Corporate Governance in Russia: Constraints and Prospects*

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* The present paper represents an attempt to generalize some preliminary results of series of research the author conducts under the auspices of IET and the Russian European Center for Economic Policy (RECEP). The paper does not pretend form a completeness of the verbal model described herein and should be grateful for comments and remarks to be forwarded at: arad@iet.ru

That which has not yet come about is easy to plan for.
That which is fragile is easily broken.
That which is minute is easily scattered.
Handle things before they arise.
Manage affairs before they are in a mess.

Tao Te Ching, 64

The fashionable topic

The problem of corporate governance[1] has become notably pressing in Russia since the late '90s. It was general processes taking place elsewhere and particularly the growing interest in the corporate governance in the US and a number of other countries that emerged over the '80s (as a reaction to the wave of 'hostile' captures of control blocks along with the strengthening of institutional investors' positions, the 1997-98 global financial crisis and challenges facing corporations in the developing economies that formed external motives for that. The adoption in 1999 of the OECD Principles of Corporate Governance allowed to generalize the respective nations' practices in the area, while the document has become a potential model set of standards and guidelines, particularly for transitional economies[2], among others.

Another important motivation was the revision of postulates of the Washington Consensus in the late '90s. The intensification of attention to corporate governance takes place in the context of informational problems, institutional and legal infrastructure[3]. Apart from the orthodox liberalization and privatization, political, social, and tax constraints to reforms, and long-term problems in the property and governance areas at last have succeeded to get recognition. Along with intensity of competition, the property form determines cross-country differences in terms of reforms conducted at the enterprise level. The quality of investment climate and the dominance of soft budget constraints determines differences on the country level[4].

In Russia, initially the interest in corporate governance objectively emerged only upon the completion of the mass privatization of 1992-94, though some economic and legal experts had yet before recognized the significance of the long-term nature of the problem. The law "On joint-stock companies" (December 1995) formed an important legal landmark in this respect. However, it can be argued that the nature of the discussion on corporate governance (more precisely, on discrimination of outsiders' rights) became applied against the background and following the outcomes of the boom on the securities market of 1996-97.

The most notorious conflicts of the time (Noyabrskneftegaz, YUKOS, Yuganskneftegaz, Samaraneftegaz, Purneftegaz, Nosta, Varyeganeftegaz, Vyksunsky Metallurgical Plant, Magnitogorsky Metallurgical Plant, Baltic Steamship, Leningradsky Metallurgical Plant, Akron, numerous communication and electric companies, etc.) became signals of the mass and chronic nature of the problem.

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[1] The term «corporate governance" is used in its strictest sense and means the system of relationship between different groups of shareholders and managers of a corporation. Such a system is established for the purpose of protection of shareholders (as a part of financial investors') interests from an opportunistic behavior of the management. We do not consider such a group of financial investors as creditors, nor we do not deal with a broader problem of stakeholders of the corporation. Obviously, in Russian conditions, the notional accents of the problem were modified with account of the specifics of the corporate control system in the country.

[2] The OECD Principles of Corporate Governance. OECD, 1999

[3] Stiglitz J. Whither Reform? Ten Years of Transition. World Bank Annual Conference on Development Economics. Washington, D.C., 1999, April 28-30

[4] Transition Report 1999. Ten years of Transition. EBRD, 1999, p.9

The discussion was generated mostly by foreign portfolio investors, who found themselves yet unaccustomed to the standards of the Russian corporate culture. Having given a rise to a new wave of and new instruments for property redistribution, the 1998 financial crisis has just contributed to the intensity of the discussion. That happened primarily due to the strengthening of managers' property positions and emergence of new shareholders in the national companies who had acquired stock packages on the cheap over the post-crisis period.

Given that the corporate governance practices of the late '90s clearly have a negative image, between 2000 to 2001 an efficient corporate governance has arisen as one of the most fashionable matters in Russia and formed the agenda for dozens, if not hundreds, of conferences and workshops. The largest corporations that in just 2-3 years before that had found themselves in the lists of the most malicious violators of shareholders' rights, are keen to adopt 'corporate governance codes', create 'shareholder-interest-watchdog' departments, introduce 'independent' directors to their boards, and ensure 'transparency'. Russia's FSC drafts its own 'corporate governance (behavior) code' whose sense and status are still unclear under the presence of the law "On joint-stock companies'. During the period in question, several private organizations offered their competitive 'corporate governance ratings' on the market, while bureaucrats have mastered the term and gradually transform it into a new fetish. On the crest of this situation there appeared a visible trend to emasculation of the sense and concept for corporate governance and its transformation into a new slogan for a new campaign[5].

Such an overall enthusiasm about corporate governance is caused by a number of reasons. First, currently the government has quite a limited kit of ways to demonstrate its pro-active stand with regard to the institutional reform area. For Western institutional investors, corporate governance has formed a painful idée fix since 'the wild '90s', and this was cast in the form of international financial institutions' recommendations. Finally, the biggest Russian issuers (and this is most important) find themselves completing consolidation of their joint-stock capitals, the financial possibilities for which have emerged only after the 1998 crisis. In addition, the expansion and emergence of newly integrated structures (groups) required additional resources, and the formal corporate governance standards formed a necessary condition for the creation of a peaceful image for programs of reorganization and accession to actual external (foreign) sources of financing.

At the same time it is clear that it should be the understanding of actual ongoing socio-economic processes in the country that should form the basis for any proposals on improvement of corporate governance in Russia. Before changing something one should have a clear vision as to whom, from what, why, and to what extent he should protect in the national corporate governance model frame.

Uncertainty of approaches

As far as key specifics of the emergence of the national corporate governance model is concerned, one should single out:

- the permanent process of property redistribution in corporations;
- specific motivations of many insiders (managers and large stockholders alike) related to control over financial flows and stripping a corporation of its assets;
- a weak or untypical role played by traditional external corporate governance mechanisms (the securities market, the market for bankruptcy, and the market for corporate control);
- a considerable government share in joint-stock capital and problems in the management and control areas related to it;

[5] In this respect, it would be useful to remember the campaign of 1993-98 on creation financial-industrial groups as a panacea for the national economy. The 1998 crisis has destroyed the myth, though apologias of such structures are still published sometimes.

- the federative structure of the state and an active role played by regional governments operating as independent agents in corporate relationships (more specifically, the agents that operate in the framework of the conflict of interests as owners, while exercising their administrative powers – as regulators, and as economic agents, too;
- an inefficient and/or selective (politicized) government enforcement (with a relatively developed law in the area of protection of shareholders' rights, though).

All the noted specifics has already been highlighted in the domestic literature[6]. However, still there are a whole range of conceptual problems, the uncertainty in interpretation of which makes applied solutions in the area of development of the national corporate governance model quite complex.

First, there still are no universal approaches, and at this point a particular, but very illustrative example with respect to transitional economies can be cited: in 1999, J. Stiglitz noted the need in increasing attention towards the role played by insiders. He argued that as long as the relation between property and management was concerned, insiders would have a favorable impact on it by minimizing the 'chain' of agent relations. At the same time, again, in 1999, EBRD identified the fight against 'entrenched insiders' interests' as one of their crucial areas of operations over the next decade.

Secondly, in a broader context, the problem of the economic nature of property rights goes beyond the framework of a 'pure' theory: in recent years, it has been increasingly related to a relatively urgent economic policy matters, including reform policies in transitional economies. Thus, while commenting on challenges caused by Russian privatization, in his recent review of a new institutional theory[7] O. Williamson points out that the privatization strategy was not quite successful and attributes that to its authors' adherence to the property rights theory developed by S. Grossman, O. Hart, and J. Moore[8].

Third, the (corporate) property structure currently emerging in Russia (as well as in other transitional economies) still appears intermediary, which makes it premature to draw any conclusions on its gravitation towards a certain classical model.

At the moment, one can note a formal existence of single components of all the traditional models in the country: a relatively dispersed property (but a non-liquid market and weak institutional investors); a clear and steady trend to concentration of property and control (but no adequate financing and efficient monitoring in place); elements of cross-ownership and the emergence of complex corporate structures of different types (though not gravitating to a certain one). Such an amorphous model also creates visible challenges to decision- making processes in such areas as legal and economic policies.

Fourth, the principle importance of the problem of affiliation relationship and beneficiary ownership (though the Russian law still lacks the latter concept) should be noted. As far as a real organization of property (control) structure and financial flows of many large national companies are concerned, practically all the original data for empiric research in such areas as property (with respect to both managers and outsiders) and enterprises' financial operations can be viewed as dubious.

In this respect, the problem of managers' property should be singled out: obviously, the share of directors cited in any polls is far from real. Their actual power in the company can be based on a relatively small stock package (according to some estimates, it is a 15% stake that often suffices), though there is a clear rend to maximization of the formal control – through their

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[6] See papers by: S. Auktsionek, M. Afanasyev, I. Belikov, D. Vasiliev,T. Dolgopyatova, B. Kuznetsov, R. kapelyushnikov, A. Klepach, P. Kuznetsov, G. Malgynov, Ya. Mirkin, A. Muravyev, A. Radygin, Yu. Simachev, R. Entov, A. Yakovlev, among others.

[7] Williamson O. The New Institutional Economics: Taking Stock, Looking Ahead.- Journal of Economic Literature, 2000, vol. XXXVIII, # 3, pp. 569-613

[8] For a greater detail, see: Radygin A., Entov, R., Malginov G. et al: Transformatsia otnosheniy sobstvennosti: sravnitelny analiz rossiskykh regionov I obschie problemy stanovlenia novoy systemy prav sobstvennosti v Rossii. M., IET-CEPRA, 2001

share in the joint-stock capital, including affiliated structures. In such a situation, it is extremely hard to test various hypotheses about the role played by managers in the form they were stipulated in classical papers ("the hypothesis of convergence" and "the hypothesis of entrenchment")[9].

Fifth, a comprehensive analysis may become possible only basing on a systematization of approaches developed in different areas, as different corporate governance mechanisms are subject to research into economic and institutional theory, corporate finance and management, law, sociology, psychology, history, and other branches of science. Notably, there has been a trend to emergence of an interdisciplinary approach to the problems over recent years[10].

Finally, the fact of discussion on the term 'corporate governance' itself, at least, as applied to a big public corporation is justified only in the case there are processes that form its *economic basis*: that is, the separation of property from management in a corporation and separation of finance (certain sources of finance) from management in a corporation.

There also are another two important aspects: in the context of the discussion about gravitation to one or another type of financial systems, it is sensible to consider the structure and level of concentration of joint-stock capital that determines forms of exercising the control powers in a corporation. At the same time, there also is a point of view that the existing legal approach (law and enforcement) is more effective for understanding corporate governance and its reform than a conditional division of financial systems into bank-oriented and market-oriented ones[11]. In other words, there arises the question about a reverse impact of the law on the development of economic preconditions of the emerging corporate governance model.

It seems appropriate to focus on the noted mutually related matters primarily from the perspective of the analysis of *actual constraints* whose aggregate will form a crucial factor determining the development of the Russian corporate governance model in the long run.

Financial systems and concentration of joint-stock capital

Traditionally, the economic prerequisites of national corporate governance models are analyzed in the framework of the comparative research into financial systems (A. Pigou, J. Tobin, R. Goldsmith, J. Zisman, A. Gerschenkron, M. Aoki, E. Berglof, among others). Financial system is understood as a certain institutional agreement that secures the transformation of savings into investment and allocates resources among alternative users in the industrial sector frame[12]. The allocation of resources is carried out by financial markets and financial institutions that deliver various intermediary services. The financial system and specific financial instruments reflect the existing in a society allocation of property rights as single financial contracts: shares, obligations, etc.

The aggregate of financial contracts, or more precisely, one or another combination of them underlies the structure of an enterprise (corporation's capital), which reflects the correlation of different financial contracts on the one hand and their allocation among investors (holders) of financial contracts, on the other. It is also important to identify how the right for control is exercised under one or another structure of capital, as it is the factor on which the efficiency of the economy functioning primarily depends.

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[9] Jensen M. Meckling W. Theory of the Firm: Managerial Behavior, Agency Costs and Capital Structure.- Journal of Financial Economics, 1976, vol.3, p. 305-360; Morck E., Shleifer A., Vishny R. Management Ownership and Market Valuation: an Empirical Analysis.- Journal of Financial Economics, 19888, vol. 51, p. 293-315

[10] See: Prentice D., Holland P. Contemporary Issues in Corporate Governance. Oxford, Clarendon Press, 1993; Monks R., Minow N. Corporate Governance. Blackwell, 1995; Turnbull Sh. Corporate Governance: Its Scope, Concenrns & Theories.-Corporate Governance: An International Review, Blackwood, Oxford, 1997, vol.5, #4, p. 180-205; Charkham J., Simpson A. Fair Shares: the Future of Shareholder Power and Responsibility. Oxford Univ. Press, 1999, among others.

[11] La Prota R., Lopez-de Silanes F., Schleifer A., Vishny R. Investor Protection and Corporate Governance, mimeo, 1988, p. 1-39

[12] Tobin J. On the Eficiency of the Financial System. Lloyds Bank Review, 1984, 153, p.1-15

The main feature that constitutes the either type of financial system is the significance of commercial banks in ensuring the functioning of industrial corporations. Depending on the role they can play in the long-term funding of economic growth, we should speak either about a bank-oriented or a market-oriented financial system, while a relatively conditional division of corporate governance models into Anglo-American and German ones, even with account of the specificity of the *kereitsu* model), is a derivative in this respect.

By 2002 Russia saw a situation when neither of the noted types of financial system dominates (according to constituting characteristics), but, even more importantly, they both function as 'thing in itself', separately from industrial corporations. The banking model of economic growth has proved to be non-credible in the late '90s. The securities market as a potential mechanism of mobilization of financial resources and control (through liquidity) over managers finds itself, with some cyclic fluctuations, in a chronic crisis.

As a result, the sole reliable parameter, using which one can try to identify the gravitation to either type of financial system, is the structure and level of concentration of joint-stock capital that determine forms of exercising the right for control. There are a great number of papers attempting to evaluate the property structure in Russia's corporate sector over the period between 1994 through 2001, and the present research takes them into account[13]. However, it would be appropriate to focus on concentration first.

Nowadays, the level of joint-stock property concentration in Russia is lower than in a number of Eastern European countries. The results of empiric research available provide for Eastern Europe of the mid-'90s more significant results[14] than those identified for Russia in the frame of the IET sample of 2000[15]. Nonetheless, such a process is underway, and it has accelerated sharply since 1998. The process concerns both the oil and metallurgical sectors where, post-crisis, a considerable amount of financial resources for consolidation of control have emerged, as well as the whole range of other sectors, too.

According to the data of a survey held in 1999 (the sample prepared by the Higher School of Economics and the RF Ministry of Economy comprised 300 enterprises), in 1998 the share of the largest shareholder accounted for 28%, the three largest ones – 45%, while every fifth enterprise reported the control block owned by the largest shareholder being 50%[16]. The 2001 REB sample noted for 53% of enterprises a "high" and "super high" levels of concentration (over 20% of stock), though the average size of a maximal stake accounted for 34.4% (vs. 32.5% in 1999)[17]. According to the Bureau of Economic Analysis data, the level of concentration of joint stock capital has doubled between the launch of privatization through 2000: as of the moment of privatization, it was only 15% of enterprises where at least one shareholder owned a blocking stock, while in 2000 – 33%. Over the period in question, the number of enterprises whose control blocks is owned by 2-3 shareholders grew 4-fold, while the number of enterprises with a single owner of a control block only doubled[18]. The latter difference is related to legal constraints to capital consolidation (the 30% cap in corporate and the 20% one- in antitrust law)[19].

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[13] A detailed review of the respective sources can be found in: A. Radygin., Arkhipov S. ownership Structure and Financial Position of Firms in Russia.- Russian Economic Trends, 2001, vol. 10, #2, p.18-26 and at: www.recep.org

[14] Frydman R., Ch.W. Gray, M. Hessel, A. Rapaczynski: private ownership and Corporate Performance: Some Lessons from Transition Economies. The World Bank. Washington D.C. Working Paper # 1830, 1997, September

[15] Radygin A., Arkhipov S. Sobstvennost, korporativnye konflikty I effektivnost (*nekotorye empiricheskie otsenki*).- Voporsy ekonomiki, 2000, # 11, p. 114-133. From the perspective of joint-stock capital concentration, 38.3% of JSC reported shareholders owing over 25% of stock, including in 31.6% of JSC- 1 shareholder with a blocking stock, while in 6.2% of JSC- 2 such shareholders. Only 12.8% of enterprises have a shareholder owing over 50% of stock, and only 4.1% of JSC – a shareholder owing over 75% of stock.

[16] Dolgopyatova T. Modeli i mechanizmy korporativnogo kontolya v rossiyskoy promyshlennosti (*opyt empirichskogo issledovania*).- Voporosy ekonomiki, 2001, # 5, p.48

[17] Kapelyshnikov R. Sobstvennost i kontrol v rossiyskoy promyshlennosti: nekotorye itogi oprosa rossiyskykh predpriyatii.- Rynok tsennykh bumag, 2001, # 20.

[18] Osnovnye napravlenia i factory restructurizatsii promyshlennykh predpriyatii. Moscow: BEA, 2001. Kuznetsov B., Simachev Yu. Fromirovanie svyazey mezhdy possiyskimi promyshlennymi predpriyatiyavi cherez uchastye v aktsionernom capitale i upravlenii. Tezisy. RECEP Seminar, 2001, 13-14 July

[19] At the same time, though with a number of reservations with respect to informal poles of control and various alliances, one can argue about the existence of a fairly notable statistical significance of a correlation between a certain level of concentration and enterprises' efficiency. The latter result was obtained both within the framework of the aforementioned IET sample and in some other research. For example, the REB data allows to argue about the existence of non-linear correlation between economic efficiency and the level of concentration; interestingly, it is

In the context of the problems related to regulation of Russian JSC (*alias* AO), let us consider an example as follows: it is a common view that a high level of companies' 'transparency' (information disclosure) usually is attained under a broad joint- stock base, i.e. under a low level of joint-stock capital concentration. If one proceeds from the fact that numerous stages of property redistribution in Russia would result in highly concentrated property, there are no real grounds for the existence of legal requirements to information disclosure in their present or even in a stricter form. Moreover, these days, they are practically not complied with. What does this trend to concentration mean from the perspective of securing shareholder rights? Speaking in La Porta, Lopez-de-Silanes, Shleifer and Vishny's terms[20], it is the process of ensuring safety of economic and legal conditions of an owner under the absence of a mature legal system of protection of shareholder rights.

As a 'shining example', in this respect one can refer to a conflict between Alfa-group and Taganrog metallurgical plant in Rostov oblast. Though the local management and affiliated structures' aggregate control share had accounted for 51%, 'Alfa-Eco' applied already well-tried takeover methods that suggest an acquisition of a minority stock (with a consequent increase of it) and the use of the notorious federal - level 'administrative resource' (filing lawsuits under any pretext, inspection raids by the Attorney General office, the Accounting Chamber of RF, Ministry of Interior, FSB, FSC, tax and antitrust authorities), while in the period prior to the governor elections the regional administration took a neutral stand. As a result, two representatives of Alfa-Eco were introduced to the Board of Directors of the plant (and such a decision can be consider legitimate, if 10 of 11 members of the Board voted for it), while the plant committed itself to transfer the major part of its annual profit on dividends. In the context of the present paper, it is particularly interesting that the conflict revitalized the local Oblast securities market: many enterprises whose classical control block has been long completed began to acquire shares to increase it up to 75% and more[21].

The noted situation raises the problem of a clear insufficiency of both the law itself and judicial procedures for protecting even large shareholders. The problem of a selective (state) enforcement at the request of private structures concerned forms a major systemic defect of the modern Russian model (see below), and it cannot be eliminated through cosmetic adjustment of legal acts and corporate behavior codes.

Separating ownership from management, agent problem and corporate conflicts

It is universally recognized that it is the separation of owner functions from managerial ones that appears characteristic of large joint-stock companies (as a fundamental trend) that gives a rise to the corporate governance problem itself[22]. In Russia, the situation is still fairly complex and contradictory. The mass privatization has led to the property dispersion, with the former (yet Soviet) managers de-facto dominating over their corporations in the early '90s. At the same time, due to various reasons, the corporate governance standards (as a way to regulate agent problems and managers' opportunist behavior) have not formed an element of the privatization and incorporation programs. The first corporate conflicts of the mid-'90s mirrored the growing concentration of joint-stock property. Managers actively involved in pursuance of the 'entrenchment strategy' and a vigorous acquisition of shares of 'their' enterprises fought by any means, legal and illegal alike, against actual external shareholders over the right of control. At

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enterprises where the largest shareholder owns 10 to 40% of shares that demonstrate the best production and financial performance.

[20] La Porta R., F. Lopez-de-Silanes, A. Shleifer, R.Vishny: Law and Finance.- Journal of Political Economy, 1998, Dec. vol. 106, # 6, p.1113-55

[21] Finansovaya Rossia, 2001, # 41, p.4

[22] It had been yet in 1924 that Th. Veblen stated the transition of control from owners to managers-engineers (Veblen Th. Enginners and the price System. N.Y. Viking, 1924), while in 1926 J. M. Keynes noted that the process of the growth of a large institution witnessed a moment when owners of the capital (i.e. shareholders) found themselves almost completely separated from management (Keynes J. Essays in Persuasion. N.T., Norton, 1963). A. Berle and G. Means provided a classical description of problems of separation (dispersion) of property and the transfer of control to managers (Berle A., Means G. The Modern Corporation and private Property. N.Y. MacMillan, 1932). Between 1960-1990 agent problems were analyzed by O. Williamson, W. Baumol, E. Fama, M. Jensen, W. Meckling, S. Grossman, O. Hart, A. Shleifer, among others)

the time, it was new shareholders and old 'entrenched' managers who represented conflicting parties.

There is a whole range of various studies of the dynamics of changes of managers in the national companies (developed by IET, BEA, RECEP, CEFIR, among others). For instance, according to the IET data, over 77% of the surveyed enterprises reported changes of managers over the period between 1992-99. One can assume that such changes were determined by the reinforcement of positions of the 'old' (under the majority control threshold) or the arrival of the new owners and the emergence of new alliances of shareholders (including 'old' managers), who gained control over the company or brought new managers (arbitration managers, etc.)[23]

The clash between managers and new external shareholders (and, accordingly, the significance of the classical agent problem) should not loose its urgency over the years to come. Nonetheless, the specific process of *convergence of functions of managers and controlling shareholders* that was so characteristic of national corporations in the late '90s is still there.

The national model of "managerial capitalism" thus emerges taking two parallel paths:

- managers at the same time gradually become controlling shareholders in a corporation, i.e. the key characteristic feature is the 'managers' capitalism', with managers as owners rather than high-rank employees (or the so-called 'insider capitalism', as it is generally known in Russia);
- in the course of consolidation of control external shareholders begin to exercise managerial functions or assign them to an entrusted representative ('junior' partner) of a group of shareholders whose relation to them is based upon a whole set of economic and extra-economic interests rather than wages or a formal contract.
- in any case, many Russian large- and medium-size corporations see an actual authentication of the manager and the controlling shareholder positions, which obviously is a compulsory situation caused by a number of reasons. First, the continuous convergence of functions can be attributed to the fact that under the existing environment ('gray' and 'black' corporate finance schemes, stripping off assets, 'optimization' of taxation, control over financial flows, complex organizational structures, crime, etc.) and the trend towards the fight over control, the owner (a formal or a final beneficiary) needs control to the extent he may not delegate to anyone even an operative control over his enterprise without running a risk to loose both the respective property titles and his control over cash flows. Secondly, it is necessary to take into account consequences of the partner system of organization of business[24] that is inherent in the majority of large private corporations. The system is organized according to the two- (three-, four-, etc.) partner principle, and the partners share both the property (control) and business. What does this mean from the perspective of emergence of the system of transparency of corporate relations?

At this point, there arise several problems: 'transparency' of the structure of property and finance; short-term investment, primarily a maximum orientation towards domestic sources, including pseudo-foreign credits, etc.; enforcement; long-term investment strategies of such corporations. Interestingly, years 2000-2001 saw an intensification of the inflow of pseudo-foreign investment in Russia de-facto representing the process of re-investment carried out by Russian owners. Numerous corporations are oriented towards foreign profit centers and, therefore, any toughening of the enforcement procedures may imply a discontinuation of this particular process. This gives a rise to certain requirements to toughening possible sanctions across the spectrum as a whole. The partnership system suggests an orientation to current short-term incomes: that is why the problems of

[23] According to FSC estimates (though evidently conditional ones), in 25% of national corporations the struggle for control was over by 1996, while by 1998 – in 50%. Hypothetically, one can assume that such an interpretation of the dynamics of changing managers (i.e. the change of control – the change of managers) can also be an indirect quantitative indicator of the development of this trend by 2001 (after an intense redistribution of property in the post-crisis period.

[24] See: Radygin A., Sidorov I. Rossiskaya korporativnaya ekonomika: sto let odinochestva?-Voporsy ekonomiki, 2000, # 5. One should also consider the trend to a legal arrangement for the purpose of 'closing' open-end joint-stock companies established in the period of the mass privatization of 1992-94 and after that.

coordination and implementation of a long-term investment strategy arise. Such an organization also provides a rigid system of minimization of losses associated with managers' opportunist behavior; such a system is not secured only by means of KZOT (*Labor Code*) procedures or lawsuits in the corporate law area.

Despite single statements made by representatives of business and academic circles, the continuous latency of the process of separation of property (controlling shareholders) from management is unquestionable. However there are nuances spotted across sectors and enterprises of different size. Thus, B. Kuznetsov noted the prematurity of debates over the problem of separation of property from management in its classical form[25]. According to T. Dolgopyatova, the main characteristics of the national property structure in Russia is the combination of the owner and manager functions[26].

Though under the convergence of these functions the 'chain' of agent relations (and the respective costs), gets shorter[27], indeed, such a situation results in a *notable complexity of corporate governance* from the perspective of objects to be protected. First, is it sensible in principle to discuss the bilateral problem of monitoring under the presence of a single subject? The answer is evident, as long as the complex of relationships between controlling shareholders and managers is concerned. Secondly, most of such conflicts take the form of relationship between managers in their capacity as controlling shareholders (controlling shareholders, including those as managers) vs. other shareholders. In this case, the modification of the corporate governance problem is related to the fact that one of the owners gains advantages that spring from his managerial functions rather than from property rights. The status of an owner allows the manager to lower costs for his protection, while, on the contrary, there is a rise in those incurred by other shareholders due to the need in monitoring the former manager's opportunist behavior[28].

Meanwhile, important form the corporate governance perspective, the relationship between managers and shareholders take shape in the following cases (variants of corporate control):

- the presence of a manager (without shares or having a small stake) and dispersed shareholders, mostly falling into the 'sleeping' or 'free rider' categories (regardless of their insider or outsider status)[29];
- the presence of several large but not controlling shareholders and an independent manager who can take an advantage of contradictions between them;
- the presence of a controlling shareholder-manager (or a manager as a junior partner fully controlled by controlling shareholders) and minority outsiders.

As a separate factor one should consider interests pursued by new pretenders for control (corporate 'capturers', takeovers) and 'blackmailers' (either within the frame of a trivial intra-corporation conflict between minority shareholders with a controlling one, or as an element of a strategy aimed at a takeover or capturing cash flows).

In Russia, the first case to a significant extent appears the most hopeless one, for the problem is related to chronic challenges in the production and finance areas (accordingly, with a minimal interest in an enterprise from the outside) and the costs of the primary allocation of

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[25] Seminar on corporate governance in Russia, 2001, May 17.Moscow, RECEP

[26] Dolgopyatova T. Modeli i mechanizmy korporativnogo upravlenia v promyshlennosti, p.48. At this point, the combination of the functions is noted only in the context of the rise in the share of insiders (the former directors), while the problem itself is undoubtedly broader.

[27] A number of empiric studies allow to speak about comparative efficiency of the insider model with the dominance of managers' property.

[28] Dolgopyatova T. Modeli i mechanizmy korporativnogo upravlenia v promyshlennosti, p.48

[29] Accordingly, it is the analysis of the multiplying effect, when given 'sleeping' partners, the control functions of the manager- shareholder grow sharply, that gains a great significance. This effect of concentration of control is also significant for a certain composition of a board of directors. Thus, according to some estimates, in year 2000, 10-15% of shareholders of OAO "Gasporm" could fall into the 'sleeping' category, for they did not react to intra-corporation events (though this example, of course, is not typical)

property rights in the course of privatization. Though according to the data of some surveys, at the first stage for many insiders the information asymmetry effect ensured getting control over more attractive objects, the mass of loss-making enterprises whose property is dispersed among small shareholders is significant. There also is the problem of so-called 'dead' enterprises that have failed to find an 'efficient owner' or were abandoned by a large shareholder.

The problem of conflicts within a company[30] between 'large minority shareholders" (10-30% of shares) and shareholders that have reached the threshold of 'dominating impact' (with their stake accounting for over 25-30% though lower than 51%) that has been actual over the post-privatization period seems to recede into the background due to a number of reasons. First and foremost this can be attributed to the processes of consolidation, intensification of operations in the market for corporate control (takeovers), emergence of strategic alliances of shareholders, and the absence of the secondary stock market. No doubt the shares remaining in employees' ownership as well as those still owned by the state create grounds for new such conflicts, however, the 10-year experience of the fight over control allows to find necessary counterbalances. As to relationship developing in terms of 'insider' and 'outsider' relations or corporate blackmail (under stock packages of any size), these matters should be addressed separately.

Finally, there also is the third case: that is, the classical problem of relationship between large shareholders (managers) and minority ones. Considering Russia's specifics, it is likely to make sense to identify (in the manner the US Securities and Stock Exchange Commission identifies them with respect to insider deals) such categories as: 'insiders' (insider shareholders) vs. 'managers', 'large shareholders'; 'outsiders' ('outside shareholders') vs. 'small shareholders'[31]. Without going into details in the area of typology and estimation of the noted sort of corporate conflicts, let us note that the most notorious scandals of 1999-2001 that involved small shareholders were mostly associated with operations of portfolio investors (primarily foreign ones) that 'surfed in' using the wave of several booms in the stock market.

It seems that this problem is important from the perspective of Russia's investment image. However, it does not appear extremely pressing, though it is objective, given the actual closeness of Russian corporations. The significance of the problem is also neutralized by the trend to consolidation of joint-stock capital, plus the problem is not unique for Russia. Furthermore, studies undertaken by the Max-Planck Institute for Comparative and International Corporate Law (Hamburg) show that currently it is the CIS countries that in contrast to the Central and Eastern European economies have the clearest and most stable tendency to the Anglo-American shareholder right protection model. The emergence of a protection system characteristic of provisions of the common law is noted in the CIS countries despite the presence of traditions of the civil law, while the Central European nations retain their adherence to the German model with a relatively stronger emphasis on protection of creditors' rights[32]. This is, indeed, the case. Suffice it to refer to the law "On joint- stock companies" (especially with account of amendments introduced in 2001[33]) and analyze the provisions that allow small shareholders to formally defend their rights. Finally, to a significant extent this matter falls within the purview of the court of law and the enforcement system on the whole as a crucial independent avenue for the institutional reform.

What are other constraints applicable to this particular aspect of the problem of corporate governance that apper most weighty? Following J. Tirole's classification, one can single out at

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[30] Following the terminology of Andreeff W. Le controle des enterprises privatizes dans les economies en transition. Une approche theorique.- Revue economique, 1995, vol.46, #3

[31] The plural interpretation of the terms 'insider' and 'outsider' in the economic literature suggests the following interpretation: (a) as insider (employees, managers) and outsider (banks, funds, other corporations) investors in the company; (b) from the perspective of integration into the inter-corporation ownership system (in holdings or under the cross-ownership system); (c) from the perspective of the degree of dispersion of ownership (insiders as large controlling shareholders vs. outsiders represented by small portfolio shareholders); (d) as 'insider executive' vs. 'independent directors in the composition of a unitary or a two-tier governing body. Some experts on the Russian law believe that all members of the board, those of a collegial executive body of a company, a person exercising the functions of a personal executive body of a company, and large shareholders that have a possibility to determine decisions to be passed by the company fall into the 'insider' category

[32] Pistor K. Corporate Law in Transition Economies. Max-Planck Institute for Comparative and International Corporate Law. Hamburg, mimeo, 1999

[33] Law # 120-FZ of August 7, 2001 substantially extended minority shareholders' rights, however, many protection means have been introduced at the moment the sphere for their application was objectively narrowing.

least three mechanisms that regulate the conciliation of decisions made in the frame of a corporation with shareholders' interests: the manager's retaining his executive position (and his business reputation on the respective market, should the corporation perform successfully); the provision of as effective incentives as possible to encourage an efficient (from the shareholders' viewpoint) management with the use of specially developed labor compensation systems; a direct monitoring exercised mostly by owners of large stock packages and their representatives[34].

The role played by each of such mechanisms, forms of their impact and correlation between them can differ substantially across different countries[35]. However, with all the differences in the current corporate control structures, each developed country sees an emergence of, or a complete system of checks and balances that can satisfy investors' (primarily owners of shares) interests, providing at the same time a sufficient managers' independence and creating conditions for their initiatives. The transition towards other conditions of a corporation's functioning is accompanied by changes in prerequisites for delegating powers and mechanisms of the direct and indirect monitoring.

The development of a corporate governance system often witnesses non-optimal processes: it could be the 'wave' of conglomerate mergers in the US between the late '60s to the early '70s that could be cited as one of such instances. However, an active functioning of competitive forces on various markets both outlines (as far as a longer–term trend is concerned) possible boundaries of such deviations and activates de-centralized mechanisms that help adjust the revealed 'distortions'. Accordingly, *the functioning of a mature system of competitive product markets, those for capital and labor* did form and still forms the crucial condition for efficiency of corporate governance[36].

The specificity of inter-corporation incentives in Russia for managers dealing with payment for and participation in capital[37], and, consequently, the non-constructivity of the current solution to corporate governance problems is evident particularly with account of the above.

Separating ownership from finance, or the problem of sources of financing.

This important aspect of corporate governance is directly related to the renewal of the largest companies' efforts to further its improvement.

According to a survey on the largest Russian enterprises of 2000-01, 80% of respondents stressed their demand for equity financing, though in practice only 14% of companies use them, mostly by means of ADR-GDR programs, while another 66% do not have a chance to attract them, and 20% appeared merely indifferent to the matter. As concerns debt finance (borrowed capital), this instrument is used by 59% of enterprises. Nonetheless, it is enterprises' own funds (for 91% of respondents[38]) that form the main source of financing.

It is investment-depressive sectors with obsolete capital assets and a high capital intensiveness (telecommunications, energy, and machine engineering) that demonstrate the strongest demand for external equity investment with the least actual outcome. At the same time, investment-growing sectors with a short production cycle (consumer goods, retail trade) that are close to the final consumer are particularly active in the area of an

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[34] Tirole J. Corporate Governance. CERP Discussion Paper # 2086. London. 1999.

[35] Some mechanisms of changing managers with respect to public corporations with dispersed property are described in: Bebchuk L., Hart O. Takeover Bids vs. Proxy Fights in Contests for Corporate Control. NBER Working Paper No. W8633, 2001, December

[36] For more details, see: Entov R. Korporativnoye upravlenie: theoreticheskie I empiricheskie obsledovania. Moscow, 1999.

[37] While addressing his audience at the Academy of national Economy in Moscow in 1998, a co-author of one of the best manuals on corporate governance Prof. R. Brailey, proposed the following remedy to ensure protection of minority shareholders in Russian companies: to propose managers to become small shareholders. He proceeded from the assumption that the manager's share (according to the British and US companies' experience) may not exceed 3% (when it boosts over 5%, the dismissal of the manager becomes practically impossible). Brailey R., Mayers S. Principy corporativnykh finansov. Moscow: Olymp-Business, 1997)

[38] Rol' nezavisimykh chlenov sovetov direktorov v upravlenii rossiyskimi perdpriyatiyami. Assotsiatsia menegerov, Assotisatsia po zaschite prav investorov. Moscow, 2001

actual attraction of external equity financing, while investment-static industry branches where volumes of own funds are considerable (mineral sector, petrochemicals, and metallurgy) reported a lowered demand for equity financing.

Interestingly, according to the BEA data, it is the sector for machine engineering of which consolidation of joint-stock capital is characteristic at most, while the opposite pole is formed by the light industry, with the oil and metallurgical sectors demonstrating the actual completion of the process. One also notes the absence of a positive impact of the consolidated property on investment activity.

From the perspective of sources of financing, the data of a more representative BEA sample appear less optimistic. As far as 289 investment-active enterprises (the data of 1997-1999) are concerned, there are the following trends: an evident rise in using their own funds (275 enterprises in 1999 vs. 257 in 1997); the renewal of the pre-crisis level of attraction of banking credits (37 vs. 38); the fall in equity financing through issuing corporate bonds (1 vs. 8); the rise in external financing on the part of Russia private investors (14 vs.5); the fall in the share of foreign private investors (0 vs.2). The rise in the share of Russian private investors is inherent in the enterprises where other industrial companies' control (in their capital, board of directors) is notable.

Given the current situation, can one expect notable changes in the medium term? The problem is multifaceted.

The 'wide director' mentality as a psychological problem of attraction of investment was pressing over the 1990s. At the time, practically all the researchers into specifics of Russian directors' psychology noted that their attitude towards external investors was basing upon the "let–them-give-me-money-and-not-mess-with-my-job" principle, while they totally approved an investment inflow into their enterprises. As it was noted above, the change of the 'old' general directors in the country has been rather rapid, while many enterprises have seen changes of owners and in the concept for investment process itself. In other words, 'wild' (and, accordingly, hopeless) variants to a significant extent have sunk into oblivion. A modern director, who himself became an owner or found himself closely related to a controlling group is quite aware that in the conditions of uncertainty investments are available only in exchange for property. At the same time, he feels that to give away a share of property is both psychologically hard (after 10 years of fighting) and even dangerous, considering the prospects for loosing control over it.

The problem of an objectively limited nature of possible sources of financing is important. The overwhelming majority of enterprises in the manufacturing sector are interested, at least theoretically, in an external joint-stock financing that in other transitional and developing economies forms just one of many means of corporate financing. However, Russia cannot allow itself to opt for such a choice[39]. The possibility of using the banking system as a locomotive for corporate governance and financing was added to the arsenal in the mid-'90s and provided a negative outcome. Meanwhile, banks still are incapable to ensure a long-term external financing of the real sector because of their capital shortages and short-term liabilities.

Some transitional nations have proved to be capable to utilize FDI to encourage corporate investment and restructuring. At the same time, the corporate governance model basing on an intense presence of foreign strategic investors in the key sectors requires a stable and thoroughly fostered political climate (notably, as mirrored by the Chinese experience, it is stability that forms the main factor in this respect). Though attracting FDI should remain a priority for some sectors, their considerable inflow is unlikely in the medium run. Given the current Russia's conditions, the external (both joint-stock and through borrowing) financing, in turn, indeed, sharply increases the risk of a hostile takeover (through purchases of stock, accounts payable, promissory notes and/or bankruptcy). Such takeovers have become a typical phenomenon between 1998-2001.

The schemes of purchases of stock, accounts payable, promissory notes, appointment of an 'own' irremovable (in the frame of the current law) competitive manager and bankruptcy for the purpose of the takeover of an enterprise are well known. In 2001, the innovation became the use between 1995 to 1997 of commodity promissory notes issued in compliance with the presidential Decree "On commodity and financial promissory notes"[40]. Originally, commodity

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[39] See: nestor, St., Jesover F. Principy korporativnogo upravlenia OECD v oblasi prav I ravnopravia aktsionerov: ikh aktualnost dlya Rossiyskoy Federatsii.- "Round Table" po voporsam korporativnogo upravlenia dlya Rossii. OECD, the World Bank, Moscow, 2000, 24-25 February

[40] See: Rubchenko M. A ved preduprezhdali! ("You were forewarned!")-Expert, 2001, # 5, p. 36-37

promissory note was viewed as a security denominated in commodity, and its transfer required just an endorsement. In 1999, after some conflicts the Supreme Arbitration Court defined such promissory notes as 'debt obligations made in writing' and ruled that they should be transferred under a cession agreement, with the accounts payable and receivable arising in this respect to be shown in books. The debts outstanding for over 3 months must have been subject to inclusion in the corporate profit tax base, however, all the participants in settlements involving such promissory notes automatically hid the respective debts and evaded taxes.

In 2001, such a collision was used by 'Alfa-Eco' to capture Orsko-Khalilovsky metallurgical plant. Considering the fact that in 1997 the estimated volume of commodity promissory notes in circulation was in 2.5-3 fold greater than M2 aggregate, the potential of the use of the noted capture scheme becomes evident. The only natural constraint to it is the potential aggressor's ability to mobilize regional authorities, including tax ones, *alias* 'the administrative resource', to reveal arrears to the budget over the period of the use the respective settlements and to initiate the bankruptcy procedure.

The self-redemption of shares and an artificial creation of accounts payable (with a concentration of shares or all the requirements with an affiliated company) has become a widespread method to prevent a hostile takeover of an enterprise. Obviously, this leads both to undermining the possibilities for self-funding and a decline in the enterprise' attractiveness in the eyes of potential external investors. Underestimation (regardless of whatever reasons) of many companies on the part of the market forms the constraining factor too.

In this respect, it is interesting to cite the data of surveys on dynamics of enterprises' debts the IET was holding in 1999-2000. Thus, of 109 surveyed enterprises 82 ones noted a decline or the absence of arrears to suppliers and to the budget in 2000 vs. 1999. Though there are many factors speaking in favor of the trend, nevertheless, it can also serve as an indirect proof of the growing awareness of the threat to use arrears as a corporate capture instrument.

In such a situation, it is corporate bonds that become the sole zero-risk means to attract external financing. The soar in interest in this instrument in 2000-01 was caused by such advantages provided by this means of financing as:

- a relative safety from the perspective of interception of corporate control;
- the market being short of financial instruments with a fixed interest rate under the respective favorable state of affairs (budget surplus, low inflation rates, lowering rates on the market for public debt);
- Russian investment intermediaries' (brokerage and dealing companies, and banks) interest in promoting new instruments for the securities market;
- mitigation of the dependence of a single borrower from a single creditor;
- a more flexible system of management of obligations, an increase in the term of crediting and the plunging cost for borrowed resources;
- tax and value advantages vs. banking credits and promissory notes;
- emergence (through 'pilot' and, most importantly, paid-off relatively small loans) of credit record and the image of a first-class borrower;
- the absence of defaults in the post-crisis record of the segment of the market that would lead to a rise in profitability rates in the market (though the volumes of issues made in 2001 effectively drive the profitability rates towards such a rise).

The FSC register comprises the data on 370 issues. Post-crisis, it was LUKOil that made the first issue of Rb.-denominated corporate bonds in May 1999, followed by OAO Gasprom and TNK holding. The companies clearly hoped to attract non-residents' funds held on C-type of accounts. By mid-2001, the volume of issues completed by over 40 companies exceeded Rb. 110 bln.. In the first half 2001 FSC registered 66 issues worth a total of Rb. 11.5 bln., while in the second half of the year the bond placement had the same rate (not less than 20 issuers, including some of them carrying out several additional issues).

Year 2001 witnessed changes in the secondary market. Until autumn the most of the issues were placed among the investors identified beforehand. Such investors were not inclined to sell the bonds prior to their maturity date, i.e. such issues were closed ones, and they were placed once. It often occurred that they formed the means of funding various projects in the real sector thus being alternative to crediting. It should be noted that such projects were related to takeovers through daughter and affiliated structures or to optimization of tax payments. The

secondary market was attended by not more than 10 issuers whose overall volume of issues was worth some Rb. 6 bln. The main trading spot became MICEX (80% of the market), where starting from 1998 obligations worth a total of Rb. 60 bln. have been placed. By late 2000 more issuers started their operations on an open market (public issuing), while the market volume tripled, with obligations having the secondary circulation worth over Rb. 20 bln. The obligation boom has given a rise to the revision of estimates of liquidity of this particular segment of the market, and the share of liquid papers in the ratings soared from 1/5 to 1/3. According to some estimates, by late summer 2001 up to 50% of bonded debts was placed publicly[41]. As a result, in two years the volume of funds attracted by enterprises and banks made up USD 2 bln., or some 3% of gross investment into capital assets in Russia.

At the same time, in G-7 countries, 30-60% of investment projects is funded by the means of bonded debt. The development of the market in this country is impeded by the following factors: the existence of the tax on transactions involving corporate bonds (0.8% of the face-value of the issue payable prior to registration of its prospect); the length of the registration procedures with FSC; common standards applied to additional issues of shares, ordinary and convertible bonds; inconsistency between the size of a company's authorized capital and its assets (the volume of the issue may not exceed the registered chartered capital); in a number of cases – appropriateness to secure the provision of bond issues; the danger of saturation of investment demand and the related need in an intense development of the secondary market to ensure the new investment inflow[42], among others.

In addition, in the foreseeable future the biggest national companies will keep on dominating this particular segment of the market (though meanwhile the largest and medium-sized issuers hold roughly equal proportions of it). From the perspective of demand, the market is dominated by commercial banks (up to 75% of the issues placed on the market) and various institutional investors, while the share of private ones is minimal. To attract private individuals' resources to the market, apparently one should, first, ensure a reliable provision for obligations, and, secondly, introduce the institution of collective (group) suits. The absence of the latter in the civil processual law even after the collapses of financial pyramids of the mid-'90s testifies to both the inability to learn the lesson and the existence of a strong opposition to this clear and simple concept.

So, the medium-term perspective implies the remaining two most typical options: 1) an enterprise' self-financing, including the return of its own funds in the guise of credits and equity joint-stock contribution as a basic source for 'independent' enterprises that are not incorporated in any technological chains or conglomerates formed by the formal or informal control (i.e. in 'groups'); and 2) quasi-external investment existing in various forms – for the enterprises that are part of a 'group' and as such receive a part of the centralized financial resources due to their position in the group hierarchy. In the latter case, possibilities for a direct self-financing are often restricted due to the specificity of cash flow arrangements within the group.

So, one can speak of a 'rationed' return of earlier withdrawn financial resources (assets), i.e. essentially of a substitution for self - financing[43]. With all due obviousness, while estimating the prospects for the emergence of an efficient (i.e. 'transparent' and oriented towards equity among all shareholders) corporate governance model, this conclusion can hardly be considered optimistic. The self-sufficiency in terms of financing, even if compulsory, in the frame of an enterprise or a group thus automatically eliminates the issue of equity joint-stock financing, which essentially forms the financial basis and incentives for corporate governance in its classical interpretation.

It should also be noted that in 2002-03 the mining industries will loose the advantages provided by the devaluation effect and high oil prices, while the problems of the structure of sources of financing will still be there. Furthermore, there will also remain obligations they undertook during the period of the post-crisis growth: credits against oil supplies at a current price, bond-related settlements, generous declarations with respect to a dividend policy, etc. The industries will still be faced by the task of restructuring and funding enterprises they have taken

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[41] Finansovaya Rossia, 2001, # 41

[42] The Round Table of FSC "Pravovoye regulirovanie rossiyskogo rynka korporativnykh obligatsiy". Materials and theses. Moscow, 2001, 17 April. Conference "razvitie rynka obligatsiy v Rossiii". Expert, 2001, June.

[43] In this case we do not mean the 'old' banking and industrial FIGs of 1993-98. For more details on new – post-crisis- structures, see: Radygin A. Koncentratsia sobstvennosti i integratsia v korporativnom sectore.-Rossiyskaya ekonomika v 2000 godu. Tendentsii i perspektivy. M.: IEPP, 2001. In this context, it is also interesting to focus on a conclusion of the cited BEA survey: the enterprises in the joint-stock capital of which the share of other Russian enterprises is highest are characterized with the worst (according to official statistical data) production and financial performance indicators, but at the same time – with a high level of investment made by private Russian investors

over. Once the growth–related euphoria is over and financial challenges arise, traditionally, it is primarily minority shareholders and creditors at the expense of whom problems are solved. So, the question remains open.

Enforcement as an instrument of corporate blackmail

The new version of the law 'On joint-stock companies' provides a number of restrictions with respect to corporate blackmail. However, the evaluation of legal possibilities of defense did not reveal efficient methods of defense (the law provides a reduced term of statute of limitation to appeal against decisions ruled by a general meeting – 6 months, the board of directors' possibilities with regard to dismissal of a general director, etc.). This does not mean at all that the law needs special amendments – such a defense should be back-upped primarily by court procedures.

Among innovations introduced between 2000-01 there is an application of Art. 49 of the law that allows a shareholder (including that owning one share) to appeal to the court of law against decisions passed by the general meeting of shareholders that caused him potential damage. Most often it is done to seek a prohibition of next meeting of shareholders (which should pass rulings supposedly substantial for the company or those concerning the change of its leadership) basing on the illegitimacy of the Board of Directors that convenes the meeting. Obviously, such a conflict is initiated by rivals or one of the actual parties involved in the conflict within the corporation rather than a formal owner of a single share. At the same time, though having every right to file a lawsuit from the formal viewpoint, the latter is unlikely to suffer an actual damage.

There are numerous instances of this kind, such as: lawsuits filed against OAO 'Krystal' (on the change of its director general), RAO 'Norilsk Nickel' (on the form of voting procedure on the issues related to the RAO restructuring), OAO 'Polymerstroymaterialy' (an attempt to ignore the court's ruling has just complicated the conflict), OAO 'Gasprom', the prohibition for OAO 'Mosenergo' to hold an early meeting (the change of its director general), an arrest of a stock package of OAO 'Severstal', the prohibition for OAO 'Transneft' to export the oil produced by LUKOil, among others.)

In September 2001, Mr. A. Volsky, President of the Russian Union of Industrialist and Entrepreneurs submitted a letter to the Supreme Court of RF requesting, first, to restrict the possibility for private individual shareholders to file suits at the place of residence to the courts of general jurisdictions and to transfer such trials to arbitration courts at the place of registration of the respective AO , and, secondly, to prohibit the courts of general jurisdictions to levy security arrests on companies' assets.

This thus allows to formally eliminate a judicial collision when an arbitration court and a court of general jurisdiction (the latter – basing on a lawsuit filed by a private individual) can make contradictory decisions. While a trial is taking place, shares are under arrest as the provisional remedy. From the economic perspective, this is a trivial capture of property that results in the uncertainty of an AO's economic operations, destabilization and reallocation of property rights. The seriousness of the problem is evident, that is why as a temporary compromise measure (until the enactment of a new Arbitration Processual and the Civil Processual Codes of RF) the plenum of the Supreme Court of RF 'did not recommend' the courts of general jurisdiction to pass rulings on prohibition of shareholder meetings basing on lawsuits filed by private individual shareholders on provision of their requirements[44]. At the same time the possibility of modification of the federal law through a decision of the plenum of the Supreme Court of RF following the noted letter of RUIE (as a precedent) prejudices the need in a new Arbitration Processual Code (passed in the first reading in spring 2001).

Yet another problem is closely related to systemic corruption – more specifically, to a mere re-orientation of the parties concerned - that are keen to pursue the same purposes - to

[44] The draft of the new Arbitration Processual Code of RF contains a provision that stipulates the closed list of cases involving citizens not being individual entrepreneurs that fall within jurisidiction if arbritration courts, including cases on legal disputes between a shareholder and a joint-stock company that result from operations of the given economic agent (except disputes in the labor area). In a greater detail, see: Gros L. APK-2000: mnenia, suzhdenia, predlozhenia.- Khozyastvo i pravo, 2001, # 9.

arbitration courts. At the same time, the refusal of securing measures leads to an evident danger of 'dilution' of the company's capital by the defendant in the course of the trial. If the court of law rules to apply securing measures, the defendant's filing a counter-claim to secure potential losses seems to be quite a sound move[45].

The Code of corporate behavior

A popular idea of adopting a national corporate behavior (governance) code does not form a priority against the background of the aforementioned problems and innovations[46]. Companies intending to follow recommendations stipulated in the Code will have an advantage of shaping their positive image in the eyes of the foreign investment community. In this sense the Code shall form some common, though formal, signal for potential investors about the state of affairs in Russia.

According to the data of a survey McKinzey held on 200 largest global investors (managing assets worth a total of USD 3.25 trln.), 75% of them put quality of corporate governance on the same level as financial and economic performance, while as far as transitional economies are concerned, they consider the corporate governance factor a priority. From the perspective of stock prices, 80% of the investors are in agreement with a corporate governance quality 'premium', while the capitalization premium caused by the quality of corporate governance can be found within the range between 20% (in countries with a mature corporate culture) to 50% and more (developing markets)[47].

Between 2000 to 2001 many largest Russian corporations have already adopted their own codes specifically for this purpose and any crucial changes in this respect are unlikely. Furthermore, they will be borrowing single provisions from the unified Code to the extent they will appear, first, interested in them due to a whole set of reasons and, second, consolidation of corporate control will be taken place. As experiences of 2000-01 showed, *it was in the course of consolidation of the control on the whole and particularly over daughter companies' assets, when a number of companies were enhancing their formal' transparency' and openness to small shareholders*. It is consolidations that play a primary role in this respect. Reducing the number of small shareholders forms the condition of improvement of the quality of their protection. Finally, the interest in external financing from abroad that currently can be implemented only by very few largest corporations should determine an orientation to corporate governance standards characteristic of the countries of investment origin rather than Russia.

The only possible form of such a Code is recommendation. However, the compliance with both recommendation and legal provisions by the companies facing corporate conflicts or the ongoing threat of hostile takeover is practically unrealistic. This implies a spontaneous nature of the process of emergence of corporate culture in the course of overcoming objective costs of property reallocation in the country. This thesis is directly related to the general problem of protecting shareholder rights.

Any attempts of a mandatory use of provisions of the Code as an external corporate governance mechanism (in this particular case through the securities market) cannot become efficient in the foreseeable future. For instance, making the access to a listing on an exchange subject to the compliance with the provisions of the Code is unsound as a mass, standard instrument due to the non-liquid and extremely narrow market and the clear trend to concentration of joint-stock capital together with the process of 'closing' open end joint-stock companies established in the privatization era forms an objective basis in this respect.

Hence, the objective purview of the present Code is clear. One can agree with an estimated very insignificant (5-10%) level of the Code's impact on the Russian securities market and a long-term investment inflow into it[48].

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[45] Finansovaya Rossia, 2001, # 37, p.3

[46] Kodex korporativnogo povedenia. Materialy dlya obshestvennoy diskussii. Moscow, FKTsB, 2001

[47] See: www.mckinzey.com/features/investor_opinion/index/html)

[48] Mirkin ya, Losev S. Zacshita investorov: granitsy vozmozhnogo i novye idei. –Rynok tsennykh bumag, 2000, # 22.

On prospects of emergence of a national model

As far as the prospects of emergence of a national corporate governance model are concerned, one can single out the respective crucial processes as follows:

- the latent state of separation of property from management (convergence of controlling shareholders and managers) will be there in the medium term;
- a very low probability of expansion over the upcoming years of an outside shareholder financing as the other key economic prerequisite for an efficient corporate governance;
- the current uncertain state of the national financial system does not allow even to presumably estimate gravitation of the Russian corporate governance system to any classical examples (primarily any other than self-financing, sources and, accordingly, types of control);
- the concentration of joint-stock capital is an evident process in the frame of which there takes place both consolidation of control and implementation, by *economic* means, of a 'self-sufficient' corporate governance model (proposed in the mid-'90s for the transitional economies in the *enforcement* context);
- given the economic conditions, legal innovations in the corporate law (protection of shareholder rights) area to a significant extent have reached their limits;
- without adequate general measures in the enforcement area, methods of protection of shareholders' rights may not be developed;
- in the absence of a developed system of competitive product markets, markets for capital and labor, and bankruptcy, the methods of monitoring of management will remain inefficient.

In addition, a whole series of empirical and legal data testified to the existence of a stable and *fundamental contradiction* in the emerging corporate governance system. That is, the latter implies the co-existence of two conflicting approaches: concentration of joint-stock capital that suggests a minimum set of legal shareholder protection means; the Anglo-Saxon legal tradition that implies maximization of means of legal protection of minority shareholders (which is fairly directly related to the ideological stance of the respective policy makers, however, adopted by parts, because of rather a strong resistance).

Their combination created a unique situation of mutual neutralization: a gradual reduction in the number of small shareholders decreases the significance of broad means of protection of minority shareholders from the perspective of the corporate sector as a whole, while the instruments of protection of small shareholders are transformed into corporate blackmail instruments; at the same time the creation of a developed system of legal means of shareholder protection, in turn, constrains the further development of the process of concentration of joint-stock capital (as a factor of the reverse impact of the law on economic processes). At the same time, one should take into account that protecting one's interests through furthering concentration is large shareholders' prerogative. They react to the enforcement 'on request' rather than the absence of legal protecting means, while minority shareholders see no conditions of consolidation, nor they can effectively defend their stand in the court of law.

Considering a more optimistic interpretation, one can speak about reaching in 2001 some 'model' balance between the level of concentration (adjusted for affiliated relationship and alliances) and a certain set of means of protection of small shareholders. A certain stabilization of the system suggests some optimism.

Does all the above mean that Russia so far lacks actual economic and institutional prerequisites for discussing a classical corporate governance problem?

The model implying the dominance of small shareholders' interests (or a strong emphasis in the law on an absolute protection of them) is, perhaps, possible. However, in practice, there are no conditions for it. Nonetheless, the role played by small shareholders is critical to ensure

companies' 'transparency'. Overall, in perspective one undoubtedly should head for some mixed model. The latter should take into consideration the aforementioned economic principles and trends and suggest the balance of interests of all shareholders and – in a broader sense – co-participants. At this point, the respective basis could be formed by model principles developed by OECD.

In the long-term perspective, one should take into account the global trend to unification of corporate governance models. In some sense, this proves the viewpoint that a legal design for a corporate governance model is secondary *per se* and based upon actual economic processes, particularly globalization ones.

In terms of applied approaches, it means an inexpedience (impossibility) of such a legal design of a 'national' corporate governance model that would match a certain classical sample (as such samples become increasingly amorphous). From the governmental perspective, a fundamental task is to consider corporate governance *in the context of protection and guarantees of property rights (rights of investors, shareholders) and ensuring the balance of interests (rights) for all the participants in corporate relationship*. As well, to maintain such a balance, the priority mission is to develop clearly set legal procedures.

Overall, one can draw a correct conclusion that currently there exist single applied tasks that allow to consider the corporate governance problem not at the mythological level. From the perspective of coping with such challenges as regulation and ensuring equity among shareholders, it would be appropriate to single out such areas as mergers and takeovers, control over big deals, affiliated structures, beneficiary ownership and owners' responsibility, the collision 'trust management vs. trust', groups of companies, bankruptcy. Should there be no efficiently functioning infrastructure and the political will to ensure enforcement, any attempts to advance in these areas would clearly become senseless.