td>(50)</td>
<td>(34)</td>
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<tr>
<td>Former federal-owned enterprises</td>
<td>5,419</td>
<td>4,921</td>
<td>1,326</td>
<td>538</td>
<td>180</td>
<td>101</td>
<td>31</td>
<td>36</td>
<td>11</td>
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<tr>
<td>Former federal-region-owned enterprises</td>
<td>6,028</td>
<td>3,744</td>
<td>859</td>
<td>393</td>
<td>221</td>
<td>178</td>
<td>203</td>
<td>138</td>
<td>93</td>
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<td>Former local-government-owned enterprises</td>
<td>2,100</td>
<td>1,149</td>
<td>631</td>
<td>192</td>
<td>95</td>
<td>81</td>
<td>24</td>
<td>25</td>
<td>21</td>
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<tr>
<td>Enterprises subject to government’s fixed-share ownership and breakdown of shares held</td>
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<td>1,496</td>
<td>698</td>
<td>190</td>
<td>84</td>
<td>142</td>
<td>101</td>
<td>72</td>
<td>59</td>
</tr>
<tr>
<td>Under 15%</td>
<td>-</td>
<td>553</td>
<td>48</td>
<td>9</td>
<td>3</td>
<td>3</td>
<td>0</td>
<td>9</td>
<td>1</td>
</tr>
<tr>
<td>16-25%</td>
<td>-</td>
<td>158</td>
<td>223</td>
<td>63</td>
<td>24</td>
<td>33</td>
<td>4</td>
<td>31</td>
<td>31</td>
</tr>
<tr>
<td>26-38%</td>
<td>-</td>
<td>418</td>
<td>189</td>
<td>68</td>
<td>23</td>
<td>38</td>
<td>3</td>
<td>13</td>
<td>3</td>
</tr>
<tr>
<td>39-51%</td>
<td>-</td>
<td>278</td>
<td>196</td>
<td>40</td>
<td>25</td>
<td>15</td>
<td>20</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>50% or more</td>
<td>-</td>
<td>89</td>
<td>42</td>
<td>10</td>
<td>9</td>
<td>53</td>
<td>74</td>
<td>16</td>
<td>21</td>
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<tr>
<td>Companies with special preference (Golden shares)</td>
<td>204</td>
<td>792</td>
<td>429</td>
<td>132</td>
<td>58</td>
<td>28</td>
<td>42</td>
<td>8</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>(107)</td>
<td>(354)</td>
<td>(169)</td>
<td>(44)</td>
<td>(30)</td>
<td>(7)</td>
<td>(19)</td>
<td>(1)</td>
<td>(-)</td>
</tr>
</tbody>
</table>

Note: The numbers in parentheses represent industrial enterprises.

Chapter 1
Chapter 2

Corporate Ownership and Control in the Russian Companies after the Decade of Reforms
- As Reflected by Statistical and Sample Surveys -

Tatiana DOLGOPYATOVA*

2.1 Introduction

Corporate governance issues in Russia were first addressed in the middle 1990’s, after the completion of the voucher privatization. The focus at that time was on domination of employees’ stock ownership and on managers who had enough control to discriminate outside owners (including foreign investors who were shocked by Russian corporate governance habits). The privatization was the result of a political compromise between the government and employees and became the foundation of property redistribution to come.

The economic upraise that followed the 1998 financial crisis triggered another property redistribution and revealed problems in Russian corporations caused by loopholes in corporate legislation and enforcement. It became extremely popular in economic research to look at corporate governance-related issued in the context of the Russian economy in transition and emerging ownership relations (see, for example, Berglof & von Tadden, 2001; * In preparing the paper the author relied on the results of her work in the research projects of the Higher School of Economics, the Bureau of Economic Analysis, and the not-for-profit organization “Projects for Future”. These projects implemented in 1999-2003 were supported by the World Bank, US AID, Moscow Public Scientific Foundation and Regional Think Tanks Partnership Program. The author highly appreciates the contribution made by V. Golikova, B. Kuznetsov, Yu. Simachev, and A. Yakovlev in the course of many years of collaboration in conducting joint empirical research, as well as fruitful discussions and comments. She is also grateful to O. Uvarova for her help in data processing. The organizations and colleagues named above bear no liability for the contents of this paper.
Chapter 2

Black, et.al., 2000; Dolgopyatova, 2001; Dolgopyatova, 2002b; Fox & Heller, 1999; Radygin & Entov, 1999). Starting in the mid 1990’s a number of studies were carried out by the Bureau of Economic Analysis (BEA), the Higher School of Economics (HSE) and other analytical organizations that were specifically focused on corporate ownership and control at enterprises.

The importance of these problems was predefined by their key role in the development of the Russian economy. On the one hand, corporate governance is a tool to protect ownership rights; this is why its quality reflected many institutional gaps in Russian reforms. On the other hand, it is an important characteristic of Russian business that has an impact on its funding, restructuring, and investment capabilities. Corporate governance risks are investment climate indicators.

Theoretically, the main corporate governance problem is related to division of ownership and control in companies and/or incomplete contracts. In practical terms, this problem comes down to establishing a balance of interests among all stakeholders. We adhere to the wider interpretation of the term ‘stakeholders’. It includes not only shareholders and managers but also other financial and non-financial investors. This has something to do with the nature of Russian corporate control. There is no division of ownership and control typical of a number of developed western countries in the Russian economy and there will hardly be any in the foreseeable future. Besides, regional and local authorities (and sometimes the employees and suppliers) have a strong impact on companies.

The purpose of this paper is to analyze trends in the development of stock ownership and its impact on the formation of corporate control on the micro level taking into account different motivations of corporate governance agents. The conclusions present a model of concentrated insider ownership and corporate control in Russian companies after a decade of intensive transformation of ownership relations. This paper is mostly based on empirical data. The information was taken from the following sources: official statistical data and data from other governmental agencies, surveys of enterprises carried out in 1999-2003 by independent analytical organizations including those surveys where the author was personally involved. Well-known formalized industrial surveys were analyzed; when possible, comparative analysis was performed on the data.

The paper starts with an overview of processes of formation of joint-stock businesses in Russia and with a brief description of statistical monitoring of those processes. The next part identifies trends in redistribution of corporate ownership and control (stock capital structure, composition of the board of directors) in industry as well as the drivers, mechanisms and institutional conditions for those changes. Based on this analysis we define
Chapter 2

qualitative characteristics of stock ownership and corporate governance in contemporary Russia. The final part of the paper contains the main conclusions.

2.2 Emergence of Corporations in Russia: An Overview

2.2.1 Sources of Joint-stock Companies Formation

The problem of balancing the interests of corporate governance agents arises when we look at stock ownership (instead of individual private property). This problem is considered in the context of special legal regulation of corporate relations. The foundation of the corresponding legislation was created when Section 1 of the RF Civil Code (passed in October 1994, effected starting from 1995) and the Federal Law on Joint-Stock Companies (№ 208-FZ of December 26, 1995) were adopted. This law was amended in 1996 and 1999 and was significantly modified in 2001 (the new version of the law was effected starting from 2002), then minor changes were made in 2002 and 2003. Corporate relations are also regulated by security markets legislation, privatization legislation and other rules and regulations. Experts can count up to 1,500 laws and regulations defined corporate governance rules and norms in Russia.

Under Russian legislation, there are two main types of joint-stock companies (JSCs) in the Russian economy – open JSC and closed JSC. The main difference of close JSC is a ban on free circulation of shares. A special type of joint-stock company is the so-called employees’ close JSC, or people’s enterprise. This type became possible when the Federal Law on the Legal Status of Employees’ Joint-Stock Companies (№ 115-FZ of July 19, 1998) was passed. Substantial restrictions apply to the circulation of shares of people’s enterprises. For instance, one employee can not have more than 5% of the shares. Some experts consider joint-stock companies of this type as a positive development of internal corporate relations, a desirable way of privatization, and a barrier against criminal takeovers (Rudyk et.al., 2001, pp.26-27; Zimina, 2002, p. 92). Others (including us) believe it is as a way of protecting themselves from outside investors and securing management control. In practice there are few people’s enterprises and they remain, as it was pointed out in (Dolgopyatova, 2002b, p.41), a special politically motivated legal case.

The main source of JSCs establishment in the Russian transitional economy was the mass (voucher) privatization aimed to create open companies. It created preconditions for stock ownership and predefined property redistribution and corporate control patterns in Russian enterprises (and, therefore, the national corporate governance model) for many years.
Many papers by Russian and foreign experts analyze this influence (Black et al., 1999; Dolgopyatova, 2002a; Woodruff, 2003).

Along with the privatization, which since the mid 1990’s has been carried out through the case-by-case sale of enterprises, there were other processes to generate corporations:

- Creation of start-ups in the form of joint-stock companies, and closed JSCs prevailing in this case;

- Reorganization of privatized and private enterprises (mergers and takeovers, split-ups, etc.) that generates and eliminates corporations.

We should stress that the government is actually pursuing a policy of nationalizing some of the enterprises. This process can take various forms: revision by court of some privatization transactions made with violations; revision by court of the results of investment tenders if their requirements are not met; debt restructuring by returning stocks to governmental or municipal bodies; transfer of the government’s shares to state-run holdings; mergers and acquisitions that increase the government’s participation in the new company. The last two methods are widely used to restore the manageability of joint-stock companies in the defense industry.

Other approaches include increasing the government’s participation in a JSC in exchange for budget investments; changing the authorized capital structure by evaluating intellectual property owned by the government; creation of new JSCs with federal, regional or municipal participation. Quantitative assessments of these processes do not exist.

Russia still retains a substantial number of JSCs with state (Russian Federation or Federation constituents) or local participation. In many companies the state holds 100% capital or controlling block of shares. And the “golden share” exclusive right (in Russian Federation property only) gives the rights of veto for strategic decisions.

The exact number of facilities fully or partially owned by federal, regional or municipal authorities is not known. Since 2000, the Russian Federation Ministry of Property Relations has been working on a Federal Property Register and this document is being continuously updated. Registry data as of the beginning of 2003 show 9,846 federal unitary enterprises and 4,222 JSCs with federal participation. These JSCs have less than a blocking stock. Regional administrations and municipal authorities own an order of magnitude more shares than the federal authorities.

2.2.2 Features of Statistical Monitoring

Not all processes related to the establishment of the corporate sector can be quantified because of the existing statistical monitoring practices (see Box 2.1). Privatization monitoring processes are the most well-developed. Statistical data show (Goskomstat, 2002b, pp. 333, 337; Goskomstat, 2003a, pp. 133-135), see also (Iwasaki, 2003, table 9)), that there was a dramatic decline in privatization activity after 1995, especially in industry. At the beginning of 2000s one facility out of 15 privatized was industrial one. During the mass privatization this ratio was 1 to 4. During the privatization in 1992- the first half of 2003, about 141,500 enterprises changed the ownership type, and over 31,2 open JSCs were created (Goskomstat, 2003b, p.138). In recent years, the number of open JSCs created every year has not exceeded 200. Almost half of them are established as partially owned by federal, regional or municipal authorities.

Box 2.1 Statistical Monitoring of Institutional Reform and Property Relations

Goskomstat RF collects and publishes data on privatization in the economy in general and in industry in particular, as well as on the government’s participation in the newly created JSCs. This data, however, are linked to specific years and do not take into account subsequent reorganizations including the sale of the government’s stocks.

New legal entities are registered in the Unified State Registry of Enterprises and Organizations. Information published on a regular basis includes the total number of enterprises and organizations in the Registry broken down by industries, ownership types and legal forms. The Registry, however, is not accurate. It contains information as on the date of registration of the company with state statistics authorities and does not take into account reorganizations except for formal liquidation. The Registry contains quite a few “dead souls” (reaching by different estimates up to 50%) and this number is growing every year. It is well-known that there are many non-functioning firms in the Russian economy. Some stopped their operations and do not want to go through expensive liquidation procedures; others were originally created as ‘one-day’ companies to perform several transactions (mainly to help legitimate companies with tax evasion).

In addition to the Registry, the number of companies operating in different industries is estimated on an annual basis when the collected statistical reporting forms are processed. Complete
censuses of enterprises and organizations provide similar estimates. However, these are conducted very rarely.

Statistical publications normally provide data for the economy as a whole and for the main sectors of the economy broken down by ownership types. Although statistical reporting forms contain information on the legal form of the enterprise, the structure of indicators broken down by legal forms is not calculated or published at the moment (“statistical development of these indicators is not carried out”).

When we look at indicators broken down by main types of ownership we identify, according to statistical classification, state, municipal, private, mixed, and some other types. Obviously, corporations can be both of private and mixed types, and some of them can even belong to the public sector (e.g. JSCs with 100% state ownership). The private and mixed types of ownership can include both joint-stock companies and other organizational forms.

The Unified State Registry data for 1993-2003 (Goskomstat, 2002b, p. 311; Goskomstat, 2003a, p. 130) show that new enterprises and organizations are often created but rarely liquidated. In the economy as a whole, the number of enterprises adjusted to the registered liquidation rate has been growing at approximately 7-8% per annum (4-5% per annum in industry). If we compare the Registry data and the number of existing (reporting) enterprises we will see that less than 45% of registered enterprises are operational in industry, approximately 40% in construction, and only 25% in retail and catering. This should be kept in mind when evaluating the accuracy of the Registry data on JSCs. As of the beginning of 1996 the number of JSCs was over 51,000; by January 01, 2001 it was already 429,600; and as of January 01, 2003 it reached 445,600. The latest Registry data, as of July 01, 2003, is 450,700 JSCs (Goskomstat, 2003b, p.135). By our estimates the number of operating JSCs in the economy does not exceed 250,000, most of them being closed companies.

The Federal Commission for the Securities Market (FCSM) registers new stock issues and new joint-stock companies. However, the Commission does not have comprehensive information on JSCs created before 1995 and does not publish consolidated data on the total amount of share issuers in Russia. Intensive reorganizations of companies make it difficult to estimate the number of working corporations accurately.

Because of the statistical monitoring features we can only use the available data to illustrate the relation between the main types of ownership in the economy and in different industries. In the total number of enterprises and organizations registered, enterprises of the
private and mixed types accounted for about 90% in July of 2003 (Goskomstat, 2003b, p. 135).

Table 1 shows the share of enterprises of different ownership types in the amount of reporting industrial enterprises, output and number of employees. The share of private and mixed ownership types reached ¾ in total output in 2001. The share of these ownership types in total volume of construction works exceeded 87%. Non-state ownership types accounted for 96% of total sales in retail and for almost 98% in wholesale in 2001 (Goskomstat, 2002b, pp. 349, 442, 484, 494). In the investment process the center of gravity is also moving the non-state sector (Table 2). More and more investments to the fixed assets are made by private and mixed enterprises and the share of private enterprises in total investments has almost tripled since 1995.

We only have at our disposal outdated results of a one-time survey of JSCs created during privatization. The survey conducted by Goskomstat as of January 1, 1996 covered more than 23,000 JSC out of 26,000. At the time, those JSCs had over one fifth of the employed population, while in industry the figure was 62%. JSCs accounted for nearly three fourths of the total industrial output, half of construction works, 26% of the transport sector, and less than 5% in trade and catering (Alimova et al., 1997, pp. 66-67, 70).

Thus, statistical data shows that private and mixed ownership (both Russian and foreign) in the main sectors accounts for up to 90% of the production, works and services volume. Joint-stock companies dominate industry and construction, while enterprises of other legal forms play the major part in the trade and service sector.

2.3 Evolution of Corporate Ownership as the Basis for Corporate Control

2.3.1 Main Trends of Property Redistribution

Large-scale privatization has given birth to a great number of corporations, primarily in the form of open, i.e. formally public companies. Upon its completion in the mid-90’s corporate property in Russia was characterized by the following basic features:

- Concentration of the major property volume in the hands of the employees. If immediately after privatization labor teams could dispose of up to 60-70% of shares, just 12-18 months later their aggregate share was reduced to half of the stock capital;

- Highly scattered property among the major holders (employees, buyers of shares at voucher auctions);
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- Large number of share packages retained by federal, regional and municipal authorities, as well as “semi-governmental” structures (industry concerns, associations).

In one of the first surveys of the corporate property in the Russian industry held in 1995, which covered 299 JSCs (Dolgopyatova, 1995, p. 22), all employees had more than 52% of shares, former employees held 11%, and the authorities and industry associations – nearly 13%. Thus, less than a quarter of the stock capital belonged to outside private owners.

Incentives for corporate property redistribution processes were underway in Russia for more than ten years:

- Reduced role of authorities of all levels as a result of privatization;
- Growing share of the management in the enterprise equity on the background of substantial reduction of the share of all employees;
- Growing share of external non-state owners, mainly due to stronger weight of legal entities. In particular, property became mutual on the basis of horizontal and vertical integration or emergence of conglomerates. Successful Russian exporters acquired large share packages;
- Substantially larger stock capital concentration by separate shareholders (consolidated groups).

The economic growth period that followed the 1998 crisis was characterized by stronger property redistribution and concentration processes. In many cases ownership was transferred from company managers to outside private business. Capital consolidation processes continued on the basis of private business expansion in the Russian economy (Deryabina, 2001; Dynkin & Sokolov, 2002; Pappe, 2002a, 2002b). Powerful private business groups took shape, among which not only national “oligarch” groups that are the soapbox of the mass media, but also regional and local formations.

The dispersed employee property becomes a thing of the past, and its place is taken by highly concentrated corporate ownership of enterprises’ managers or outside investors representing private business. The status of the dominating owner turns an outside shareholder into an “insider”, for such an owner takes a direct part in management or exercises tough control over the managers it appoints.

The results of the governmental and independent surveys of the industry may serve to illustrate these trends. In fact, distortions are characteristic of any formalized survey, the results of which depend on how representative the sample is. Later we will see that empirical data illustrate very well the reduction of employee and state property as well as capital concentration, and, indirectly, the role of integration. The most difficult thing is to identify the results of capital consolidation by companies’ managers.
2.3.2 Property Redistribution: Empirical Evidence

The most representative study is the Goskomstat structural survey that is conducted annually (since 1998) at about 27,000 large and medium industrial enterprises. This survey is the only official source allowing for observation of distribution of the industrial enterprises’ authorized stock. Unfortunately, the results of the surveys are published with a considerable delay. Available survey results (Table 3) relate not only to JSCs, but also to other businesses. The structure of the authorized capital may be calculated using its size as “a weight”, so on the average it characterizes larger objects. The two-year dynamics identifies reduced participation of the authorities of all levels and individuals in the background of a growing share of non-financial commercial organizations. Their growing share indirectly confirms greater property intertwining among organizations.

The data of a structural survey of a small subsample (243 JSCs) was used for more accurate and detailed calculations (the average share was defined by summing up the shares by each enterprise). Enterprise employees prevail in the authorized capital structure of these JSCs (Table 4) followed by commercial non-financial organizations (2nd place) and outside individual investors (3rd place). The authorities of all levels accounted for less than 9% of the authorized capital stock.

If we calculate the average share of every type of shareholders only by those JSCs where it is represented as one of the owners, it will indirectly characterize the degree of capital concentration. Although employee shareholders form the most frequently encountered category, their share of the capital hardly reaches 50 percent. Outside individuals and non-financial organizations have won the leading positions among private investors, while the authorities of the members of the Federation dominate among the state owners. The average share of such shareholders in the authorized stock has exceeded 50 percent. Financial institutions are the least represented category. Foreign owners are only present at every ninth enterprise of the sampling and own less than 43% of the authorized stock.

Outside private owners were represented in 78% of the sample and had on the average more than 67% of the authorized stock. Authorities with 46% of the authorized stock were

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2 The results received in the HSE project “Structural Changes in the Russian Industry” have been partially analyzed in (Dolgopyatova, 2003). In the framework of the project statistical data were collected (over 1,200 enterprises) and a formalized survey was conducted at about 500 enterprises of the sample (including nearly 350 JSCs).
present in 19% of the sample. Outside private owners were predominant at 55% of the JSCs, whereas employees dominated at 36% and the authorities at the remaining 9% of the sample.3

Another representative official source is a quarterly survey of 750-850 industrial enterprises conducted by the Center for Economic Conjuncture (CEC) under the RF Government. In the first quarter of 2000-2002 information was collected regarding shareholder capital (with about 400-500 respondents interviewed on property matters). The survey results are published as a percentage of the total number of enterprises surveyed (all legal forms) and record capital distribution in the interval scale. The data show what part of the sample a certain shareholder group is represented in and where it dominates (i.e. owns more than 50% of the shares). Thus, in 2002 ordinary employees were shareholders of 60% of the sampled enterprises, the enterprise management – of 45%, and the state – of 24% (TsEK, vypusk 37, 2002, p.10). Dynamics (Table 5) shows a falling share of companies with the state or the employees among the shareholders, and, correspondingly, a growing share of enterprises with outside owners. The specific weight of the enterprises with a predominant role of external shareholders or the management was increasing considerably due to enterprises with the working team or the state dominating.

Now we are getting down to discussing independent surveys on ownership issues. After the 1998 crisis such surveys were conducted by the HSE in 1999, 2001 and 2002 with the participation of the author; the BEA in 2000; Russian Economic Barometer (REB) every two years starting from 1995; the Institute for Economy in Transition (IET) at the end of 1999 and at the beginning of 2003; the Institute for Social and Economic Problems of the Population (ISEPD) under the Russian Academy of Sciences nearly every year starting from 1995; the Center for Economic and Financial Research and Development (CEFIR) in 2002. The results of these surveys (Table 6) refer to different periods of time. The samples are not always representative, but it does demonstrate the declining share of the state and the ordinary employees in the capital and the growing share of outside owners (non-financial organizations) and the managers. The results received by the ISEPD stand somewhat apart because of the specifics of the sample – only enterprises of the defense industry were surveyed.

The survey results (Table 7) also testify to growing concentration starting from mid-90’s, as well as to the fact that a big part of industrial JSCs have a controlling or “blocking” shareholder. We will give just a few additional empirical proofs of this fact obtained of late.

3 In this case we regarded a group of shareholders owning an interest exceeding the interest of each of the other two groups as the dominating owner.
In particular, it was a survey of 304 open JSCs in different sectors of the economy (of them 127 in industry) conducted by “Projects for the Future” not-for-profit organization with the participation of the author in autumn 2002 in three Russian regions (Golikova et.al, 2003). Over 70% of the respondents (76% in industry) thought that their enterprise already had an owner with the control interest. A joint survey conducted by the CEFIR and the IET in 2002, which covered more than 600 industrial JSCs (Guriev et.al., 2003), showed that the average share of the biggest external shareholder at all companies was about 24% of the equity capital, while that of the company's administration was more than 19%. At those JSCs where these owners were represented the share of the biggest outside owner reached 40%, and the share of the administration was nearly 28%.

Thus, comparison of the corporate ownership structures in 2000’s by statistical and survey data identifies only a minor role of financial and foreign investors. The main owners are legal entities (non-financial enterprises) and employees (in particular managers) of the enterprises. Capital consolidation in the hands of the largest owners that gain control over the companies' business is continuing.

2.3.3 Property Redistribution: Incentives and Institutional Conditions

Corporate ownership was initially created as dispersed property of public companies, and the Russian regulatory base was built as a system of norms and rules oriented at such a structure. But, as was demonstrated above, life changed the course of events, and an internal conflict was born between the norms and rules imposed from “the top” and the motivation of the economic agents (Yakovlev, 2004).

The driver of redistribution is gaining of legitimate corporate control based not only on access to operational management, but also on property concentration in the hands of an owner or stable coalition of owners.

The main motive of shareholders’ striving for property concentration lies in the establishment (for external owners) or retaining (for managers) of control over the business. In a situation of transformation drop and the tax avoidance schemes widely spread in the 90’s property shares did not bring any benefits to the shareholders. Shares had low liquidity, dividends were not paid. It was the management that mainly benefited from control. By acquiring and concentrating their share package, the managers fixed in the long-term perspective their control rights and their status of director as the actual “master” of the business.

For outsides, gaining control was in fact the only way of exercising their property rights. Even with a medium-sized share package they could not overcome the extreme
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opportunism of the managers who controlled cash flows. External shareholders were striving
to increase their interest and replace the company’s management. At first they wanted at least
to participate in shadow schemes (e.g. receive "shadow dividends" together with the
managers) to the detriment of other shareholders. A detailed description of the ways used to
receive profit from property and establish rules of interaction between big shareholders and
managers from mid-90’s is given in (Rozinskii, 2002).

Concentration of control in the hands of the dominating owner encouraged minority
shareholders (and sometimes owners of blocking packages among them) to sell the shares
that gave nothing in terms of control over the enterprise and returns from property. If some
shareholders became controlling owners, others had no other choice but leave the business.

The internal motives of big private business development have recently become
another tangible incentive for further redistribution (mergers and acquisitions). First of all,
the purpose of property and control transformations that big business is engaged in lies in
market shares redistribution (Deryabina, 2001, pp. 55-56). Based on establishing corporate
control over the “necessary facilities”, big business is guided not so much by the need to
control certain enterprises with the purpose of receiving incomes as by the interests of the
whole business, by the logic of its development. For this reason, acquisition of property is
driven, in particular, by emerging of vertical chains for reducing supply (sales) risks, bringing
down the production and transaction costs, and winning a considerable share of the market
(Dolgopyatova, 2002b, pp. 91-94). This driver was especially manifest after the 1998 crisis,
when big integrated business groups became the main acquirers of shares in Russian
industrial enterprises.

There is a whole set of institutional prerequisites underlying the past changes and
features of corporate ownership. First of all, it includes conditions and procedures of large-
scale voucher privatization which formed the corporate ownership institute in Russia,
determined the nature and proportion of the powers of economic agents competing for such
ownership, and granted a number of specific advantages to managers. (Dolgopyatova, 2002c,
pp.7-8; Woodruff, 2003).

The second prerequisite is poor corporate governance. Large-scale expropriation of
shareholders’ interests by company managers (sometimes in coalition with some of the
owners) against the background of impossibility to receive ownership revenues became a
factor of corporate ownership concentration and growth of external owners’ share.

The third prerequisite is mortgage auctions and other actions of the Russian
government facilitating the development of large private business (Pappe, 2002a, pp. 33-34).
Foreign investors were avoiding the Russian market due to many reasons, which are beyond
the scope of this paper. However, a large “local” player emerged, who was ready to participate in ownership acquisition, possessed capital and, most importantly, leverage over the government and certain officials.

An important condition of property redistribution was economic attraction of the enterprise for the potential buyer. The positive role of the 1998 crisis consisted in the fact that it improved the potential performance of many industrial enterprises for external investors. Many enterprises had new prospects of rapid development, especially in case of restructuring and management improvement. It led to more intensive property redistribution and takeover of enterprises by private business which possessed sufficient funds and good management quality according to Russian standards.

If in early and mid-90’s control was mainly formed through inner corporate or privatization deals, after the crisis of 1998 it was external deals to capture control that came to the forefront. The corporate control market operates outside stock markets. Its specific feature lies in absorption of the most successful enterprises. Corporate control is captured (consolidated) through formal change of property rights at the moment of sale and purchase of shares, as well as by bankruptcy and debt restructuring (securitization of debt) procedures.

Since the end of the 90’s stock capital transactions in the interests of big shareholders based on the use of internal corporate governance procedures under their control (resolutions of shareholders’ meetings and boards of directors) have taken a prominent place among property consolidation techniques. A special role belongs to dilution share issues, share consolidation and exchange. The resultant positions of dominating owners have become still stronger, whereas minority shareholders have actually been subjected to expropriation.

Russia has seen a sharp rise in the number of corporate reorganizations, especially mergers and acquisitions. Statistics does not monitor these processes. Legal reorganizations are registered by the Russian Ministry for Antitrust Policy and Business Support and FCSM. The Ministry data (see (IEPP, 2002, p. 90)) show that number of structural transactions in Russian companies was 5,000 in 1997, about 9,000 in 1998, and 16,000 in 2000. The Ministry expects that number of reorganizations will be over 20,000 in 2001. PricewaterhouseCoopers survey of mergers and acquisitions in Central and Eastern Europe (PWC, 2001) showed that by 2001 Russia had turned out a recognized regional leader in the amount (USD 6 billion) and number of publicized (237) non-privatization deals. Big Russian business groups lead the market. The survey was far from covering all such deals, so the correct amount of mergers and acquisitions is much higher – over USD 10 billion a year according to certain estimates.
Judging by empirical data, shares are issued at 3-7% of enterprises annually (such issues are primarily connected with capital consolidation, not investments), bonds – at 2-3%.

The above-mentioned survey of 304 open JSCs in various sectors of economy conducted in autumn 2002 showed that over 37% companies had taken different corporate actions during the past three years. Over 20% of the enterprises issued shares, over 16% redeemed shares from minority shareholders, 7% retired shares, 5% exchanged or consolidated shares, 2% of the surveyed enterprises issued bonds. 4.7% of the respondents said they were trading on the Russian stock market, and 2.0% (6 companies of financial sector and communications) - on the foreign markets.

According to the CEC data (TsEK, vypuski 29, 33, 37, 41, 2000-2003, p. 9), in 2000-2002 7-8% of surveyed enterprises annually issued shares, while bonds were issued only by 1-2%. And 3% had plans for issuing shares in 2003, 1% - for issuing bonds.

2.3.4 Boards of Directors under Concentrated Insider Property

The Board of Directors of a joint-stock company is a collegial body set up by the shareholders’ meeting for making strategic decisions, organization and monitoring of the performance of the JSC executive bodies. The proportion of representatives of different groups of shareholders characterizes the corporate control (power) structure at the enterprise more accurately than formal ownership structures. Quantitative assessment of the boards of directors can be performed only by special data collection. Empirical data in regard to boards of directors were received, with the author’s participation, by the HSE in 1999 and 2002, by the BEA in 2000 (Dolgopyatova, 2001; Dolgopyatova, 2003; Byuro, 2001).

In a current situation of concentrated insider ownership dominance, the formation and activity of the boards of directors in the majority of companies is characterized by the following:

- a tendency for decreasing the number of the board’s members. The trend is limited only by the necessity to comply with the legislative norms for JSCs in which the number of shareholders exceeds 1,000 or 10,000;
- dominance of insiders’ representatives on the board, and the leading role of executive management;
- an important role in control over many JSCs of such stakeholders as work teams, regional and local authorities which often form coalitions with the enterprise management.

Table 8 contains the results of a number of surveys which characterize the “average” structure of the boards of directors of JSCs. The leading role in the board is played by management representatives (from one third to 40% of the members), the second place
belongs to representatives of work teams or principal outside shareholders (15-25% of the members). At present formal ownership structures are dominated by external shareholders, and boards of directors – by enterprise employees.

The most recent data (2002) of the HSE above-mentioned survey (Dolgopyatova, 2003) show that in 1998 the average number of members on the board was 7, and three-four years later – 6.8. Enterprise employees dominate in the ownership structure of almost 36 % of JSCs (see 2.3.2), while in the board they play a predominant role in half of the sample. Managers are large owners or recently appointed by dominating shareholders. In fact, this survey showed a significant negative correlation between the level of property concentration (the share of principal shareholder) and the duration of the general director’s employment. Elections of a under-controlled board are used by owners for replacement and strict control of the executive bodies of the joint-stock company.

For analysis of relative advantages of shareholders in corporate control we may compare the structures of ownership and board of directors. We calculated the representation coefficient determined as the representation share on the board of directors per 1% of the stock capital for each group of shareholders. As a rule, the ratio of the share on the board of directors to the share in the stock capital for all employees exceeds the unity (1.3-1.5), mainly due to corporate managers. For external private owners this ratio is significantly lower (0.6-0.8). It partly reflects limited control possibilities for external minority shareholders. For the authorities this coefficient in general does not exceed 1, mostly due to more active role of regional and local authorities.

In fact, other participants exert certain influence on decision-making in corporations together with principal shareholders and managers. In the opinion of some experts who conducted in-depth interviews in the companies (Dolgopyatova, 2002a, pp. 236-238; Pappe, 2002b, p. 86), the company management considers regional and local authorities and sometimes working teams (usually at large enterprises) to be the most influential forces. Boards of directors at many enterprises include representatives of work collectives (usually medium-level managers or trade union leaders), especially if there are employee shareholders

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4 The coefficient was proposed in the paper (Basargin & Perevalov, 2000, p. 124), where the authors calculated it in regard to 43 JSCs in Sverdlovsk region for 1993-1998.

5 At the same time, respondents may overstate the representation of ordinary employees in the boards of directors and their participation in ownership, and understate the share of managers’ ownership.
in the collective. In some cases these representatives pursue a relatively independent policy, but more often they are closely affiliated with the management.

In the second half of the 90’s a tendency to include representatives of regional or local authorities, who are not shareholders, in the boards of directors became evident. In this way the authorities “add” to administrative regulation and informal relationships some direct (and legitimate) methods of corporate control over the activity of JSCs. This should be taken into account while assessing the activities of the so-called independent directors.

By the way, the above-mentioned survey of 350 JSCs conducted in 2002 by the HSE specifically related to the necessity of coordination of the main decisions of the company’s executive bodies with the participants of corporate management. Naturally, the necessity to coordinate the decisions with the principal owners turned out to be the strongest. Then followed the work collective, partners of the enterprise in joint projects and alliances, regional and/or local authorities. The least necessity of coordination was demonstrated in regard to the federal authorities and banks providing services to the enterprise.

As a result, the board of directors is formed by dominating owners and follows their directions. At the same time, the board is closely related to the executive management (in certain cases to the authorities as well). To a certain extent the activity of the board is becoming a formal organizational responsibility, and actual decisions are taken by a limited number of individuals. In this situation the board’s role as a monitoring mechanism of executive management and protection of shareholders’ rights cannot be implemented.

2.4. Specifics of Ownership and Corporate Governance

Russian corporate ownership today is concentrated insiders’ ownership, including principal external shareholders. In this situation outsiders are minority shareholders, and corporate control is usurped by dominating owners. This type of ownership and control has determined many features of the national corporate governance.

First of all, Russian corporate economy of the last decade was characterized by constant redistribution of property, which was usually accompanied by takeover or stabilization of corporate control. As it is justly indicated in (Ustyuzhanina, 2001, p. 90-92), the ownership institution in Russia is characterized by the state of permanent redistribution. A number of empirical studies (HSE, REB, CEC) state that from the mid 90’s each year the principal owners of 6-8% of industrial enterprises on the average could change. Redistribution processes annually affect up to one sixth of stock capital. In general, transactions are made outside the organized markets.
Another fact of reality is non-transparency (complexity) of the ownership rights, concealment of true owners behind a multi-level chain (5-6 and more levels) of affiliated individuals and companies, offshore firms, nominal holders, as well as multistage company management systems. The number of these levels is not expected to decrease. The exception is only several companies which revealed true shareholders in order to enter the stock markets. This was the result of the general institutional environment of the Russian economy, the use of illegal finances and not always legitimate ways of property acquisition. Today non-transparency of property relations is artificially maintained by the management of many companies as a barrier against possible interference of the state or private businesses – potential “capturers” (Pappe, 2002b, pp. 89-90).

Not only the ownership structure and business organization are non-transparent, but also the results of business activity. Not all open JSCs comply with even formal legislative requirements in regard to publication of their results. The existing accounting practice is oriented at tax authorities’ needs, therefore the quality of joint-stock companies’ reporting remains low and does not provide adequate information to the shareholders, creditors and business partners (Aspisov, 2003, pp. 218-219).

Transition to international financial accounting standards is performed by certain companies which deal with foreign investors or place securities in financial markets. Various surveys show that 8-15% respondents mention the use of such standards. In the survey conducted by the HSE in 2002 less than 10% out of about 500 enterprises stated that they had transferred to these standards. The CEC survey showed that such enterprises made up 8% of the number of participants at the end of 2001 (TsEK, vypusk 31, 2001, p. 10), but a year later they made up already 17% (TsEK, vypusk 36, 2002, p. 12).

As we mentioned above, corporate property did not envisage any dividends. The dominating owner received profits mainly in non-dividend forms. At the same time, in the last two to three years a tendency to pay dividends emerged in a number of large companies, which had consolidated ownership and practically displaced minority shareholders. In this case dividends serve as a legal source of high incomes of the companies’ owners and can be openly used for acquisition of new assets. Large corporations with significant state shares (energy and communication companies) also pay dividends under the influence of the government. At the same time, the majority of open JSCs companies fail to pay dividends or do it irregularly. The above-mentioned survey of 304 open JSCs conducted in autumn 2002 shows that about 60% of the participants did not pay any dividends in 2000-2002. Only one fourth of the participants paid dividends on a regular basis (i.e. every year), and one third of the participants paid dividends twice during these years. The fact of dividend payment
positively correlated with participation of the enterprise in an business group based on property or contractual relations.

An important feature of insider corporate control is protection from new shareholders. The logical consequence is a policy of self-financing of business development or its financing out of the funds of the partners, with which the company often has property or other relations. This statement is confirmed by statistical data and a number of surveys.6

As Goskomstat data show (Table 9), for many years the share of external sources of investments into fixed assets in the economy has not exceeded 50%. It is not so very little, but in the raised capital the money from the budget and off-budget funds prevail. The share of bank credits is still insignificant – less than 5% of investments. A tangible part is formed by loans of other enterprises and partner investments. The share of foreign investments in the economy is about 5-6% (by the way, in 1995-1997 it was only 1%).

In the industry, the share of own sources is considerably higher than in the economy, but it has been constantly on the decline since 1998. The share of all budgets is less than 4%.

The share of stock issue as a source of investments into fixed assets remains at a minimum level – in the last 5-6 years it has not risen over 0.7%. There were no statistical monitoring of the input from corporate bond issues before 2003.7

Surveys of industrial enterprises record a still greater share of own sources than statistics does. This is partially due to the fact that respondents assess not only investments into fixed assets, but also into working capital and non-financial operations. The data of surveys among industrial JSCs held in late 1990’s – early 2000’s (Table 10) shows that the self-financing share equals about 80-90%, while that of external investments is, respectively, 10-20%. Different estimates are made of bank participation in the investment process (from 3 to 11% of investments), as well as of the role of all budgets (1-5%). The share of foreign

6 Statistical data give an idea of the investment structure as regards financing of investments into the fixed assets by all legal forms of enterprises. Surveys show the structure of sources (as different from statistical assessments) by the JSCs sampling and allow for evaluating the frequency with which JSCs use this or that source.

7 In 2002 bond issues were equal to 10.3% of investments into fixed assets (Danilov, 2003). It is not known what part of the issue revenues was channeled into non-financial investments, and what part – into financing mergers and acquisitions and other financial investments. The new data published in (Goskomstat, 2003b, p.148) show that 0.2% of investments into fixed assets due to bond issues in January-June of 2003.
investments and the securities market is always negligible. Partner enterprises usually rate third, although they cover a mere 3-5% of investments.

The overwhelming majority of JSCs – over 90% - use their own assets for investments. In different samples, 10-27% of JSCs reported access to bank credits, and 5-10% of companies – to partner funds.

The CEC survey of the first quarter of 2003 (TsEK, vypusk 41, 2003, p. 9) showed that half of the surveyed enterprises (not only JSCs) used own assets, one fourth – bank credits, while 3 and 2% of enterprises respectively turned to public offering of securities or to closed subscription.

Judging by the results of all the known surveys (see 2.3.3 also), the share of JSCs using the securities markets for investments did not exceed 1% of the investing companies. Nevertheless, one survey covered managers of 100 biggest Russian enterprises and investment companies registered as open JSC (AMR & AZPI, 2001, p.14) and produced different results. It turned out that 91% of such companies used predominantly own funds, while 59% turned to debt financing. Although nearly 80% of respondents said they were interested in raising share investments, only 14% really raised them.

The mentioned evaluations confirm one more specific feature of Russian corporate governance – a very minor role of the stock market in raising investment. The market is not used by the majority of open JSCs for investment financing, and the volume of attracted funds is quite small. The Russian stock market listing includes less than 250 Russian issuers (and shares of only 7-10 companies are liquid). New companies practically do not enter the Russian markets, and there are permanent market leaders (Grigor’ev et.al., 2003, pp.118-120).

According to the FCSM\(^8\) data as of the middle of 2003, shares of approximately 150 joint-stock companies are represented in the Russian market, at New York Stock Exchange – shares of 5 companies (in the form of third-level American Depository Notes), at European exchanges – ADN and GDN of about 40 companies. Eurobonds of 14 companies are circulating in the foreign markets.

The corporate bond market is today the most dynamic sector of the Russian market. In 2002, the nominal volume of their offering exceeded RUR 54 billion (share offering is lower by 140 times), and the total bond offering volume in 1999-2002 exceeded RUR 129.7 billion. The number of bond issuers is estimated as some 100 companies. The purpose of bond loans is to raise investments or to implement certain corporate actions within business

\(^8\) The author is grateful to A.Asipov for provided data.
groups. An additional advantage lies in the company’s acquiring a credit history. (Abramov, 2003, p. 187; Danilov, 2003).

To conclude, we would like to make two comments in regard to the specifics of corporate control for identifying a formal approach to definition of the object of corporate relations – a joint-stock company.

First, many open JSCs which appeared in the course of privatization at present are actually owned by one person (a limited group of persons). They have gradually developed into individual, family business. This mainly concerns small and medium enterprises, though it has also affected larger companies. From the point of view of the nature and objectives of their activity, corporate relationship and management culture they are not corporations. The same is true for joint-stock companies newly created by businessmen, although in this case they prefer to register a company of the closed type.

Secondly, as a result of post-privatization redistribution of property and restructuring of enterprise control, various managing (holding) companies were created in the Russian economy. Usually they are registered as limited liability companies (LLC). Big, often controlling, shareholdings of open and closed JSCs were transferred to them for managing or as property. The same approach was taken by private entrepreneurs who form their business groups, and sometimes by the state when it creates integrated holdings or transfers its shares into trusteeship. In the private sector tight property relationships exist between joint-stock companies and enterprises of other legal forms.

To wind up, we would like to emphasize the fact that the specific features of concentrated property with insider control, including business self-financing, actually transform the majority of existing Russian open JSCs companies into close in fact private companies.

2.5 Concluding Remarks

The prevailing feature of Russian corporate property is concentrated property of insiders, including large external shareholders. Formal dominating owners are company managers and non-financial enterprises, behind which stand the same managers or business groups, finally owners thereof. It can be well-known large oligarch groups, or regional groups founded by private business, often with latent support and participation of regional and municipal administrations.

The prevailing type of corporate control based on concentrated property is control by the dominating owner who takes a direct part in management or strictly controls employed
managers. Separation of ownership from corporate control is a rare case at the Russian companies. But minority shareholders are for the most part kept away from corporate decision-making. Expropriation of minorities' rights determines the core issue of corporate governance in contemporary Russia.

The companies’ boards of directors are characterized by the dominant role of insiders. Executive management, directors and dominating owners often form a consolidated group. They make decisions actually using informal coordination mechanisms. Under such circumstances the self-enforcing model of the Russian corporate law (Iwasaki, 2003) cannot be successfully operate. Moreover, in many aspects the legislation is not consistent with the interests of the main corporate governance agents, and they confine themselves to formal compliance with norms, and even use them in their own interests (Yakovlev, 2004).

The investment policy is aimed at the use of own funds, in certain cases partner (business group) funds are involved. Bank participation in the equity and investment activities of companies is very small. Neither is the stock market an effective control or investment flow tool in the Russian economy. Only few Russian companies really raise investments in the form of debt or share capital in the Russian or foreign markets.

The main property redistribution and corporate control acquisition transactions are going on outside organized markets. Bankruptcy procedures, hostile acquisitions, corporate stock capital manipulations are frequently used methods. The greater part of open JSCs formally belongs to public companies, and is really operating as private enterprises.
Chapter 2

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Yakovlev, A., ‘Corporate governance in Russia: formal rules and real incentives of economic agents,’ in S. Ikemoto & I. Iwasaki (eds.) Corporate Governance in Transition Economies: Part I – The Case of Russia, Institute of Economic Research, Hitotsubashi University, 2004, pp. 73-95. (Chapter 3 of this Book)

### Table 1. Composition of Operating (Reporting) Industrial Enterprises by Forms of Property (%)

<table>
<thead>
<tr>
<th>Forms of property</th>
<th>Number of enterprises at year end</th>
<th>Volume of production</th>
<th>Manufacturing staff</th>
</tr>
</thead>
<tbody>
<tr>
<td>State (Russian Federation and Federation constituents)</td>
<td>4.9</td>
<td>3.1</td>
<td>3.2</td>
</tr>
<tr>
<td>Municipal</td>
<td>2.9</td>
<td>2</td>
<td>2.2</td>
</tr>
<tr>
<td>Public associations/unions</td>
<td>0.9</td>
<td>0.4</td>
<td>0.6</td>
</tr>
<tr>
<td>Private</td>
<td>72.4</td>
<td>88.2</td>
<td>85.6</td>
</tr>
<tr>
<td>Mixed Russian</td>
<td>16.8</td>
<td>5.6</td>
<td>6.6</td>
</tr>
<tr>
<td>Mixed with foreign interest, and foreign</td>
<td>2.1</td>
<td>0.7</td>
<td>1</td>
</tr>
</tbody>
</table>

*Source*: Goskomstat RF (2002a, pp. 49-51).

### Table 2. Composition of Investment in Fixed Assets by Forms of Property (%)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>State (Russian Federation and Federation constituents)</td>
<td>50.8</td>
<td>31.3</td>
<td>22.8</td>
<td>22.1</td>
<td>19.5</td>
</tr>
<tr>
<td>Municipal</td>
<td>12.4</td>
<td>6.3</td>
<td>5.2</td>
<td>4.9</td>
<td>4.5</td>
</tr>
<tr>
<td>Private</td>
<td>12.1</td>
<td>13.4</td>
<td>30.1</td>
<td>36.7</td>
<td>43.9</td>
</tr>
<tr>
<td>Mixed Russian</td>
<td>22.1</td>
<td>46.2</td>
<td>34.9</td>
<td>21.6</td>
<td>18.2</td>
</tr>
<tr>
<td>Joint Russian and foreign, and foreign</td>
<td>2.5</td>
<td>2.7</td>
<td>6.9</td>
<td>14.5</td>
<td>13.7</td>
</tr>
<tr>
<td>Other forms of property</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.3</td>
<td>0.2</td>
</tr>
</tbody>
</table>

Table 3. Breakdown of Stock Capital of Industrial Enterprises at Year End (% of Stock Capital)\(^a\)

<table>
<thead>
<tr>
<th>Shareholders or founders</th>
<th>1999</th>
<th>2001</th>
<th>Change in percent points for 2 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Authorities – total, including:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Federal authorities</td>
<td>10.4</td>
<td>6.6</td>
<td>- 3.8</td>
</tr>
<tr>
<td>- Authorities of Federation constituents</td>
<td>7.3</td>
<td>5.1</td>
<td>- 2.2</td>
</tr>
<tr>
<td>- Local authorities</td>
<td>0.8</td>
<td>1.8</td>
<td>+ 0.9</td>
</tr>
<tr>
<td>Commercial organizations (except credit and financial institutions)</td>
<td>41.6</td>
<td>65.2</td>
<td>+ 23.6</td>
</tr>
<tr>
<td>Credit and financial institutions</td>
<td>3.2</td>
<td>6.1</td>
<td>+ 2.9</td>
</tr>
<tr>
<td>Not-for-profit organizations</td>
<td>4.3</td>
<td>1.8</td>
<td>- 2.5</td>
</tr>
<tr>
<td>Individuals</td>
<td>20.1</td>
<td>13.4</td>
<td>- 6.7</td>
</tr>
<tr>
<td>including staff</td>
<td>10.3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>For reference: contributions by foreign legal entities and individuals (^c)</td>
<td>6.6 (40.3)</td>
<td>10.0 (47.2)</td>
<td>+3.3 (+6.9)</td>
</tr>
</tbody>
</table>

\(^a\) Without small enterprises, includes JSCs and other legal forms (for example limited liability companies).
\(^b\) Data provided from Goskomstat RF to HSE.
\(^c\) In brackets, only by enterprises with foreign interest.

Source: Author’s calculations based on Goskomstat RF (2002a, pp. 81, 98-99) and Goskomstat RF (2000, p. 72).
### Table 4. Breakdown of Stock Capital of Industrial JSCs at Year 2001 End (% of Stock Capital)

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Total 243 JSCs</th>
<th>JSCs having this type of shareholder&lt;sup&gt;a&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal authorities</td>
<td>3.3</td>
<td>35.9 (22)</td>
</tr>
<tr>
<td>Authorities of Federation constituents</td>
<td>3.5</td>
<td>52.9 (16)</td>
</tr>
<tr>
<td>Local authorities</td>
<td>1.9</td>
<td>36.6 (13)</td>
</tr>
<tr>
<td>Commercial organizations (except credit and financial institutions)</td>
<td>26.9</td>
<td>50.8 (129)</td>
</tr>
<tr>
<td>Credit and financial institutions</td>
<td>0.8</td>
<td>15.6 (12)</td>
</tr>
<tr>
<td>Not-for-profit organizations</td>
<td>4.2</td>
<td>33.1 (31)</td>
</tr>
<tr>
<td>Individuals</td>
<td>59.4</td>
<td>66.2 (218)</td>
</tr>
<tr>
<td>including staff</td>
<td>38.7</td>
<td>49.3 (190)</td>
</tr>
<tr>
<td>Total JSCs</td>
<td>100</td>
<td>-</td>
</tr>
<tr>
<td>For reference: contributions by foreign legal entities and individuals</td>
<td>4.6</td>
<td>42.9 (26)</td>
</tr>
</tbody>
</table>

<sup>a</sup> In brackets, the number of JSCs having contribution from this shareholder in their stock capitals.

*Source*: Author’s calculations based on Goskomstat RF primary data provided to SU HSE.
### Table 5. Representation of Shareholder Groups in CEC Sampling (% of Totally Surveyed Enterprises)

<table>
<thead>
<tr>
<th>Shareholder groups</th>
<th>Shareholders' representation</th>
<th>Shareholders' domination</th>
</tr>
</thead>
<tbody>
<tr>
<td>State (authorities)</td>
<td>33</td>
<td>24</td>
</tr>
<tr>
<td>Work team</td>
<td>61</td>
<td>54</td>
</tr>
<tr>
<td>Enterprise management</td>
<td>44</td>
<td>40</td>
</tr>
<tr>
<td>External owners</td>
<td>58</td>
<td>59</td>
</tr>
<tr>
<td>Others</td>
<td>6</td>
<td>7</td>
</tr>
</tbody>
</table>

*Source: Author’s calculations based on CEC surveys data (TsEK, 2000, vypusk 29, p.10); (TsEK, 2002, vypusk 37, p.10).*
Table 6. Structure of Equity Capital of Industrial Enterprises according to Independent Survey Data

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>SU HSE-1 a</th>
<th>BEA b</th>
<th>REB c</th>
<th>ISEPD d</th>
</tr>
</thead>
<tbody>
<tr>
<td>% share, end of 1998</td>
<td>Change in percent points</td>
<td>% share, beginning of 2000</td>
<td>Change in percent points</td>
<td>% share, beginning of 2003</td>
</tr>
<tr>
<td>Work team, including:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- managers</td>
<td>40.1</td>
<td>-9.7</td>
<td>52.5</td>
<td>-15.0</td>
</tr>
<tr>
<td>- employees</td>
<td>31.1</td>
<td>-10.9</td>
<td>34.7</td>
<td>-19.9</td>
</tr>
<tr>
<td>State, including:</td>
<td>8.4</td>
<td>-1.3</td>
<td>5.7</td>
<td>-6.6</td>
</tr>
<tr>
<td>- federal level</td>
<td>4.6</td>
<td>-0.5</td>
<td>3.1</td>
<td>-4.5</td>
</tr>
<tr>
<td>- regional and local level</td>
<td>3.8</td>
<td>-0.8</td>
<td>2.6</td>
<td>-2.1</td>
</tr>
<tr>
<td>Outside shareholders, including:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Russian non-financial enterprises</td>
<td>13.9</td>
<td>1.9</td>
<td>15.1</td>
<td>7.1</td>
</tr>
<tr>
<td>- Russian banks, investment companies, funds</td>
<td>13.1</td>
<td>2.5</td>
<td>4.5</td>
<td>2.3</td>
</tr>
<tr>
<td>- foreign shareholders</td>
<td>3.7</td>
<td>1.9</td>
<td>2.9</td>
<td>2.6</td>
</tr>
<tr>
<td>- others (mainly individuals)</td>
<td>20.8</td>
<td>4.7</td>
<td>19.3</td>
<td>9.6</td>
</tr>
</tbody>
</table>

\( \text{SU HSE-1} \) a SU HSE-1, the survey of 318 JSCs in 1999, more than 260 JSCs responded. Change for 3 years: from end of 1995 to end of 1998.

\( \text{BEA} \) b BEA, the survey of 437 enterprises in 2000, over 360 JSCs responded. Change for 5-8 years: from start of privatization till 2000 (BEA, 2001, p. 187).

\( \text{REB} \) c REB, regular enterprises’ surveys, over 110-150 JSCs responded. Change for 8 years: from 1995 to 2003 (Aukutsionek, et. al., 2003, p. 4).


% including 3% - affiliated firms.

\( \text{Of them 21%} \) - state, and \( \text{7%} \) - other state-owned enterprises.

\( \text{Of them 6 percent points are growth of other state-owned enterprises interest, and 1 point of state interest.} \)

Source: Author’s calculations based on surveys primary data or published data. The author appreciates Dr. Boris Kuznetsov provided primary data of BEA survey. His support helped to implement detailed comparative calculations for tables 6-8 and 10.
## Table 7: Industrial Property Concentration in 1995-2003 according to Independent Survey Data

<table>
<thead>
<tr>
<th>Year</th>
<th>SU HSE-1</th>
<th>REB</th>
<th>IET</th>
<th>BEA</th>
<th>SU HSE-2</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995, End of</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1999, End of</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Source: Author's calculations based on surveys primarily of published data.*

Data for share of JSCs with a shareholder having more than 20% of shares.

- End of 1995
- End of 1998
- Start of privatization 2000
- End of 1999
- 02.2001
- End of 2001

Concentration indicators:

- Share of the biggest shareholder, %
- Share of the 3 biggest shareholders, %
- Share of enterprises (JSCs) having a shareholder with interest over 25%
- Share of enterprises (JSCs) having a shareholder with interest over 50%

Change for 3 years: from end of 1995 to end of 1998.

<table>
<thead>
<tr>
<th>Year</th>
<th>SU HSE-1</th>
<th>REB</th>
<th>IET</th>
<th>BEA</th>
<th>SU HSE-2</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995, End of</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1999, End of</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Table 8. Membership of a Board of Directors in Industrial JSCs according to Independent Survey Data

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>SU HSE-1&lt;sup&gt;a&lt;/sup&gt;</th>
<th>BEA&lt;sup&gt;b&lt;/sup&gt;</th>
<th>SU HSE-2&lt;sup&gt;c&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Composition, % of number of members</td>
<td>Indicator of representation&lt;sup&gt;e&lt;/sup&gt;</td>
<td>Composition, % of number of members</td>
</tr>
<tr>
<td>Work team, including:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- managers</td>
<td>57.4</td>
<td>1.43</td>
<td>68.8</td>
</tr>
<tr>
<td>- employees</td>
<td>38.0</td>
<td>4.22</td>
<td>39.2</td>
</tr>
<tr>
<td>State, including:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- federal level</td>
<td>8.9</td>
<td>1.06</td>
<td>5.4</td>
</tr>
<tr>
<td>- regional and local levels</td>
<td>5.7</td>
<td>1.50</td>
<td>2.7</td>
</tr>
<tr>
<td>Outside shareholders, including:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Russian non-financial enterprises</td>
<td>33.7</td>
<td>0.65</td>
<td>25.8</td>
</tr>
<tr>
<td>- Russian banks, investment companies, funds</td>
<td>15.0</td>
<td>1.08</td>
<td>10.8</td>
</tr>
<tr>
<td>- foreign shareholders</td>
<td>11.2</td>
<td>0.85</td>
<td>4.1</td>
</tr>
<tr>
<td>- others (mainly individuals)</td>
<td>2.1</td>
<td>0.57</td>
<td>1.4</td>
</tr>
<tr>
<td>For reference: total average number of members</td>
<td>5.4</td>
<td>0.26</td>
<td>9.5</td>
</tr>
</tbody>
</table>

<sup>a</sup> SU HSE-1, 278 JSCs responded.
<sup>b</sup> SU HSE-2, 289 JSCs responded.
<sup>c</sup> BEA, 393 JSCs responded
<sup>e</sup> Indicator of representation was calculated as ratio of shareholder’s participation in a Board of Directors to shareholder’s stake in equity.

Source: Author’s calculations based on surveys primary data.
Enterprises' own funds (profits, depreciation) & External funds

<table>
<thead>
<tr>
<th>Year</th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Own funds</td>
<td>53.2</td>
<td>52.4</td>
<td>47.7</td>
<td>50.3</td>
<td>48.0</td>
</tr>
<tr>
<td>External funds</td>
<td>46.8</td>
<td>47.6</td>
<td>52.3</td>
<td>49.7</td>
<td>52.0</td>
</tr>
</tbody>
</table>

- Of them budget funds: 19.1, 17.0, 22.0, 19.8, 19.6
- Of off-budget funds' resources: 10.8, 8.6, 4.8, 2.6, 2.6
- Of bank credits: 4.8, 4.2, 2.9, 4.4, 4.4
- Of loans from other organizations: 8.8, 8.6, 4.8, 8.9, 8.9
- Of share issue revenues: 0.4, 0.7, 0.5, 0.1, 0.3
- Of resources of higher level management: 9.6
- Of other funds: 6.8

Of total volume – foreign investments: 3.5, 6.6, 4.6, 4.6, 4.1

<table>
<thead>
<tr>
<th>Source</th>
<th>Industry</th>
<th>Economy</th>
</tr>
</thead>
<tbody>
<tr>
<td>00</td>
<td>02</td>
<td>02</td>
</tr>
</tbody>
</table>

Chapter 2

Table 9. Composition of Sources of Investments in Fixed Assets (%)

Source: Data for the industry see in Goskomstat (2002, p. 113); data for the economy till 2000 see in Goskomstat (2002, p. 579); preliminary estimates of the January 2002 report were published in 2003a, p. 145.) and other

Without small enterprises.
### Table 10. Investment Process in Industrial JSCs according to Independent Survey Data

<table>
<thead>
<tr>
<th>Investments sources</th>
<th>Investments source composition, % of total investments</th>
<th>Frequency of using the source, % of respondents</th>
<th>Share of the source in investments (%) for JSCs using the source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Own sources of investments</td>
<td>86.8</td>
<td>88.9</td>
<td>80.5</td>
</tr>
<tr>
<td>Bank credits</td>
<td>2.6</td>
<td>5.8</td>
<td>10.9</td>
</tr>
<tr>
<td>Federal budget</td>
<td>4.6</td>
<td>0.2</td>
<td>0.3</td>
</tr>
<tr>
<td>Regional and local budgets</td>
<td>4.6</td>
<td>0.2</td>
<td>0.3</td>
</tr>
<tr>
<td>Russian partners’ resources</td>
<td>3.6</td>
<td>3.5</td>
<td>3.6</td>
</tr>
<tr>
<td>Other Russian external investors</td>
<td>1.4</td>
<td>2.2</td>
<td>4.9</td>
</tr>
<tr>
<td>Direct foreign investments</td>
<td>1.0</td>
<td>0</td>
<td>0.8</td>
</tr>
<tr>
<td>Securities market (shares, bonds)</td>
<td>...</td>
<td>0.004</td>
<td>0.3</td>
</tr>
<tr>
<td>Other sources</td>
<td>...</td>
<td>0.9</td>
<td>...</td>
</tr>
</tbody>
</table>

\( ^a \) SU HSE-1, 267 JSCs responded.

\( ^b \) SU HSE-2, 307 JSCs responded.

\( ^c \) BEA, 275 JSCs responded.

**Source:** Author’s calculations based on surveys primary data.
Chapter 3
Chapter 3
Corporate Governance in Russia*
- Formal Rules and Real Incentives of Economic Agents -

Andrei YAKOVLEV

3.1 Introduction

Corporate governance mechanisms in Russia are interesting because they are the result of a large-scale institutional experiment performed by the Russian government in the early 1990’s with vigorous support of international financial institutions. The purpose of this experiment was to bring a certain model of interaction between enterprises and investors, owners and managers to the Russian environment. The logic of law making – from defining a general privatization framework to specific activities to develop stock market infrastructure – was strongly influenced by the idea to create this model. Multi-billion, loans were extended to the Russian government by the World Bank and IMF to pursue these objectives. Leading Russian reformers and many foreign consultants were involved in practical implementation of this model. And until the middle of the 1990’s, despite all inconsistency of the Russian government’s economic policy in the other areas, its activities in terms of institutional reform,

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especially the launch and implementation of the mass privatization, were very highly estimated (Åslund, 1995; Radygin, 1995).

Then, however, as corporate conflicts spread and shareholders’ rights were massively violated, the optimism with regard to the outputs of institutional reforms in Russia characteristic of the early and middle 1990’s, was replaced with profound skepticism. This skepticism (together with doubts that Russia had chosen the right privatization model), was expressed in a sufficiently comprehensive manner in the well-known report by Stiglitz (1999).

The obvious rejection of external investors and violation of the laws had a negative impact on the reputation of Russia and Russian business. This trend reached its peak during the 1998 financial crisis, when the major Russian banks that were close to the government and owed a lot of money to their western partners preferred to transfer all their liquid assets to their affiliated structures and to file bankruptcy.¹ And despite the significant changes that have occurred in Russia in the recent years, most investors still have a skeptical and negative attitude to Russian business and Russian corporations. The following short phrase from the April 2003 issue of US-Russia Business Council monthly report is very characteristic in this respect: ‘Corporate governance in Russia is awful’. (It should be noted, however, that in making this point the authors in fact refer to corporate conflicts in 1997-1999.)

In this connection it would be logical to ask a question about the reasons for such radical discrepancies between the reformers’ expectations and the actual behavior of Russian companies. It should be underlined that this question is not new for researchers of the Russian transitional economy. To experts, the weakness and inefficiency of corporate governance in Russia in the 1990’s has been a generally recognized fact for a long time.

The forms and methods of violating shareholders’ and investors’ rights are described in detail in many papers (Radygin & Sidorov, 2000; Black, Kraakman, & Tarassova, 2000). Most experts believe, however, that the unfavourable conditions for attracting investors to Russia are not the result of the poor quality legislation.

Formally, the Russian corporate legislation is well-developed. Practically, however, it is applied very badly or not applied at all (Vasilyev, 2000; Berglof & von Thadden, 2000). In this connection, a traditional corporate governance recommendation to the Russian government is to strengthen enforcement mechanisms, to toughen requirements for protecting shareholders’ rights, for disclosing information on joint-stock companies’ operations, etc.

¹ These banks include ONEXIM Bank, Rossijsky Kredit, SBS-Agro, and others. However some papers (Pappe, 2002) consider this asset stripping instead of debt repayment as a positive step, which enabled Russian business to retain control over the largest national enterprises.
Chapter 3

Such recommendations suggest the development of the stock market regulation and corporate governance model that was created in Russia in the second half of the 1990’s and that was based, ideologically, on US and UK experience. It is this area where Russian Federal Commission on the Securities Market (FCSM) has been especially active recently. In 2000-2001, FCSM drafted amendments to the law on joint-stock companies and to the law on the securities market. The new edition of the joint-stock company law was made effective on January 01, 2002. Amendments to the securities market law were introduced by the Government to the State Duma at the beginning of 2002. The Government has also passed the Code of Corporate Governance whose development was initiated by FCSM.

However, recent empirical studies show that the current “rules of the game” very often do not encourage owners to restructure their enterprises, regardless of the law enforcement practice (Dolgopyatova, 2002). More general theoretical papers also reveal a strong objective nature of developing and transition economies (Berglof & von Thadden, 2000) which limits the application of traditional corporate governance mechanisms created in countries with developed market economies.

In the context of these discussions we will try to give our answer to the question on the reasons of corporate governance failures in Russia in the 1990’s and to explain what caused the recent positive changes in this area. Our analysis will be broadly based on identifying changes in economic agents’ motivation at different stages of development of Russian corporate structures.

In Section 3.2 of the article we will look at the logic of creation and practical aspects of functioning of the Russian corporate governance model, including data on the scale of the corporate sector and the system of regulation of corporate activities in the Russian Federation. In Section 3.3 we will do detailed analysis of incentives to attract investments through the stock market and motivation of open joint-stock companies’ shareholders and managers depending on the performance of the business they control. And finally, in Section 3.4, we will address the reasons for recent improvements in corporate governance in Russia and will outline possible directions of further evolution of Russian companies’ relations with their shareholders and investors. On this basis general conclusions will be presented along with policy recommendations aimed to support positive changes in the behavior of economic agents.

3.2 Russian Model of Corporate Governance in the 1990’s: Theory and Practice
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The logic of the Russian corporate legislation in the 1990’s was based on massive imports of institutions, with an orientation towards the Anglo-Saxon stock market and corporate governance model. To implement this model in the Russian conditions, the Government took the following practical steps:

- ‘Voucher’ privatisation with a forced re-organisation of former state-owned enterprises into public companies and with a distribution of their shares among a great number of small-scale shareholders.
- Forced development of the stock market and its infrastructure (exchanges, brokers, depositaries, and registrators).
- Creating a collective investment institution (voucher investment funds, mutual funds, non-governmental pension funds, etc).

It was expected that dispersing shares across a big number of small-scale shareholders would result in high liquidity of the stock market and give outside investors access to the shares of privatised enterprises (through transactions on the secondary market). A developed infrastructure of the stock market would, in turn, reduce transaction costs and give small-scale shareholders the opportunity ‘to vote with their feet’ in case they do not agree with the policy pursued by the company management. The possibility of free purchase and sale of shares was also expected to encourage the creation of a corporate control market where big shareholders could replace the existing management and take control over the company by increasing their stocks when shares are ‘dumped’ by small-scale shareholders. Finally, investment institutions would be able to accumulate shares of small-scale shareholders and to protect more effectively their interests by controlling the management of the respective enterprises.

In practice, however, as we can see from the conditions and structure of the Russian corporate sector, and from the evolution of corporate governance legislation (see Boxes 3.1 and 3.2), these assumptions were implemented only partially.

The extensive imports of corporate legislation institutions and the ‘dispersal’ of property in the course of the mass privatisation could not neutralise the apparent demand for the ‘insider’ privatisation model promoted by managers of former state-owned companies. As a result, two trends could be clearly observed in the corporate sector in the mid 1990’s:
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a) **Tendency towards property and control concentration** – purchasing up to 75% of the shares.²

b) **Tendency towards minimum transparency in joint-stock company operations** – creating sophisticated systems of corporate control over big enterprises through multiple affiliated firms and off-shore companies (Yakovlev, Kuznetsov, & Fominykh, 2002).

As a most important and special characteristic of the Russian corporate governance model based on these two trends we could mention obtaining revenues from stock ownership not through profits (which is characteristic of the ‘Anglo-Saxon’ model) but through control exercised by the dominating owner over the enterprise’s cash flows. Using transfer pricing mechanisms you can systematically transfer profits of the head enterprise to companies affiliated either with the dominating shareholder or with top managers of the head enterprise (Rozinsky, 2002). In doing so you can obviously ignore the interests of minority shareholders (including the employees) who do not participate in the decision-making process.³ It should be emphasised that such schemes of obtaining revenues were used not only by old-style ‘red’ directors but also by new big private shareholders.

Logically, this system of obtaining ownership revenues caused almost no payment of dividends in the 1990’s. When combined with the total indifference of dominating owners and managers to creating a market for the shares of enterprises they controlled, this caused low capitalisation and very low liquidity of the stock market. Even during the peak times of the Russian stock market (1996-1997) less than 1,000 out of 30,000 registered open joint-stock companies could meet the moderate requirements for getting listed with Russian stock exchanges; transactions were performed with the shares of only 200-300 companies; and trading was performed for only several dozens of blue chips.

In fact, the rapid development of the stock market in the mid 1990’s and its decline afterwards were caused, to a large extent, by the demand for the stock market as a mechanism of share holding consolidation. Once such share holdings were formed, the demand disappeared in a natural way.

Obviously, there were systematic discrepancies between the rules stipulated in the legislation and business practices. In a certain sense we can say that the Russian model of corporate governance was created in the 1990’s against the government policy and was functioning on the basis of **systematic violation of formal rules**.

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² For more details, see Kuznetsov (2002).
³ For more information on systematic violations of shareholders’ rights in Russia, see Radygin & Sidorov (2000) and Black, Kraakman, & Tarassova (2000).
We believe the reasons for that lie in the way corporate governance institutions were formed. These reasons will be more thoroughly addressed in the next section.

Box 3.1 Conditions and Structure of the Russian Corporate Sector
- Based on Materials from Dolgopyatova (2003) -

**Types of JSCs.** Under Russian legislation there are two main types of joint-stock companies (JSC) in the Russian economy – open joint-stock company (OAO) and closed joint-stock company (ZAO). The main difference of ZAO is limitation on free circulation of shares. If one of the owners sells his stock the other shareholders have a preferred right to buy it. In addition, the Joint-Stock Company Law effective since January 01, 1996 introduced the following limitations for ZAOs: 1) the number of ZAO founders (shareholders) can not exceed 50; 2) joint-stock companies where the state (federal and regional governments as well as municipalities) have a stock can only be created in the form of open joint-stock companies. These limitations do not cover the ZAOs created before the limitations were introduced. There is another type of joint-stock companies – workers’ ZAO (or people’s enterprise). However, it remains rather an ‘exception’ which has no influence on the development of the corporate sector. For instance, there were not more than 100 ZAO’s of this type in industry as of the end of 2002.

**Number of joint-stock companies.** Evaluation of the size of the corporate sector in Russia involves certain difficulties. Official statistics only provide information on the number of registered enterprises, including the joint-stock companies in the Unified State Registry of Enterprises and Organizations. The number of joint-stock companies in the registry was over 51,000 as of the beginning of 1996 and as much as 426,600 as of the beginning of 2001. The latest data from the registry (as of January 01, 2003) show 445,600 registered joint-stock companies.

This data, however, is not accurate because does not take into account transformation and reorganization of enterprises, except for their official liquidation. According to estimations of Goskomstat of Russia and some independent experts, the registry contains from 30% to 50% of enterprises that stopped their operations a long time ago. So we can look at approximately 200,000 – 250,000 joint-stock companies operating in Russia today.

Goskomstat data does not provide any information on the proportion of ZAOs and OAOs among the registered joint-stock companies. However, some insight on this can be obtained from the end-of-2001 data of the regional division of Federal Commission on the

According to this data, there were 202,224 joint-stock companies registered in the CFD, which includes Moscow and a number of adjacent regions, at the end of the year. In 1997 – 2002 the department of registration of the regional FCSM division considered applications for the registration of securities issues from 37,007 joint-stock companies, of which 5,577 are open and 23,430 are closed joint-stock companies. Taking into account the concentration of business activity in the CFD we can assume that there is an average of 6 ZAOs per one open joint-stock company in Russia.

Role of joint-stock companies in the economy. Although Goskomstat of Russia collects from enterprises information on their organizational and legal types, consolidated economic data for them is not calculated. The role of joint-stock companies in the economy can be estimated indirectly based on the data of a survey of joint-stock companies created during the privatization. The survey covered over 23,000 joint-stock companies out of 26,000 and was done by Goskomstat as of January 01, 1996. At that time they accounted for over 20% of all employees (in industry – over 62% of employees). The share of joint-stock companies created during the privatization in total products (services) was already almost \( \frac{3}{4} \) in industry, over \( \frac{1}{2} \) in construction, 26% in transportation, and less than 5% in retail and catering (ISARP, 1997). Taking into account the newly created joint-stock companies mainly in retail, services and the financial sector, we can argue that the corporate sector is dominant in the Russian economy.

Structure of ownership and control. Since in 1993-1994 approximately \( \frac{3}{4} \) of all privatized enterprises chose the so-called second privatization model (under which 51% of all shares was passed over to the workers) the employees and managers initially prevailed in the structure of JSC owners. However, as early as in the late 1990s, according to the annual structural research by the RF Goskomstat covering nearly 27 thousand large and medium-size enterprises (Goskomstat, 2002) the share of individuals in the charter capital of the surveyed companies shrank down to 15-20%. At the same time in the period from 1999 through 2001 alone the share of non-financial commercial organizations in the charter capital of industrial enterprises grew from 42% up to 65%. To be fair, it should be remembered that the data is “weighed” against the size of charter capital and, therefore, to a larger degree reflects the ownership structure of largest companies. It can also be pointed out that contributions by foreign legal entities and individuals to charter capitals of Russian companies in the period at issue did not exceed 10% in average. However, when it comes only to the companies with foreign participation the indicator rises up to 40-47%.

A number of empirical studies conducted in 1999-2001 by the Higher School of
Economics (HSE), the Bureau for Economic Analysis (BEA), the Russian Economic Barometer (REB) and the Institute for Economy in Transition (IET) demonstrate that the average share of the largest shareholder, depending on the samples, varied from 28% to 42%. That indicator had a growth trend. At the same time, according to some surveys by HSE and REB from one quarter up to one third of the responding companies already had a dominating owner controlling 50% of shares or more.

The structure of investment sources, scale and liquidity of the stock market. Equity remains the major source of investments for industrial enterprises, although its share has a downward trend – from 77% in 1998 down to 68% in 2001. The capabilities of bank financing have been significantly expanded over the recent years as well as the corporate bonds market has shown its dynamic development. As an example, MICEX – the leading stock exchange, had about 112 billion rubles or nearly $4bln worth of initial placement of corporate bonds in 1999-2002.

The stock market has shown positive dynamics over the recent years. The RTS index (the leading stock index in Russia) had grown up to 500 points in June 2003 which exceeds the late 2000 level fourfold. However, the scale and liquidity of the stock market are rather low. In 2002 the MICEX average daily turnover in the secondary equity market totaled about $150mln while for the secondary corporate bonds market the figure was about $10mln. Average daily volumes of trading in equity in the RTS system (the second largest trading place) were ranging within the levels of $20-25mln. For the purposes of comparison it is worth pointing out that market capitalization of such companies as Gazprom and Yukos exceeded $20bln in 2002 in every case.

Box 3.2 Evolution of Corporate Governance Legislation in Russia  
- Based on Redkyn (2003) -

Stage 1: late 1980s – 1994. The period is characterized by the development of legal institutions connected with the consolidation and re-distribution of rights on private property assets. Legislation on privatization featuring separate elements of the corporate law was enacted within a very short timeframe. However, it was of low regulatory potential and was rather designed to create an effect of serving a legal foundation for the appropriation of state property by individuals and private institutions. That was the reason for the regulations’ short life and their high mobility: the bulk of the regulations at issue were either abolished or radically amended during the 1990s. At the same time the privatization of state-owned enterprises appeared to be the key factor for growth of demand calling for introduction of
corporate law as well as securities legal institutions.

At that period corporate law was represented by a rather brief Provision on Joint Stock Companies approved by #601 Resolution by the RSFSR Council of Ministers on December 25, 1990. There were also several instructions issued by Russia’s Ministry of Finance and the Central Bank governing corporate relationships.

The insufficiency in legislations and regulations complicated the conduct of corporate activities and triggered acute conflicts. There was a major conflict to become internationally known in 1993-1994 between foreign shareholders and top management of Komineft joint stock company. The essence of the conflict had to do with the issuance of additional shares by the company in relation to the re-evaluation of its fixed assets. Instead of the shares’ pro rata distribution among shareholders the company distributed them free among its employees. The conflict that lasted for nearly two years could not be resolved on the basis of existing legislations and regulations and investors lost their money due to imperfection of the corporate law. There were numerous cases of the same kind at that time. However, such heated rows in the stock market contributed to the growth of demand for legal regulation of corporate relationships.

Stage 2: 1995 – 2000. This period was characterized by significant improvement in the quality of legal regulation of corporate relationships. It resulted from the introduction of a legislative basis for regulating relationships with shareholders in joint stock companies, the establishment of a state system for stock market regulation (Federal Commission for the Securities Market), the consolidation of the system for registering rights on equity, the introduction of procedures calling for the protection of investors in the securities market.

In 1994 the first part of the RF Civil Code was adopted followed by the passage of the second part in 1996. In the wake of privatization and large-scale redistribution of property the demand for the securing of property rights – laws on immobile property registration and notary – came high on the agenda. Concurrently, new institutions on the registration of rights came into being (chambers of registration, private notary services). Registrars and depositaries came to the stock market in numbers.

During that period of time it was the corporate law and the legislation on securities that underwent meaningful development. The legal regulation of such relationships was elevated to the level of law for the first time. In 1995 the Federal Law on Joint Stock Companies (presentation of the JSC law’s basic provision is found in Iwasaki (2003)) was passed, in 1996 the Federal Law on Securities Market followed suit (prior to that the regulation of such relationships was subject to regulatory acts only). The practice of the laws’ application in court began taking shape (for particulars refer to the Joint Resolution #4/8 of April 2, 1997 by the RF
It was the FCSM-issued regulations that played an important role in the development of corporate law in Russia, notably those were the standards for securities and bonds issuance (the first edition was adopted in 1996). The problems of “diluting” charter capital and illegal activities by “pocket” registrars made the FCSM of Russia introduce more stringent requirements for securities issuance to meet as well as regulate in every detail activities by securities rights registering institutions.

But by and large the measures introduced were clearly not sufficient. The corporate legislation in the late 1990s was primarily of a regulatory nature and was not reinforced by adequate legal sanctions in case of violation.

**Stage 3: 2000 – present time.** The period is characterized by a more integrated approach to the regulation of corporate relationships and further improvement of enforcement mechanisms.

The RF Code on Administrative Violations as well as the RF Arbitration and Procedural Code saw their new editions come into force in 2002. Supplements were effected in the RF Criminal Code to deal with crimes in the securities market. Due to their broad functional purposes the legal acts to a certain extent address corporate relationships in terms of protective mechanisms. The new Labor Code has been in force since February 2002 and despite being not perfect it is based on market realities and is more in line with the law on joint stock companies than its Soviet counterpart.

Amendments were introduced in the Federal Law on Joint Stock Companies (The nature of amendments introduced in the JSC is scrutinized in Medvedeva, Timofeev (2003) and the Federal Law on the Securities Market in 2002 reflecting the lessons having learned over the previous years in applying this legislation. A new version of the Federal Law on Bankruptcy came into life.

At the same time there is still a lack of effective and efficient protective mechanisms in place to counter fraud on the part of companies CEOs, “insiders” deals and other kinds of swindling by top managers. Procedures to raise claims against companies’ CEOs to be awarded damages to the company (so-called indirect claims) do not work as a consequence of their legal deficiency incorporated in Article 71 of the Federal Law on Joint Stock Companies. The category of “affiliated persons” is to be better identified while the protection of an economic entity’s interests within the framework of deals arousing interest is to be better secured.
3.3 Development of Joint-stock Companies in Russia and Motivation of Owners and Managers of Enterprises

Critically analysing the existing approaches to the problem in economic literature, Berglof & von Thadden (2000) propose a classification of corporate governance models characteristic for developing economies, economies in transition as well as developed market economies. Within this classification they identify key issues of corporate governance.

For transition economies and especially for Russia significant differences are connected with the division into “new” and “old” (former state-owned) enterprises. Berglof & von Thadden (2000) believe that the problem almost does not exist in the de novo sector because enterprises in this sector have not yet reached in the course of their development a stage when it is necessary to differentiate between property and management. On the contrary, the former state-owned sector is a source of serious problems.

Privatised enterprises need serious restructuring and, theoretically, should generate demand for external sources of finance. In reality, however, they do not generate this demand, which, according to Berglof & von Thadden (2000), is caused by soft budget constraints, which reduce this need for restructuring. In case outside investors themselves want to come to big Russian business, the weak and imperfect Soviet era legacy judicial system turns out to be unable to ensure sound protection of outsiders’ rights.

The main recommendations resulting from this analysis come down to developing enforcement mechanisms and hardening budget constraints. This will create the necessary pressure on ‘insiders’ and conditions for giving enterprises new outside owners (including foreign ones) who can attract finance and initiate restructuring.

In our opinion, these recommendations are right on the whole; however, they are a bit one-sided and formulated from outsiders’ perspective. The analysed phenomena and processes could also be looked at from insiders’ perspective. This angle could be useful because it allows to better understand the actual costs and benefits of turning a company into a joint-stock company.

In the course of a natural development of a business its reorganisation into a public company is possible under at least two conditions:

- **The business is efficient enough.** This makes it attractive for investors, secures the positions of the previous managers/owners at the initial stages of the privatisation process, and creates the proportions for exchanging property for investment acceptable to the previous managers/owners.
- The previous managers/owners of the company are interested in attracting additional funds for business development purposes in exchange for some of their stakes in the company. In practice it means readiness to co-operate with investors, including adequate disclosure of information, payment of dividends, etc.

As an example of companies developing in accordance with this pattern we could mention AO Vympelkom, which was created in the early 1990’s as a co-operative, then it was re-organised into a closed joint-stock company and then it became the first Russian company to trade its shares at the NY Stock Exchange in 1996. Another example is AO Wimm-Bill-Dann Produkty Pitaniya, which successfully placed 25% of its shares in February 2002 thus attracting over $130 million in investments.

However, for the absolute majority of big Russian enterprises the privatisation process was not natural. During the privatisation they were forced to become public companies. These enterprises had been created during the Soviet period and were oriented towards absolutely different, non-market values. That’s why in most cases they proved inefficient in the new economic conditions and needed drastic restructuring. This caused several important logical consequences:

1) Before the consolidation of property and control in the hands of enterprise managers their positions remained quite unstable. On the one hand, this caused hostility on the part of the previous management towards potential outsiders; on the other hand, it encouraged the transfer of liquid assets of the base enterprise to affiliated structures controlled by the managers.

2) Consolidation of property and control in the hands of managers was performed by using some of the working capital of the enterprise, which only further weakened the enterprise, made it less attractive for investors, and made the restructuring process more complicated.

3) After consolidation of property and control and before restructuring, enterprises’ opportunities to get access to outside finance remained very limited. Low business efficiency made it unprofitable for managers to exchange shares for investments while the pure performance and old non-liquid fixed assets did not allow attracting credit resources. As a result, privatised enterprises had to use their own funds for development purposes.

To make the picture complete, we can add that during the re-organisation and privatisation under ‘voucher’ schemes enterprises themselves did not get any investment at all. It is not surprising, therefore, that from the point of view of managers and ordinary
employees loyal to them all outsiders looked as spongers who claimed some profits of the enterprise without any apparent reason.

This forced privatisation that did not take account of objective stages of enterprises’ life cycles caused deformation of the public company institution and creation of a number of ‘quasi open’ joint-stock companies that did not need outside shareholders at all and, for this reason, provoked corporate conflicts. In a broader theoretical context this institution mutation process in transition economies is analysed by Kapelyushnikov (2001). It is noteworthy, though, that the interests and motivation of insiders did change as property and control were concentrated in their hands.

At the initial stage, the insiders who did not have complete control over enterprises and were involved in a struggle against outsiders were not at all interested in any restructuring and usually tried to strip assets as quickly as possible. Once they became dominating owners again and regained legal control over enterprises, insiders still did not need minority shareholders and continued violating their rights. As regards restructuring and transfer of assets, however, their policies were completely different. They controlled businesses and were interested in making them more efficient by restricting theft (including that by medium-level managers), by reducing unproductive costs, by implementing new technologies, etc.

Obviously, this evolution of interests depended on many factors (for example, on managers’ qualifications). At present, Russian enterprises are at very different stages of their corporate development. Nevertheless, all of them, including few newly created efficient private companies like AO Vympelkom, have the same organisational and legal framework of an open joint-stock company and should comply with corporate legislation requirements.

In fact, most big Russian enterprises show discrepancies between their legal framework and the economic content of their activity. The costs of such discrepancies have been compensated for by a loose observance of rules and laws, which has happened for a long time. At this stage, however, big enterprises will more often face real additional costs without getting any compensating benefits since most of them are still unprepared for opening their businesses to outside investors.

We believe, therefore, that resolving corporate governance issues in Russia requires not only putting more pressure on insiders, strengthening budget constraints, protecting shareholders’ rights and developing enforcement. Creating ‘the right motivation’, a system of indirect positive incentives for insiders, and measures aimed at reducing the costs caused by the legislation can also play an important role here.
3.4 Recent Changes in the Behaviour of Russian Corporations and Options of Corporate Governance Evolution in Russia

In our opinion, the change in the status of insiders, the fact that they acquired legal control over enterprises created an enabling framework to improve corporate governance in Russian companies. To support this point, the following recent trends can be highlighted:

- Significant improvement of shareholder relations, improved transparency, regular payment of dividends, which has already increased the market capitalization of some major companies (YUKOS is considered one of first movers here);
- Real implementation of International Accounting Standards (IAS), which is especially visible against the collapse of the corresponding program approved by a special government resolution in the spring of 1998;
- Vigorous issue of corporate bonds and the precedents of IPOs (Wimm-Bill-Dann, RosBusinessConsulting, 36&6 Pharmacies).

At the same time, we believe, a number of other factors (apart from consolidation of ownership and control) had an effect on the behavior of Russian companies.

The August 1998 devaluation of the ruble resulted in increased competitiveness of Russian exports along with dramatic growth of prices for imported products and their withdrawal from the domestic market. Growing sales improved the performance of Russian business. As a result, the new owners had an opportunity to recoup their investments in block shares not only by withdrawing liquid assets from their enterprises but also by generating revenues from actually doing business. This created incentives to invest in the development of enterprises, which did not exist in the 1990’s. One of the consequences of the new investment opportunities in Russia was a noticeable reduction in capital outflow. While in

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4 It should be considered that this process was pursued both by the management (e.g. AO Severstal) and by new investors, outsiders as related to the old management (e.g. Norilsk Nickel). However, regardless of the starting point, the emerging consolidated owner continued to act as the classical insider.

5 We can point out that in some cases the main purpose of corporate bond issues was not to raise funds but to improve the company’s image on the market. This is characteristic, for instance, of natural resource-based industries that have had no major problems with liquidity in the recent years.
1997-1998 annual capital outflow from Russia was estimated at $20-25 billion, by 2001 this figure was reduced to $17 billion and by 2002 – to $11 billion. According to the Central Bank and the Russian Ministry of Finance, Q2 of 2003 was the first time capital inflow had exceeded capital outflow.6

A new bankruptcy law came into effect at the beginning of 1998. It triggered a new wave of ownership redistribution and acute corporate conflicts, since the law, contrary to its original purpose, were used against performing and relatively efficient enterprises. However, such an opportunistic use of any, however small it could be, overdue debt to ‘intercept’ control at successful enterprises cleared out the arrears accumulated in the 1990’s.

Apart from the devaluation effect that improved the competitiveness of Russian products and ensured an inflow of liquidity to more efficient enterprises, a more adequate tax policy pursued by the government also contributed to reducing the non-payment problem. For instance, in 1999-2000 the government wrote off a significant amount of fines and penalties on overdue tax payments and provided a debt restructuring opportunity to enterprises which had made current tax payments on a regular basis within a certain period of time. Eventually, by 2001 industrial arrears were concentrated in inefficient ‘down’ enterprises, unlike in the mid 90’s when they were typical of almost all major industrial enterprises.

The end of mass privatization also expanded the horizon of interests in Russian business. This reduced the size of potential rent as well as the capabilities and efficiency of rent-seeking strategies which were popular in the 1990’s.

Among other factors influencing business behavior, the effect of the 1998 crisis should be highlighted. Together with the devaluation and default the crisis caused the government to be replaced. For the first time since 1991 the government had included active representatives of the Communist party. So, Deputy Prime Minister Yu. Maslukov, eminent Communist party deputy and the leader of a State Duma Committee, was in charge of economic issues in the Primakov government.

Although the crisis mainly affected the middle class in big cities, it outlined for the ‘oligarchs’ the possibility of losing their capital and property – if the rules of the game did not begin to change, if they continued to enable some individuals to make huge profits without creating conditions for economic and social development. On the whole, the completion of the primary division of state property and the realization of political risks related to rent-seeking behavior encouraged business (primarily big business) to act more vigorously on the legal field which still remains highly inadequate.

6 See interview of Minister of Finance Alexei Kudrin in Financial Times on June, 23 2003.
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It is noteworthy that there were serious problems with the legal framework in the 1990’s as well. At that time, however, they were resolved by creating semi-legal and illegal asset redistribution schemes within the framework of informal business groups (Yakovlev, Kuznetsov & Fominykh, 2002) – since the efforts to change the legal environment in the short term proved initially inefficient. All this caused a rapid development of the shadow economy and an active outflow of capital.\(^7\)

In the recent years, the increased investment activity and the need to guarantee the protection of the existing ownership rights have encouraged business to seek more civilized and legal ways to interface with the state. Unlike in the 1990’s, when ‘investment’ into relationships with specific officials or policy-makers paid back fairly quickly, legal interaction with the state could only be effective for individual companies under certain conditions. Such interaction is effective if it is based on collective interests and coordinated collective activities of the entrepreneurial community. The realization of such collective interests helped create demand for law on the part of business,\(^8\) and the readiness for collective activities strengthened the role of entrepreneurial associations as representatives of collective business interests. This applies not only to the “renewed” Russian Union of Industrialists and Entrepreneurs but also to a number of industrial associations of entrepreneurs.\(^9\)

The above factors created conditions for positive change in Russian companies’ attitude to outside shareholders and potential investors. In general, speaking about the evolution of the Russian corporate governance model within a certain simplified reference system, we can point out the following (see Figure 1).

Initially, Russian reformers tried to implement an Anglo-Saxon experience-oriented corporate governance model. However, diffusion of ownership objectively contradicted the need to restructure enterprises. To come out of the crisis and develop their business, they

\(^7\) According to World Bank experts, the share of the shadow economy in Russia was up to 40% in the mid 1990’s (Kaufman & Kaliberda, 1996). For more detailed analysis of the influence of shadow economy on the development of economies in transition see Johnson, Kaufman & Shleifer (1997).

\(^8\) For more details on the development of demand for law in Russia, see Hendley (1999), Pistor (1999) as well as Yakovlev (2003), Medvedeva, & Timofeev (2003), Simachev (2003) on creating demand for legal institutions in the field of corporate governance.

\(^9\) For information on the interaction between the Russian Association of Household Electronics (RATEK) and the State Customs Committee, see Radaev (2002).
needed one owner capable of making and implementing hard decisions and of taking responsibility in negotiations with potential outside investors. As a result, during the process of objective ownership consolidation Russian companies quickly moved from the upper left hand to the upper right hand corner in Figure 1.

The evolution, however, will hardly stop at this point. As we mentioned earlier, consolidation of ownership has occurred in most major Russian companies and we can see discrepancies between their legal structure and the economic content of their activity. As they function as open joint-stock companies and incur costs typical of this organizational and legal form, they do not have any compensating benefits (e.g. access to cheaper investment resources through the stock market) because they are not yet ready to really open their companies to outside investors.

We believe the regulation system is likely to change partially in the next few years to become closer to the ‘continental model’. In the future, a certain reduction in the ownership concentration level is possible, as Russian companies (primarily medium-sized ones) really become open to attract investments. A key factor in this process will be Russian investors’ behavior because we know from other countries’ experience that an abundant inflow of foreign investments normally starts when domestic investors really begin to invest into their country’s economic development.

It is noteworthy that similar changes in the corporate governance system have occurred in other countries as well. Despite the attempts by the American occupation authorities to radically transform Japan’s corporate mechanisms in the first post-war years (Aoki, 1988), those remained close to the European ‘continental’ model. It is believed that one of the reasons for that is domination of Romano-Germanic traditions in the Japanese judicial system and its rejection of innovation characteristic of common law and creating the basis of the ‘Anglo-Saxon’ corporate governance model (Johnson et al., 2000).

Similar things took place in Russia in the 1990’s. In Russia, like in Japan, civil law traditions still prevail. And one can rejoice that the experts who participated in the development of the original Russian corporate governance model are beginning to admit the role of the ‘institutional landscape’ in analyzing the transplant effect (Shleifer at al., 2003).

3.5 Conclusions and Policy Implications

We tried to demonstrate in this paper that inefficiency of corporate governance in Russia and blunt violations of investors’ and shareholders’ rights in the 1990’s were related not only to the ‘insider’ structure of ownership but also to insufficient preconditions for implementing
the ‘Anglo-Saxon’ corporate governance model, which the reformers tried to transplant to the Russian environment. In our opinion, at least two requirements need to be met to make such an institutional experiment successful:

1) Availability of an existing legal framework that can support the functioning of sophisticated intermediary institutions (stock market, professional investors, etc.) characteristic of the ‘Anglo-Saxon’ model;

2) Certain level of business efficiency at which the managers are not afraid of losing their positions if the owner is changed and the original owners can obtain a sufficient compensation for their block shares.

Neither requirement was met in Russia in the 1990’s. Recent studies, however, have been focused on the imperfection of legal institutions followed by the traditional recommendations to improve enforcement. These recommendations are correct but not sufficient.

It must be admitted that insiders play a key role in corporate processes in Russia and this is why government policy in this sphere cannot ignore their interests (which has been the case so far). This said, the interests of insiders themselves may differ significantly depending on the level of concentration of ownership and control. It is only consolidated owners that can have sufficient incentives to restructure and improve their business in the current Russian conditions. This category might be potentially interested in attracting investors and improving corporate governance. And it is for this reason that policy-making needs to take into account the interests of various groups of insiders.

The above means that the government – unlike in the 1990’s – should not be looking at this or that pre-defined corporate governance model. Legal regulation should become more flexible. It should create conditions for the development of various corporate governance mechanisms and take into account the interests of market players, their evolution and differentiation. We need a transition from the model of ‘political modernisation’ of the institutional environment, with institutional supply being generated by the government, to the ‘market modernisation’ model where demand for institutions is generated by market players themselves (Cadwell & Polishchuk, 2001).

In the field of corporate governance business, in our view, is ready for constructive cooperation with the government based on collective interests of the entrepreneurial community. However, for this cooperation to produce positive results, it is important that the government – and, in a broader context, the state – pursue public rather than some other interests. Unfortunately, the situation is still unclear.

Almost immediately after taking office President Putin announced his policy of strengthening ‘the vertical line of power’. Since there was no real political competition,
however, this policy resulted in consolidation of the state machinery. While it remained out of control of both society and supreme political power, the state machinery guided by standard bureaucratic aspirations began to play a more and more important role in the economy. As a result, the model of state capture or informal privatization of power in the interests of business typical of the 1990’s is gradually replaced with that of informal capture of business to subordinate it to departmental interests.

The above said is indirectly confirmed by data from managers of Russian enterprises who were surveyed on the efficiency of court procedures used to resolve conflicts with private counterparties and government agencies (Frye, 2002; Golikova et al., 2003). Contrary to popular skepticism, arbitration courts are sufficiently effective in resolving disputes between enterprises while the probability of winning the case and having the court decision enforced in a conflict with government agencies is estimated by the respondents as significantly lower.

This means that today the threat of ownership rights violation in Russia comes from the state machinery pursuing its bureaucratic or political goals rather than from the insiders. 10 It is for this reason that the future of corporate governance in Russia depends not only on the strengthening of the judicial system but also on whether the government will pursue the interests of the society in its interaction with business or its policies will be defined by the interests of individual agencies and political groups.

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10 It is in this context that most observers viewed the events that took place at the beginning of July 2003 when Platon Lebedev, a major YUKOS shareholder, was arrested on charges of breaking the law when pursuing a privatization transaction in 1993-1994 (see “Presidential Ambiguity Undermines”, The Moscow Times. Monday, Jul.14 2003. Page 8; “Power struggle in the Kremlin”, The Economist July 12, 2003, etc).
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Figure 1. Corporate Governance Policy in Russia and Response of Business: Trajectory of 1990s
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Experiments and Reality
- A Comment on Andrei Yakovlev’s Paper -

Bruno DALLAGO

4.1 Introduction
Andrei Yakovlev’s paper gives a thoroughly and convincing presentation of the features and evolution of corporate governance in Russia in the Nineties. In particular, the paper presents a most interesting case study of what happens with firms and within firms when an alien set of formal institutions are imposed upon actors who were used to produce and exchange in a quite different economic system made of both formal and informal institutions.

The paper offers various interesting insights and supplies thoughts and elements for realistically analysing the Russia situation in its complexity and for devising alternative policies. The value of the paper is increased by the many elements it offers to generalisations on the role of institutions in economic life and the importance of having formal and informal institutions somehow in tune. It is in this sense an interesting paper on the danger of weakly based institutional experiments and the strength of sticky informal institutions. In these cases not only a dichotomy is created between formal and informal institutions that makes economic calculation and coordination of firms difficult, but also incentives to economic agents are distorted. The paper is illuminating on how economic agents react and adapt in such a situation.

In this comment I will first summarise what are in my view the fundamental messages of the paper and put them in a more general perspective (Section 4.2). I will then discuss at some length the only two points on which I have some minor disagreement with Yakovlev’s paper: in the reading of the Russian situation (Section 4.3) and in policy suggestions (Section 4.5).
4.2 The Fundamental Messages

The fundamental message of the paper is that, when an alien set of formal institutions is imposed amidst sticky informal institutions, incentives become distorted and economic actors look for adaptation mechanisms that generate an economic system far from the one that reformers envisioned, although still different from the old one. This conclusion is important and different from other conclusions that are well established in the profession. It is more convincing and more balanced than those conclusions, because it is better founded on a deep knowledge of the situation of Russian firms. My contention here is that this interpretation is also sounder when seen in the light of institutional economics.

The paper presents corporate governance reform in Russia in early 1990s as an experiment with implementing an alien system (the Anglo-Saxon system of corporate governance) in a pre-existing institutional environment or – as the reformers put it – with implementing the correct reform in the “unsuitable” Russian context and with “inappropriate” actors. The reformers’ reasoning was that if the reform is radical and swift enough, the natural self-interest of economic actors will push them to adapt reasonably fast to the new (formal) institutions. This is the well known “window of opportunity”.

The Anglo-Saxon system of corporate governance is based primarily on two pillars: dispersed ownership, and profit maximisation. It is implicitly considered that there are no important costs in reallocating resources from one use to the other (better, this costs do not influence the economic and social actors’ decision making), following the actors’ “natural” aspiration to maximise the return to the resources they own. So mobility of resources in the economy is high. In short, the free competitive market mechanism is natural to human beings, once “imperfections” and constrains are removed by means of a radical and swift reform. If this happens, actors will be under the influence of good incentives that push them to maximise also social production.

All this is beautiful but, unfortunately, misleading and simplistic. In particular, it disregards the complexity of evolution and adaptation and the relation between formal and

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1 There are two influential extreme positions on Russia. According to one, everything went wrong because of the anomalies of the country in general and its firms in particular. Cf. Black et al. (2003). According to the other, the Russian economy has had a normal evolution towards “a typical middle-income capitalist democracy”. Cf. Shleifer and Treisman (2003).

informal institutions. Indeed, it completely disregards informal institutions, their stickiness, and also the costs of transition, while downplaying also transaction costs.

The correctness of this view obviously depends on the importance of adaptation and evolutionary mechanisms to that model of corporate governance, the costs that actors have to afford to adapt to the reform and evolve in the “right” direction and the way in which such costs enter decision making of the economic actors. Obviously, those costs are particularly high and the process complex when the distance between old formal institutions and surviving informal ones and the new formal institutions is great, such as in the Russian case. In this perspective, intertemporal and interindividual processes are of crucial importance and such a reform create abundant opportunities for free-riding, moral hazard, and rent-seeking.

If one supposes with the reformers that the new, Anglo-Saxon system of corporate governance will benefit firms and the society alike, a minimal condition for sustainability is that the costs that the reform creates are not greater than the social gain from the reform. However, also in the case of zero net costs or even in the more favourable one of net social gains the outcome is not granted. First, one has to discount the (future) benefits to the present, when costs must be afforded. Here intertemporal and intergenerational problems create well known problems. Elder people have less time to enjoy the benefits of reform, but have plenty of time to pay for its costs. If they are rational non altruistic actors, as the Anglo-Saxon reformers suppose, they should oppose reform. And indeed they usually did so. Unfortunately, among these are usually persons who occupy key positions in the firms (and the ministries and public administration). So they also have the power to block and deviate reform.

Second, a real reform can never astray from the crucial role of time in transformation processes. A complex reform such as corporate governance reform includes different processes that are implemented in a certain order (e.g. commercialisation of firms first, then privatisation and finally corporate governance reform followed by restructuring) at different speed and with different degrees of organisational complexity. This mixes up intertemporal issue with interindividual ones. Individuals occupy different positions in societies in general and in firms in particular. To put it simply, some have abundant opportunities to profit from the changes, so they are likely to be active in the market for reforms, while others do not have such opportunities and chances are that they have to pay the cost of change.

If better corporate governance in the Anglo-Saxon line requires – as it does – privatisation and “lean” firms, some people will have opportunities of profiting from privatisation (former managers and people in the former party and political structure who may control the privatisation process and who in any case have privileged information and advantageous connections), while others will be required to sacrifice their jobs and welfare in
order to allow for improved firm performance and greater efficiency. This is likely to create free riding, moral hazard, and rent-seeking of the former and opposition of the latter.

Obviously, proper enforcement mechanisms can be implemented and equity of outcomes can be pursued with redistributive and other mechanisms. Unfortunately, all this is at odds with the asymmetry just described among actors, with the weakness of the state – which in the best case is going through deep transformation and slimming down itself – and also with the philosophy of the reform model. If we consider that these policies require substantial resources in a time when the state budget is shrinking – as an important part of the reform itself – we have a complete picture of the dramatic unlikelihood of such adjustment being made, or at least made in a proper way and sufficient measure. Such unlikelihood is part of the problem, since it adds to the serious distortion of incentives underlining the reform.

The paper is quite clear on this: under such conditions the outcome could only be contradictory and far from the envisioned efficacy. The situation is expressed in a fortunate dichotomy: formally Russia has received a well-developed corporate legislation, practically this legislation remained irrelevant and actors systematically violated formal rules. This outcome could only worsened economic performance, at least until actors adapted properly and formal rules evolved.

There are three consequences for corporate governance that are worth highlighting. First, in spite of the reformers’ attempt at dispersing ownership – a necessary condition for the Anglo-Saxon model to work properly – firms’ ownership ended up highly concentrated and the general situation of firms loaded with lack of transparency and conflicts with both administrative and political authorities and external investors. The consequence of the “perverse” behaviors of insiders has been the lack of true outside investors and non-contendibility of firms’ ownership.

Under these conditions, the primary goal of the owners is to secure the newly acquired property rights against the central administration and against courts and other potential or actual pretenders. A rational strategy for doing so is to form strategic alliances with insiders (particularly employees) and avoid the utilisation of external finance, in particular equity finance. In short, greater internal cohesion to afford external threats. This attitude makes the market illiquid: firms avoid external finance as a potential or actual threat to the owners’ position and outsiders do not trust this kind of firms. The other way around is also true: since the market is illiquid, only internal and, at most, external relational finance can be used.

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3 Richard Scase (2003) depicts this attitude with the fortunate term of “proprietorship” as against entrepreneurship that should exist in a sound market economy.
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Assets can be exchanged: indeed in Russia important private dealings took place, nearly exclusively outside the market, among businessmen who know and trust each other (or else using alternative enforcement means).

Such a situation may be viable and stable, yet it prevents firms from capturing interesting opportunities and their owners from appropriating potential profit. So it is probably bound to change. On the one side, formal alien institutions progressively fade away, both because actors do not adapt to them and because the enforcers realise that it is impossible to support them. On the other side, the situation of actors stabilises (in particular, the situation of new owners becomes stronger with time) and they require viable rules to capture more opportunities. This implements an implicit transition to a different corporate governance system which is far from the reform blueprint, but also from the old system.

4.3 Interpreting Transformation of Corporate Governance in Russia

Andrei Yakovlev’s paper represents the trends of the 1990s on a bidimensional chart, showing that Russia started (formally) from the Anglo-Saxon model of corporate governance in the upper left hand corner and reached a peculiar location in the upper right hand corner, with concentrated ownership. This is a contradictory and unstable location, though. In the present decade Russian corporate governance is probably migrating in the bottom right hand corner, the one typical of continental capitalism.

I have some problems with this representation. First, the vertical axis should represent explicitly another dimension of the models of capitalism, namely regulation, not the models themselves. Models should be represented by at least two dimensions: in our case, ownership and regulation.

Second, Yakovlev’s representation mixes models with reality. Indeed, Russia was never in the upper left hand corner: only the reformers’ dreams were there. To overcome this dichotomy, it is necessary to introduce a third dimension and transform the chart into a cube (See figure 1). This third dimension is, in my view, the most crucial feature of Russian firms in the nineties: the goals that firms pursued. I define this dimension in terms of its extremes: proprietorship and entrepreneurship, in the sense defined above.

Real Russia (or, at least its informal institutions) was in the rear bottom right hand corner of the cube: concentrated ownership, relational regulation and proprietorship, which has much to do with uncertainty in the property rights of the new owners. Therefore, Russian corporate governance is implementing a double transition: formal institutions descend rightward, informal institutions proceed frontward.
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When considering corporate governance reform in transition countries, two issues should be openly and carefully considered. First, what kind of corporate governance is needed in transition countries in general and in Russia in particular? In the debate on corporate governance, the two traditional paradigms of the shareholder value and stakeholder interest have been recently complemented by a third one, the innovative enterprise paradigm of Schumpeterian origin.\(^4\)

While the former two are static and move around ownership allocation and regulation, the latter is dynamic, but has in mind highly developed capitalist economies (entrepreneurship is its third dimension). All three paradigms typically stress some kind of separation within the firm: between ownership and control the shareholder value paradigm, between shareholders and stakeholders the stakeholder interest paradigm, between owners/managers and entrepreneurs the innovative enterprise paradigm. Although these dimensions are important, transition countries critically need a further dimension: that of the transformation. We still miss a corporate governance paradigm that puts the dichotomy transformation/conservation at the centre or, in our terms, the dichotomy proprietorship/entrepreneurship.

Second, what should be the ultimate goal of that reform? Here a profound dichotomy exists between the reform dreamers, who prefer to choose the “best” corporate governance system first and transplant it,\(^5\) and the conservatives, who prefer to leave things unchanged, maybe stressing that change is too costly or improbable. The real issue at stake is a different one: which kind of feasible reform is to be implemented in order to foster corporate governance as a force supporting the transformation of firms and making them more productive and possibly more transparent?

Feasibility is important to minimise the costs of reform implementation and to avoid (or reduce) unwanted and unforeseen consequences, i.e. “perverse” or “distorted” outcomes. Support to transformation is important to help the evolution also of informal institutions. Productivity and transparency are needed to attract capital necessary to finance much needed investment, i.e. the transformation and growth of firms. The viable choice can only result from a proper consideration and understanding of the potentiality of the country in general and its firms in particular, the nature of existing institutions, and the corporate governance solutions that have proved to work reasonably well in similar contexts.

\(^4\) Cf. Dallago (2002).
\(^5\) See Djankov et al. (2003) on the negative consequences of transplantation of institutions.
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In this perspective, Yakovlev’s paper offers important hints, explicitly or implicitly. The following seem to me particularly important. First, private benefit of control may be necessary to support long-term investment in a situation of uncertain property rights. Second, and following from this, the protection of (external) minority shareholders is probably not an important policy issue for the time being. Third, and following from this, the fast development of the stock exchange should not be the subject of particular policy concern.

4.4 Policies

Although I agree with Yakovlev’s policy conclusions mentioned in the former section, I have some reservation on other points. In a transition context such as the Russian one policies should pursue both private and public goals. The most important private goal is to provide firms with productive incentives, in Baumol’s meaning of the term. By this I mean addressing the desire of owners in a capitalist economy to use their property rights to have a proper return. Since the latter can be obtained in different ways (e.g. as profit, as quasi-rent, as outcome of the criminal use of those rights), it is important that policies support profit in a competitive environment and discourage the rest. To this end, proper public goal is necessary: regulation in tune with the private goal.

Yakovlev’s paper considers various ways of pursuing these goals. One possibility, that of the reform dreamers, is to keep the Anglo-Saxon corporate governance system as the final goal and solve the Russian “unpreparedness” by improving legislation, enforcing legislation, modernising firms, and forcing firms to open to external investors. Another possibility is that of the conservatives: since Russian institutions (the “special conditions of Russia”) are consistently and permanently averse to that system, the reform should either be abandoned or pursue completely different goals, practically formalise what Russian owners want: full control of firms that they often obtained in a less-than-transparent way. The paper correctly refutes both perspectives.

Yakovlev’s proposal is to look for a corporate governance system able to foster the transformation and development of the Russian firms and economy. To do this, he proposes two different approaches: policy pragmatism, including long-term support to the stock market, and bottom-up evolution (“market modernisation”). Although acceptable, if implemented now these proposals are likely to hide a danger, for three reasons.

First, firms are controlled by strongly entrenched managers/owners and insiders’ coalitions. Although these managers/owners are probably proceeding to give a more rational profile to their firms, as Dolgopiatova’s paper in this proceedings suggests indirectly, still firms contendibility is low. This is likely to put too weak a pressure towards entrepreneurship as against proprietorship. Second, there is a real lack of a liquid capital market in Russia to finance investments. Although I agree that pushing the fast development of the stock exchange market would be a mistake, still the problem remains. Third, the present property rights allocation is the outcome of past and present legal violations: should we accept them? If so, we should expect that violations will continue in the future, and thus jeopardise the very essence of transition and the stability of the market economy.

Are there alternative solutions to corporate governance reform? The issue is too important and complex to be treaded exhaustively in a comment. Still, some hints may be useful. First, entrenchment and lack of contendibility could be solved by supporting competition, for instance by means of anti-monopolistic policies, support to the foundation and the growth of small and medium sized enterprises, openness to foreign competition. Other important policies instruments to pursue this objective are taxation and bankruptcy. Second, illiquidity of capital markets should be primarily solved by reforming and fostering alternative sources of capital (in particular, banks).

Third, violations should be considered seriously as an important component of fully re-establishing legality, with due concern for avoiding the uncertainty that prosecution would cause among owners. The only solution I see to this touchy issue is to prosecute the most blatant past violations with a credible pre-announced time limit (e.g. two years) within which prosecutors must complete preliminary examination and show clear evidence, possibly verified by an independent non political body. At the same time, some \textit{ex ante} opportunity for substantial “reparation” should be offered to violators in exchange for discharging them of any further potential examination or accusation. This can be done, e.g. in the form of an extraordinary donation in a federal or local fund for supporting the establishment of new small and medium sized firms.

All this should take place without much concern for the theoretical model describing the type of corporate governance that will actually come out, whether Anglo-Saxon, continental, or else.
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Figure 1. The Evolution of Corporate Governance in Russia