The Problems of Corporate Governance in Russia and its Regions

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Introduction

Privatization is the logical reference point to be taken for the analysis of corporate management (control) and the general problems of transformation experienced by the property relations in an economy in transition, as well as for a comparison of Russian regions. The absolute argument in favour of this methodological approach is the very fact that it was mass privatization in Russia that conduced to the emergence of the corporate sector and to the development of a national model of corporate control and management. Accordingly, the approach of our research team consists in the notion that the process of privatization must be interpreted broadly - that is, not only as technical procedures accompanying assets sales (transfers) from the government sector to the private one, but a more fundamental process of creation of private property and formation of the institutional preconditions of further development of the market environment at the national and regional levels.

In this respect, the present project can be considered as a logical development of the subject-matter and methodology addressed at the first stage of research referred to as «Transformation of property relations; a comparative analysis of Russian regions and the general problems of development of a new system of property rights in Russia»[1].

It should be noted that up to now no complex analysis of this problem has been conducted on the qualitative and empirical levels as regards the conditions existing in Russia and its regions. At the same time, there is a number of problems (relating to corporate control and management in an economy in transition) which have never been solved even on the theoretical level (the limitations on the use of general theoretical approaches in an analysis of the model of corporate management in economies in transition should also be taken into account).

First, there exist no general approaches even on the level of theoretic and applied discussion - it is sufficient to refer to just one specific though very revealing case. Thus, in the year 1999, Joseph Stiglitz noted the necessity to pay more attention to the role of insiders who could favorably influence the reduction of the chain of the agents' relations in the context of the relations between property and management in economies in transition (Stiglitz, 1999). Also in 1999, the European Bank for Reconstruction and Development specified the necessity to

[1] See: Radygin, Entov, Mal'ginov et al., 2001.

struggle against "the interests of the entrenched insiders" as one of the principally important trends for the next ten years (EBRD, 1999).

Taken more loosely, the very issue of the economic nature of property rights transcends "pure theory" - recently it has been more and more frequently associated with some rather acute problems of economic policy including the policy of reforms in the countries with economies in transition. Thus, O. Williamson, in his recently published review of the new institutional theory (Williamson, 2000, p, 609-610) while noting the problems brought about by the Russian privatization associates the strategy of privatization, not completely successful in his opinion, with the adherence of those who have developed it to the Grossman-Hart-Moore theory of property rights.

Second, the structure of (corporate) property forming in Russia (as well as in other countries with economies in transition) still has an intermediate character, and all the conclusions as to its orientation towards a certain classical model (of the structure of ownership and corporate governance) must be somewhat revised.

Actually, at present, Russia formally has the components of all traditional models: a relatively dispersed property (but a non-liquid market and weak institutional investors), a clear and stable tendency toward a concentration of property and control (but in the absence of adequate financing and effective monitoring), some elements of crossholding, and the formation of complex corporate structures of various types (though in the absence of gravitation to any specific type).

Such a vagueness of the model also creates obvious problems as regards decision making in the sphere of law and the economic policy. For example, it is customary to assume that a high degree of transparency on the part of companies (disclosure of information) is usually achieved under the conditions of a broad shareholding basis (i.e., of low concentration). Based on the assumption that many stages of property redistribution in Russia would result in the emergence of highly concentrated property, any legal requirements (in their existing form and even more so - as they become more rigid) of information disclosure would be groundless. Moreover, these requirements are met with an extremely weak response even in their present form.

Third, the problem of affiliated relations and beneficial ownership is of principal importance. When the actual structure of property (control) and that of finance flows is taken into account as regards many of the largest Russian companies (see: Radygin, Sidorov, 2000), it would turn out that practically all initial data for empirical research - both in the sphere of property (including managers and outsiders) and the sphere of financial indicators of the activity of enterprises ~ would be open to question.

The property owned by managers poses a special problem. It is obvious that the share owned by directors as indicated in any surveys is far from real. The actual power wielded by company managers can be based on a relatively small parcel of shares (according to some estimates, frequently not exceeding 15%), though there exists a clear tendency towards maximization including that through affiliated structures. In this situation, any examination of various hypotheses of the managers' role as they were formulated in the now classical papers becomes difficult (for the "convergence hypothesis", see Jensen, Meckling 1976, and the "entrenchment hypothesis" - Morck, Shleifer, Vishny 1988).

The afore-mentioned specific examples, in particular, point to the necessity to conduct a complex theoretical review of these problems in order to reveal the most substantial gaps and understudied applied aspects.

The said requirement for a fundamental analysis of the existing theoretical approaches has predetermined the authors' considerable attention to this issue. The absence of such examinations in Russian literature ensures a self-sufficient importance of the obtained results.

Within the framework of the present research, a theoretical review of the problems of corporate governance was prepared. Consideration was given to certain formulations (definitions, general approaches, etc.), the problems of the interaction between corporate ownership and corporate management, the mechanisms of confrontation and cooperation within a corporation (special mechanisms of corporate governance as a complex hierarchical system of checks-and-balances).

The logic of research envisages - with regard to the achieved results - the need to further reveal the specific features of the formation of the corporate-governance model under the conditions of an economy in transition. Consideration is given to the general preconditions and typical features of development of a system of corporate governance under the specific conditions of an economy in transition, typical features of formation of the Russian model are analyzed.

The next logical step, and accordingly, the object of research are related to the specific features of Russia's regional development. Therefore, an important aspect of the present research is to investigate the regional specific features of the formation of the corporate-governance model in Russia (in the context of the system of the relationships "regional legislation - corporations" and the specific features of the property structure in corporations existing in various regions). The assessment of specific regional features of the formation of the corporate- governance system in Russia is based on the study of regional legislation and on an econometric analysis of the groups of enterprises from different regions.

In particular, the authors present an analysis of enforceable and legal enactments introduced by Russia's regions in the sphere of corporate legislation. Differences between federal and regional legislations are singled out, the distinctive characteristics of individual regions are pointed to.

The present research also contains a region-oriented examination of the influence exerted by different indicators characterizing a certain enterprise (for example, the distribution of corporate property of enterprises, the specific features of management, the presence of active assistance rendered to the enterprises from the budgets of different levels, the year of privatization) on the effectiveness of their operations. Apart from this, it can be assumed that such a dependence will differ according to the region and the sector this enterprise belongs to. Therefore, a regression analysis of the existence of corresponding relationships is conducted both for the whole data base (an unbalanced panel for three years (1997, 1998, 1999) consisting of 395 observations per annum which cover nine regions (Moscow, Moscow Oblast', Nizhnii Novgorod, Novosibirsk, Samara, Perm) and seven branches) and for each of the regions on a singular basis.

The first stage of the present research involved an examination of the standard neo-classical industrial function (in logarithms) which included certain corresponding variables characterizing the specific features of the enterprises from the sample such as the fictitious sectoral variables and (in the case of a joint data base) the fictitious regional variables. It should be noted that at this stage not all the variables characterizing the distribution of property were used to identify the model. [2]

Examination of the material presented by the Canadian side will make it possible to offer final comments and recommendations concerning the formation of the Russian model of corporate governance, with due regard to Canadian experience which can be very helpful in this case.

The applied results (to be used in the framework of the state economic policy) include the development of specific short- and medium-term recommendations addressed to the agencies of executive and legislative authority of the Russian Federation. The achieved results can be used:

[2] Considering the numerous difficulties associated with an econometric analysis of the specific regional features (the problem of endogenicity, correct selection of dependent variables, etc.), it is intended to conduct a separate study.

- as the elements of the legislative basis of state regulation (e.g. to introduce amendments to the existing normative-and-legal acts and to develop new normative-and-legal documents),
- to develop short-, medium- and long-term programs of the development of economic reforms in Russia and its regions and to map out a concept of the development of a long-term model of corporate governance,
- to conduct a complex assessment of the role played by different factors determining the character and the dynamics of investments in the Russian economy, and also of the role of their differences on the interregional level, to assess the proposals regarding the development of the mechanisms aimed at improving the investment climate in the RF regions and in the Russian economy as a whole.

The potential users of the results achieved by the project can include the RF Government, the State Duma of the RF Federal Assembly, the RF Ministry of State Property, the RF Ministry of Economic Development and Trade, the Federal Commission for the Securities Market, the administration and the legislative authorities of Russia's regions.

Section 1. Theoretical approaches to the problems of corporate governance

1.1. Formulation of the problem

The term "corporate governance" is relatively new in the literature on economics[3]. Until recently, the meaning of this term has also been rather vague. Thus, the authors of one text-book especially devoted to the problems of corporate governance define the latter as the relations between different parties as regards the tendencies of the development of a corporation and the effectiveness of its functioning (Monks, Minow 1995, p.1). According to the authors of one of the most prominent reviews treating the said problems, A. Shleifer and R. Vishny, the term "corporate governance" characterizes the methods by which the economic actors rendering financial resourses to a corporation can secure the profitability of their investments (Shleifer, Vishny 1997, p.1).

Such disagreements regarding the initial definitions of this new concept can be illustrated by numerous examples. In the present work, the term "corporate governance" is used to characterize the totality of the economic and administrative mechanisms by the use of which the rights of corporate ownership are realized and the structure of corporate control is formed.

The theoretical market model based on perfect competition usually suggests an extreme decentralization (the role of market participants is commonly played by individual entrepreneurs and individual consumers), while the mechanisms of management has an exceptionally market character - see, for example, Demsetz 1982. Under the conditions dictated by the existence of a complete system of markets (Magil, Shafer 1991) and the complete listing of all possible conditions in the contracts to be signed, the adoption of major decisions including those taken within the framework of a firm will be regulated by market competition.

The problem of corporate governance emerges in those theoretical models which tend to take into account the incompleteness of contracts and the asymmetrical character of information in the specific principal-agent relationships developing in a modern corporation.

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[3] It cannot be found in "The New Palgrave: a Dictionary of Economics" 1987 and apears only in "The New Palgrave Dictionary of Money and Finance" 1992 (Vol.1, pp.472-474).

To illustrate this more formally, one could use the starting assumptions presented by O. Hart in his article on corporate governance (Hart 1995a). Let us assume that the net income of a corporation, Π, is the function of efforts exerted by the management, e, and some stochastic factors characterized by the variable $\tilde{\varepsilon}$:

$$\Pi = g(e, \tilde{\varepsilon}) \qquad (1)$$

Since the shareholders delegate their right to take certain decisions to the managers, there emerge specific relationships between the former and the latter as regards the delegation of authority. The values of the variable e are nor observable, while the values of $\tilde{\varepsilon}$ are even non-predictable. Therefore, the owners of share capital are eager to secure effective (from their point of view) management by concluding a contract which not only lists some of the managers' responsibilities but also stipulates a positive dependence of their fees, Y, on the profit:

$$Y = y(\Pi) \qquad y'>0 \qquad (2)$$

Then heed is given to the hypothesis of the principal incompleteness of contracts which is so popular in modern economics. The more varied the scenarios of future events, the larger are the costs relating to the development and the discussion of such a contract[4]. It inevitably leaves numerous situations not stipulated in the contract totally unattended. Thus there emerges a certain space within which the managers are free to engage themselves in "egoistic" activities. As mentioned above, these activities can pass unobserved, and under the conditions of a competition-based economy, their consequences can be detected only after some time.

The very possibility of an access to the most complete and precise information and the possibility to take decisions based on it become the source of "power" of the (top) managers within a given corporation (Aghion, Tirole 1997; Rajan, Zingales 1997). The asymmetry of this information widens the scope of the managers' actions aimed at increasing Y while leaving the values of Π unchanged (or reduced).

And yet such an approach narrows the scope of actual conflict. The interests of a top manager usually are not limited to monetary payments; all other things

[4] Even in the instances of direct violations of a contract, taking legal action against the managers can turn out rather Inefficient, because in accordance with the existing tradition of "business judgement rule" the courts are extremely reluctanct to intervene in the sphere of managerial decision-making - see Fishel 1985.

being equal, they can prefer a larger firm[5], especially when it has luxurious offices, country houses, airplanes and other prestigious attributes (see Burrough, Helyar 1990). And finally, they can spend a lot of resources in order to preserve their position (according to the afore-mentioned authors, their position of "strength" inside the firm)[6]. All these factors can conduce to the growth of agency costs and to the deepening of the conflict of interests inside the corporation.

The conflict of interests of the shareholders and the managers is especially obvious in the sphere of accumulation of capital owned by a company. The most common example of such conflicts is a situation existing in the US oil industry after the more than a ten-fold increase in oil prices which took place during the 1970s. Much was said by the experts to the effect that any further prospecting for oil in US territory would be extremely costly and unpromising. Nevertheless, the administration of oil companies which came into the lime light in the years of the energy crisis was spending fantastic amounts of money on obviously loss-making prospecting. The assessment of such actions on the part of top managers later became a subject of heated discussions, and a number of influential economists (see, e.g., Jensen 1986) tend to see this phenomenon as a vivid example of insufficiently effective corporate management.

The sources of the conflict are unlikely to be completely eradicated with the help of perfect stimulation of the managers - in terms of relationship (2) it would mean finding some ideal function of y. The choice of an optimal (from the viewpoint of the owners of the strategic parcel of shares) strategy of the firm substantially depends on the shareholders' attitude to risk. Meanwhile, the managers would strive to find the best (according to their criteria) relationship between the income being drawn, Y, and "their own" risk generated, for example, by the sensitivity of Y to any fluctuations of Π[7].

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[5]See the discussion on Baumol's hypothesis (Baumol 1959; Marris 1964; Williamson 1964) and the contemporary approach to the said problems (Holmström1999; Milgrom, Roberts 1992a).

[6] A non-optimal behaviour contradicting the strategy of maximization of the firm's value can take place on any level of its management. Thus, the managers of a lower level eager to please their superiors can waste resources, carry out unjustified reshuffling, etc. (see Milgrom 1988).

[7] Some theoretical considerations demonstrating the principal incongruity of preferences regarding risk as expressed by the shareholders and the managers striving to preserve their posts or to get promoted are presented in the work by B. Holmström (Holmström 1999, Section 3).

The problems of separating control from property (and maybe those of a possible conflict between them within a large corporation) have been discussed in literature on economics for more than 60 years - since the time of publication of the widely known work by A. Berle and G. Means (Berle, Means 1932). An important stage in comprehending the problems of corporate governance was manifested by the works of Coase laying the foundation of the contemporary theory of firm (Coase 1937; 1960) and the development of a new approach to the analysis of costs generated by delegation of authority proposed by M. Jensen and W. Meckling in one of their articles (Jensen, Meckling 1976). The empirical studies devoted to managers' behaviour and first of all to that of the managers in largest American corporations (see, for example, Donaldson 1984) were in a sufficiently good agreement with the theoretical concept put forward by M. Jensen (Jensen 1986) according to which the administrative personnel operating within a large joint-stock company would try to maximize not the value of "their" firm but rather the free cash flows which they are capable of controlling more or less independently. Thus the conflict of interests between the shareholders and the management becomes more obvious, and this is also true for the costs generated by the delegation of authority within the corporation.

The following sections of the present work will characterize in more detail the mechanisms of interaction between the shareholders and the managers as treated by the theory of corporate governance. The relationships between them are considered from the standpoint of the realization of the rights pertaining to corporate and individual private property and also from the standpoint of the participants' interaction within a corporation.

1.2. Corporate property and corporate governance.

When corporate property is being defined through the use of categories usually characterizing individual property, there emerges a number of problems: the typical set of prerogatives secured by ownership inevitably splits among the stakeholders partaking in various operations implied by the functioning of a given corporation. Some authors (see, for example, Votaw 1965) proceed from the fact that within a joint-stock company, the relations pertaining to ownership, usage and control over the results of activity are mainly entrusted to the administrative personnel, while the right of appropriation of the net income generated by this activity belongs to the owners of capital. According to a number of authors (see Blair 1995; Hansmann 1996), when the character of some corporate property is being defined, it is necessary to take into account the whole complex of the relations being formed in the course of a corporation's functioning as regards the

shareholders, the owners of the borrowed capital used by the company, the administrative personnel, the workers and officials, etc.

In a few past years, theory has been especially and invariably attentive to the judicial infrastructure of relations regulating the relationships among various groups of shareholders, the owners of capital loaned to the corporation, and the administrative personnel. Research is usually focused on the problem of protecting the shareholders' rights. Meanwhile, it is emphasized that the very possibilities of realization of property rights depend not only on the laws existing in the country but also on the existing practice of judicial decisions.

The authors of one research devoted to this very problem, have come to the following conclusion: practical realization of the requirements envisaged by the laws (quality of law enforcement) is on the highest level in the countries with the German and Scandinavian structures of civil law, and is on the lowest one in the countries with French civil law (see La Porta, Lopes-de-Silanes, Shleifer, Vishny 1998). The existing legal-economic infrastructure can exert substantial influence on the character of the distribution of corporate property, on the system of the relations emerging within a corporation and on the direction of cash flows.

Economics accentuates the fact that property rights in different countries are combined with the rights envisaged by the system of contracts (including implicit agreements). Using this concept in connection with the activity of an individual company, A. Alchian and H. Demsetz characterized the firm as a certain "nexus of contracts" (see Alchian, Demsetz 1972). In a situation when contract rights and responsibilities can be reliably secured, the attributes of ownership are manifested, first of all, in connection with the afore-mentioned incompleteness of contracts. As soon as the circumstances regarding which the contracts contain no (direct) indications of any corresponding rights and liabilities of the parties, the terms stipulating the use of the factors of production which are not regulated by the agreements should be determined by the actual owners of these factors. Therefore, in the last few years, human rights have been most frequently defined as residual rights of management and control (in reference to the contracts' conditions) (see, for example, Milgrom, Roberts 1992b; Gravelle, Rees 1996). This approach was further theorized in the works of O. Hart, S. Grossman and Y. Moore (see Grossman, Hart, 1986; 1988; Hart, Moore 1988; 1990; Hart 1995).

The Hart-Grossman-Moore system of theoretical models suggests that each of the participants in the operations conducted by a certain firm owns some actual monetary and/or human capital. Trying to sell the factors in their possession, some owners resort to specialized investments; it is particularly true of the ad-

ministrative personnel accumulating knowledge and experience in certain spheres.

According to the concept under consideration, the scale of such specific investments would substantially depend on the degree to which the manager has managed to preserve (or obtain) the position corresponding to his or her specific investments. The most solid guarantees of the use of these investments are secured by ownership of the corresponding elements of capital.

Let us consider a theoretical model of some corporation where at least a limited number of participants can effect specific investments to be used in this firm only. When such participants obtain property rights to the elements of property or monetary capital, or, in other words, in a situation when at least one of the participants in the market exchanges preceding the formation of the company enters into the possession of some (supplementary) asset, there emerge additional stimuli to increase the amount of equilibrium investments.

In the final account, the action of the competition forces must provide such a configuration of property when the company emerging as a result of some agreement between all the owners of the factors of production gets an opportunity to most effectively combine the specialized resources. It is the functioning of a given firm as a uniform organism that creates the conditions for optimal specific investments; at the same time, the emerging combination of resources must secure the utmost benefits for every owner of property- or human capital (in other words, the emerging equilibrium must be Pareto-optimal).

In the framework of such a corporation playing the role of the "nexus of contracts", the investments effected by the majority of the participants (including the investments of human capital effected by the managers) are more or less securely backed by the system of corresponding agreements, nevertheless, this is not true of the hierarchical relations between the superiors and the subordinates within a firm. Because of the afore-noted asymmetry of information and the incompleteness of contracts, any delegation of authority can be only partly stipulated by a single contract, while the rest of the relationships necessarily have a rather informal character. Therefore, the relations among the owners are qualitatively different from the relations of subordination emerging within the firm. The specific features of the latter relations can be regulated by the characteristics of an equilibrium created in the repeating situations involving the superior and the subordinate: the sphere of responsibilities passed down the hierarchical vertical substantially depends on the size of possible losses on the part of the firm (the superior) and the benefits enjoyed by the subordinate, their preferences in time, etc. (see Baker, Gibbons, Murphy 1999).

The enforcement of contract and property rights is conducted to a large extent by the market. This concept is not new. A. Marshall argued that "supply of entrepreneurial talent in the sphere of capital management adapts, as a rule, to the demand for it" (Marshall, vyp. 1, str. 399). The regularity of repeating relationships bolsters the role of the "reputation" effect and the subsequent reaction of market partners: thus, most of the purchasers and sellers prefer to limit their business relations with the firms violating the terms of the corresponding agreement. A number of conflicts can be regulated within the firm itself (administrative punishment or sacking of a guilty employee).

Nevertheless, it is easy to notice that even when all the contracts forming, so to say, the framework of a corporation are in presence, the lest protected party is the investors who have invested their money in ordinary shares. Being the shareholders, they realize their property rights - the residual rights which include the right to the residual income (on payment of all disbursements envisaged by the contract) of the corporation.

The stability of both property rights and the existing contractual relations turns out to be fruitful when it is determined by market forces; it stimulates the owners to effect additional transaction-specific investments. But to support the existing configuration of property can be counterproductive if the previous forms of activity coordination and the routine technology are "artificially" conserved by the top management proceeding from its own egoistic interests[8].

Modern economics concentrates on the analysis of the dependence of the capital market's functioning on the effective enforcement of property- and contractual rights. If this enforcement can be based on the effective judicial support, solid traditions and business ethics, it becomes possible to ensure opportunities for a more intensive development of the stock market. In its turn, it creates new conditions for functioning of the corporation itself; at the present time, alongside the official reporting there emerge market assessments of the effectiveness of the transactions carried out by a corresponding company (in many cases, alterations in the market share-price can reflect the information on major changes in the firm's affairs more accurately than any published reports). Thus the investors op-

[8] Technical innovations should inevitably result in some changes in a corporation’s structure and therefore change the optimal system of contracts. As this takes place, utmost solidity should be demonstrated by those configurations of property which combine the most "synergetic" factors of production, that is, the factors complementing each other to the largest extent (see Hart 1995, Chapter 2).

erating on the financial markets indirectly monitor all the transactions conducted by the firm.

Moreover, developed financial markets can actively enforce discipline by introducing various forms of "punishment" applied not only to the insufficiently effective firms, but also to those companies which violate contractual commitments, do not ensure sufficient transparency of transactions, etc. (the external mechanisms supporting corporate governance will be considered in more detail below).

The most radical rearrangement of the structure of a corporation including the structure of corporate governance is carried out on the basis of market redistribution of corporate property. Examination of these market mechanisms concentrates attention on a rather specific market - that of corporate control.

Economics (see, for example, Grossman, Hart 1988; Barclay, Holderness 1989) distinguishes two groups of motivations to conduct transactions on this market. First, it is mutual interest, for example, interest in such income which is distributed by the firms among the shareholders in accordance with the quantity of shares in their possession. Second, it is certain individual benefits enjoyed by the holders of the strategic parcels of shares. While ordinary financial markets (portfolio investments) are dominated by the considerations relating to general income, the corporate-control markets are guided, first of all, by individual benefits.

In contrast to the standard model of an effective financial market (Fama 1970; 1991) it is hard to expect an extremely high elasticity of demand in terms of prices on the control market. If a share price significantly departs from the fundamental characteristics of the company in question, it can (all other things being equal) attest to the existence of substantial private benefits which can be provided by these shares to some purchasers, making it even more difficult to find any substitutes for these securities. Apparently, the following circumstance is still more important: the corporate-control market is characterized by the presence of numerous barriers blocking the progress of market forces, the "transparency" of this market is much weaker, and non-transparent bilateral transactions play a much more prominent role.

The market of large lots from the very beginning has been forming as a market of corporate control. Thus, in the USA, in the late l9th-early 20th century, the stock market not so much financed the large actual investments as provided resources for massive mergers and absorptions. Subsequently, in developed countries, purchase and sale of exceptionally large parcels of shares and take-over operations transcended the limits of stock-exchanges, but the said regularity once

again manifested itself with the first steps towards the development of the financial markets in the economies in transition.

The existence of substantial private benefits even in a developed economy can be attested to by the correlation of prices observed on the financial markets. Thus, the sale of a large lot of similar securities should apparently be conducted at lower prices (wholesale transaction plus the acceptance of additional risks caused by the fact that the portfolio being bought is not diversified). Meanwhile, the sale of a large parcel of shares would inevitably be conducted at a price well in excess of the ordinary market prices; the significant amount of the "bonus paid for the possibility of control" (see below") can indirectly attest to the scale of private benefits.

The existing theoretical models (Shleifer, Vishny 1986; Holmstrцm, Nalebuff 1992; Hirshleifer 1998) encompass a number of interesting notions illustrating the dependence of the market price at which large parcels of shares (in fact, implying control over the company) are sold on the degree of the initial concentration of property. These models suggest, among other things, that the larger the proportion of corporate property belonging to the potential purchaser, even before bids are invited, the cheaper (all other things being equal) could the latter get the "missing" shares. At the same time, certain dependencies - apparently, nonlinear (see Stulz 1988) - relate the price of corporate property to the initial proportion of the shares belonging to the managers of the company under consideration.

Intuition suggests that these conclusions, in general, are justified. The results of a number of empirical studies (Walkling, Edmister 1985; Morck, Shleifer, Vishny 1988; Hubbard, Palia 1995; Zingales 1995) are apparently in agreement with the above-noted characteristics of the corporate-control market.

In most cases, private benefits relate not simply to the possession of a large amount of shares, but to control over the existing corporation. In particular, it can also explain the regularity detected in many countries: corporations where a substantial parcel of shares guarantees corporate control extremely seldom have other owners of large amounts of shares (see La Porta, Lopes-de-Silanes, Shleifer 1999).

Nevertheless, it should be noted that certain premises used in the said theoretical models are clearly abstract. They seldom take into account the factors of uncertainty which in reality play a very prominent role on the markets of corporate control. Thus, the Grossman, Hart (1988), Shleifer-Vishny (1986), Hirshleifer, Titman (1990) and some other models suggest that all participants of the transactions on the corporate-control market possess some "absolute foreseeing"

and clearly understand the consequences of the firm's reorganization which will be carried out by the new owner[9].

Apart from this, the above-noted theoretical constructions usually suggest that private benefits are always realized by the shareholders effectively exercising corporate control. Meanwhile in real life, a certain - sometimes rather significant - share of private benefits is acquired by the CEOs. According to some assessments, private benefits obtained by the top managers of American companies in the 1980s amounted to approximately 4% of the corresponding companies' value (see, e.g., Barclay, Holderness 1989; Barclay, Holderness, Pontiff 1993).

The existence of private benefits can considerably limit any effective market redistribution of corporate property. Thus let us suggest, to begin with, that there is no private benefit both for the present owners of the corporation and for the potential purchasers. Let us also consider that a new owner would be able to secure a growth in the firm's value and that after the company passes into the hands of this "efficient" proprietor and undergoes reorganization, the share price (w_1) would exceed the former price (w_0). In such a case the potential purchaser would consider it reasonable to buy the strategic parcel of shares at a higher price if the extra charge would be less than (w_1 - w_0). It should be noted that the sellers of shares realizing the corresponding income from the difference in price will also gain.

Thus, when the financial markets are highly organized (in the above example there were no obstacles to competition, and all financial operations of both the firm and the purchasers remained absolutely "transparent", while, for the sake of simplicity, the transaction costs were assumed to be negligibly small) and the absence of private benefits is manifest, the market mechanism of the redistribution of corporate property alone can be expected to secure a more or less favourable (from the owners' viewpoint) distribution of property and to ensure effective corporate governance. However, the situation becomes more complicated when

[9] One of the effects emerging therewith in the theoretical-game models relates to the initial situation characterized by a strong dispersion of corporate property. The point is that effective control over any corporation is a social commodity; in an "atomistic" corporation, the concentration of property and the establishment of closer relations between property and corporate control can be obstructed by the free-ridering effect. But according to M. Bagnoli and B. Lipnan, the games with a limited number of participants are usually characterized by the existence of the Nash equilibrium (and none other) because a rational participant, the seller of a certain amount of shares, cannot assume that the outcome of the struggle for control does not depend on his decisions (Bagnoli, Lipman 1988, see also Teall 1996).

the scope of consideration is extended to include private benefits including those being extracted by the former owners who possess a large amount of shares or can influence the shareholders' behavior [10].

The most serious obstacles blocking the transition to a more effective corporate governance emerge in the situation when the former bearer of the rights of control uses his position to extract such private benefits (B_0) that significantly exceed the potential purchaser's benefits (B_1). Then, even if the change of owners results in an increase in the firm's value ($w_1<w_0$), the present owners of the strategic parcel would often refuse to sell their shares (and/or the managers would exert pressure on small shareholders in order not permit such sales to happen) on any conditions which could become attractive to potential purchasers.

Let the total number of voting shares equal N; and let us assume that the number of shares necessary to obtain an assured control over the corporation is (0.5N +1). For the sake of simplicity, we should consider that the acquisition of control over the given corporation yields no more or less substantial private benefits to the purchasers. In other words, according to the definition, $B_1 = 0$, while $B_0 > 0$. In such a case, the transition of control over the corporation to a more efficient private owner cannot take place when $(w_1-w_0)<B_0/(0.5N+1)$. In other words, the capital market does not ensure a transition to more effective (by the criterion of maximization of the firm's value) structures of corporate governance in situations when the private benefits being extracted by the present owners of the strategic parcel and /or the managers having certain means to influence the shareholders, as calculated per one of the (0.5N + 1) shares, will exceed the growth in share prices secured by the transition of control to an "efficient" owner[11].

At the same time, the rapid growth in the number of mergers and takeovers observed throughout the 1970s and the 1980s (for further details, see Jensen

[10] In such a context, the assumption of an absolute transparency of the market looks even less realistic. It results from the fact that the assessments of the purchaser's private benefits so important for functioning of the corporate-control market are significantly hampered by the inevitable asymmetry of information and by purposeful efforts of the administrative apparatus; while the said assessments play an incomparably more important role on the corporate-control market than on the markets of standard financial instruments, for example, the government bond market.

[11] We should repeat that the elementary models of this type are characterized by the assumption of "absolute foreseeing", while in reality the prospects of private benefits are often insufficiently "transparent" and stable; moreover, they entail substantial additional risks.

1988) and the new wave of activity in this sphere which has become manifest recently attest to the intensive functioning of the corporate-control market (though, naturally, not all of the mergers and takeovers are just a means to enforce a required level of "market discipline").

Private benefits assured by such a control can apparently amount (as already noted) to rather considerable sums; this can be attested to by the scale of overpayments in the purchases of large parcels[12] of shares. It is notable that the scope of overpayment demonstrates a stable positive correlation with the liquid assets (cash plus the most liquidable financial instruments) belonging to the "victim" of the absorption, and a negative correlation with the dispersion of share prices of the firm being absorbed (Barclays, Holderness 1989; 1992). The amount of the above-mentioned (see page) additional bonuses paid to the seller of a large parcel of shares is also rather impressive: in the USA such bonuses amounted, on the average, to 2.0% of the price at which the parcels of shares have been sold (Barclay, Holderness 1989). Especially large (up to 50-70%) were the overpayments in the case of takeovers of banks (Meeker, Joy 1980). The above-noted dependencies can give a certain idea of the objectives pursued by the firms carrying out the corresponding takeovers, and of the scale of private benefits realized by them.

Equally instructive are the differences in market prices of shares under the conditions ensuring more than one voice for certain classes of shares (the so-called multiple shares). In such cases, it is possible to calculate the sums of money characterizing the market "price of one voice" - see, for example the calculations presented in Lease, McConnel, Mikkelson 1983; 1984 и De Angelo, De Angelo 1995[13]. Recapitalization envisaging the issue of multiple shares was actively used by the management as one of the means of defense from aggressive take-overs (Jarrel, Poulsen 1988).

The following circumstance is apparently also of certain interest: those corporations where a serious conflict between a part of shareholders ("dissidents") and the supporters of the existing system of management is taking shape, have a much higher "price of one voice" than other companies (Zingales 1995). The

[12] According to the standards of the New York Stock Exchange, a large parcel should include not less than one hundred round lots (10,000 shares).

[13] The said overpayments are not just bonuses emerging in the course of an aggressive tender: none of the corporations examined by Lease, McConnel and Mikkelson was facing a hostile take-over.

"price of one voice" inevitably increases in any situation when the rights of shareholders are insufficiently protected (see Modigliani, Perotti 1998).

It is clear that the concentration of multiple shares in the hands of those who, in fact, realize the rights of control considerably hampers passing of a corporation into the ownership of a more efficient proprietor in a market fashion. According to S. Grossman and O. Hart, the smooth functioning of market mechanisms regulating the passing of corporate control to a more "efficient" owner most heavily depends on maintaining the correlation of the degree of participation in collective decision-making and the degree of the acquisition of the residual income, in other words, by the observation of the principle "one share - one vote"(Grossman, Hart 1988).

In practice, the above principle is gradually becoming more and more widespread. Thus in the USA by the mid-1990s the New York and American stock exchanges, as well as the trading system NASDAQ, had increased their listing procedures by the requirement "one share-one vote"[14].

The pyramidal (multi-tier) structures of corporate property can also be used to this end. The investigation undertaken by A. Shieifer et al. singles out 20 largest corporations in 27 countries (predominantly in developed countries with market economies); according to their estimates, in order to obtain 20% of all the shareholders' votes, 18.6% of capital is required on the average if all the countries are taken into consideration, while in the countries where the Anglo-Saxon model of corporate legislation is predominant (England, USA, Canada, Australia, Japan, Ireland, New Zealand, etc.) it is necessary to possess 19.7% of capital in order to achieve this objective (La Porta, Lopez-de-Silanes, Shleifer 1999).

Special attention has been paid recently to the problem of the influence exerted by the forms of property and corporate governance on the economic effectiveness of the firm. The solution of this problem is exceptionally complicated in the situations when the said influence combined with other factors is augmented by the influence of various mechanisms of economic regulation (of a planned character or market), while under the conditions of a market economy - by the heterogeneity of the market structure (based on competition or oligopolistic).

Apart from this, a considerable role in any analysis of the aforementioned problems can be played by the endogenicity problem. In the logic of reasoning described above, the type of property plays the role of an exogeneous factor, while the company’s efficiency is treated as a dependent endogeneous variable.

[14] Though, at the same time, the stock exchanges do not exclude the possibility of issuing various categories of shares "as an exception" - see Lang 1995.

However, the opposite approach is likely to be reasonable enough (see, e. g., Densetz, Lehn 1985) - when the equilibrium structures of property are formed under the influence of a number of factors, including the distinctive characteristics of the particular branch where the firm is functioning, the effectiveness of its operations, etc. Thus, the investments in shares effected by the institutional investors will depend to a great extent on the position of the company, its size, efficiency, etc. (as is shown below). The top managers possessing the most complete information on a firm's state of affairs can prefer share options to be their rewards only when they are expecting the real value of the firm to increase.

Nevertheless, our following presentation will proceed from the assumption that the now-existing structure of property is specified as exogeneous. Then, in order to especially emphasize the influence of competition, one could juxtapose the microeconomic characteristics of the effectiveness displayed by state-owned and private enterprises functioning in the competition-based and oligopolistic (monopolistic) branches. The estimates have brought a number of authors to the conclusion that private firms, as a rule, were more efficient than the state-owned ones both on the oligopolistic and the competition-based markets (see, e. g., Boardman, Vining 1989). The extensive review presented in this work clearly demonstrates that the authors of most investigations have also discovered a relatively higher degree of functional efficiency on the part of private firms [15].

Thus, among the conditions ensuring an effective corporate governance and an optimal distribution of resources, the key role is apparently played by the effective enforcement of private-property rights including the realization of "strict budgetary restrictions" (with the inevitable and strictly specified procedures of bankruptcy for the "violators"), and also active functioning of market competition.

Modern concepts of privatization (see, e. g., Shapiro, Willig 1990) most frequently proceed from the assumed fact of omnipresent existence of a certain "environment", in fact, typical of only a developed market economy. This assumption is apparently based on an unquestionably just thesis according to which the management of state-owned enterprises, acting from various (mostly non-economic) considerations, should pay salaries and all kinds of bonuses to a larger

[15] The overwhelming majority of the above-mentioned investigations dealt with American, British and Australian companies, i.e., the countries with a long history of the development of the institutional infrastructure of market relations, which in its present form guarantees effective functioning of private property and modern corporate governance. Privatization of enterprises under the conditions of a post-socialist economy should solve more complex problems (see below).

number of employees than it would be in the case of an "ideal" competitive company of the same type. Then follows an elementary conclusion about the economic effect which can be furnished by privatization (see, e. g., Boycko, Shieifer, Vishny 1996); thus, the transition to private property would enable the owners to demand from the company's managers to provide them a maximum-possible access to the information on the activity of the firm, and to demand from the state to effect the payments compensating for the benefit lost. It is not hard to notice that such a logic of reasoning unfortunately leaves “behind the scene” the problems of the formation of the economic and legal infrastructure of market relations ensuring the possibility of effective functioning of private property and corporate governance.

1.3. The mechanisms of confrontation and cooperation

The importance of corporate governance results from limited possibilities to use market methods (bidding based on competition and the subsequent agreement of purchase and sale) when establishing the relations between the required actions on the part of the manager and their defrayal. The agreement concluded by the participants cannot (as mentioned in Section 1.1) envisage every potential situation, and moreover, each of the managerial decisions per se cannot become a direct object of any market bidding and cannot cause any side payments. In other words, the sphere of corporate governance does not furnish conditions for a full realization of market processes envisaged by the Coase theorem (Coase 1960; Mas-Colell, Whinston, Green 1995, Chapter 11); the structure of corporate control and management emerging in a modern corporation characterizes an *alternative* method of organizing economic and legal relations.

Most difficult problems are produced by the following circumstance: any monitoring of the managers' actions and decision-making in the sphere of corporate governance represents, in fact, public goods, and many participants, no matter how interested they might be in upgrading the process of management, are eager to minimize their efforts and to realize the free-riding effect. And if it is also considered that participation in the firm's affairs inevitably entails significant expenses, it becomes clear that even among the shareholders capable of influencing decision-making in the sphere of corporate governance there are many of those who would not get involved in the said process. As in the situation with the supply of other public goods, the joint efforts expended in the absence of special administrative mechanisms, most likely, would be less than optimal.

The special mechanisms of corporate governance which were developed in the 20th century or are being developed nowadays, as a rule, represent a sophisti-

cated hierarchical system of checks and balances. This system centers on the relations between the owners (of the strategic parcel) of shares and the administrative personnel. The system of corporate governance uses the varied systems of stimulation of managers and equally varied forms of control; as this takes place, the mechanisms of supervision over the results of management in any corporate company are frequently subdivided into the internal and external ones.

1.3.1. The mechanisms of internal control

According to the theory of corporate governance, such mechanisms would include,[16] first of all, the monitoring usually carried out by the board of directors (Fama, Jensen 1983). However, the number of directors in a company can be rather large. Some of the directors (especially not "executive") are initially appointed by the chief executive officers (CEOs), and therefore they can preserve rather close links with the old administrative personnel and can be prone to the inertia of the former strategy of governance.

It is customary to consider that the real independence necessary to protect the shareholders' interests is possessed to a greater extent by the "external" directors, because they have less personal relations with the existing administrative personnel. In the multinational companies of the USA and England, the number of foreign entrepreneurs among the external directors has markedly increased in the last few years (Charkham 1995).

The results of empirical research, as a rule, confirm this hypothesis. The investigations revealing a significant negative correlation of the fluctuation of the market share prices and the frequency of subsequent replacements of CEOs have gained widespread recognition (see Coughlan, Schmidt 1985; Warner, Watts, Wruck 1988; Barro, Barro 1990). Especially indicative are the results of the calculations carried out by M. Weisbach who has demonstrated that in the firms with the predominance of external directors in their management (not less than 60%), a considerable drop in the market share prices increases the possibility of the CEOs being replaced in the year to follow three-fold as compared to with the rest of the companies (Weisbach 1988)[17]. From this point of view, the results of

[16] This section will primarily treat the forms of corporate governance especially widespread in the USA, England, Ireland, Canada, Australia and New Zealand, i. e., in the countries where the Anglo-Saxon model of corporate legislation is predominant.

[17] The "opposite side" of the said spectrum can be characterized by an equally common regularity: in the closely held companies, and especially in the "family firms", the relation between the change of the top administrative personnel and the preceding fall

investigations conducted by J. Byrd and K C. Hickman are also of interest: all other things being equal, the financial markets would higher evaluate the new shares of those corporations where the boards of directors include not merely external but apparently independent external directors (see Byrd, Hickman 1994).

The majority of the above investigations notes the well-observed fact that the external management is commonly renovated after a serious decline in financial fortunes of the company. It is clear that this phenomenon cannot invariably be a sufficient indication of the transition to a more effective corporate governance, but nevertheless, the facts can demonstrate that the advent of a new administrative personnel frequently entails not only some reorganization of production and sale but also a restructuring of the former system of accounting and reporting (see, e.g., Pourcian 1993). The following circumstance is apparently especially interesting: the financial markets usually perceive such an innovation as a signal enhancing the hopes for a rise in profitability of the company in question, and respond to it by an increase in the price of the corresponding shares.

When considering the functioning of the internal control mechanisms and the problem of renovation of the administrative personnel, we invariably come across the following circumstance: the above-mentioned processes are closely interlaced with the action of the external (in respect to the corporation) market forces; thus, the sharper the competition on the labour market, and in particular on the market of professional managerial cadres, the more care is to be exercised by the CEOs (and, accordingly, by the rest of the managers) as regards the interests of the strategic parcel's owners.

At the same time, the board of directors frequently demonstrates a tendency for bureaucratic swelling. The theoretical models of the optimal management of firms[18] indicate the possible sources of a gradual decrease in efficiency concurrent with the swelling of the "representative" personnel within the board of directors. Examination of this problem on the basis of a sample of American corporations reveals a significant and stable negative correlation of the frequency of sacking of the CEOs and the size of the board of directors; there is also a negative correlation of the rate of growth of the firm's market value and the total number of directors (Yermack 1997).

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in profitability (a growth of financial difficulties) of the firm is much less traceable (see, e. g., Allen, Punian 1982; Furtado, Karan 1990).

[18] For a review of such models, see Tirole 1999; Brickley, Smith, Zimmerman 1997; Holmstrom, Tirole 1989.

Another mechanism of internal control relates to the formation of an "opposition" objecting to the strategy exercised by the corporate management; in confronting the adopted strategy of development, the "dissidents" are eager to get support from other shareholders (proxy contests). But for the majority of shareholders, the upgrading of the system of corporate governance is a public commodity (see above), and therefore the initiatives of some of them can encounter a wait-and-see attitude of other participants (see Ickenberry, Lakonishok 1993).

Though the "dissident" shareholders rarely manage to achieve a direct success and to entice the majority of shareholders to follow them[19], nevertheless, they can exert a significant influence on the management's behavior. Let us note just one of the possible channels: the leakage of information usually occurring in such situations not only prods the board of directors into action but also stimulates an interest on the part of large purchasers on the market of control ("raiders")[20].

The problems of actions coordination and the formation of coalitions in corporations characterized by an atomistic structure are formulated through the use of the theoretical games models which have been developed in the past few decades (see Grossman, Hart 1980; Bagnoli, Lipman 1988; Teal 1997, etc.). One of the achieved results looks quite natural: all other things being equal, the concentration of corporate property conduces to a more careful selection of the administrative personnel. The results of specific investigations, as a rule, conform to this conclusion (see, e.g., McConnel, Servaes 1990; Denis, Serano 1996).

The structure of the corporate property existing in a corporation (alongside other factors influencing the formation of various coalitions and their stability) also determines the character of corporate control emerging on this basis. By using the probability model of voting, D. Leech and J. Leahy who analyzed the data

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[19] According to some sampling surveys of American companies (1962-1978), this was achieved, on the average, only in one case out of five (Dodd, Warner 1983).

[20] In the USA, in the 60 days preceding the publication of the information on the expected "battles" in "The Wall Street Journal", the additional yield on the shares of the corresponding firms had risen, on the average, nearly by 12%. Then, the 59 corporations where the "opposition" had been defeated were singled out from the total number of the firms under survey. During the three years after the emergence of the first news of the initiative undertaken by the shareholders opposing the strategy of the management, there were about forty retirements of the chief executive officers in twenty of these thirty nine firms, and those retired were presidents or chairpersons of the corresponding corporations (which significantly exceeded the average indicators of the sample) - see De Angelo, De Angelo 1988.

on 470 English companies quoting their shares on the stock exchange have come to the following conclusion: the more rigid type of control the shareholders manage to introduce, the higher is the characteristic of rentability (the share of profit in the price) on the part of the corresponding company (Leech, Leahy 1991).

The external owners of shares: the increasing role of institutional investors. The specific features of the internal corporate governance significantly depend on the category of the strategic parcel's owners and on the objectives they pursue. In the first half of the 20th century, a predominant proportion of shares in the USA belonged to individual holders; at present, an enormous amount of shares is at least partly controlled by the companies, first of all, by financial mediators. Throughout a long period of time, there have been formed various financial and industrial groups within which the banks and other financial mediators were capable to act as the owners of a large parcel of shares and as strategic investors or an institution more or less controlling these shares. Monitoring and control of the financial establishments are most important in Germany, Japan and some economies in transition.

With the emergence of institutions concentrating control over large parcels of shares issued by a number of companies, there inevitably arises the question of the role played by "external" owners. A hypothesis frequently found in literature on economics stipulates that a relatively high awareness of the situation displayed by the CEOs, the influence of continuous fluctuations of market share-prices and the threat of a frequent replacement of the owners inevitably result in the predominance of short-term objectives in the strategy of the firm (the "short-termism" effect).

Thus, it is argued that when facing a threat of a hostile takeover, managers experience a moral hazard; they are prone to take non-optimal decisions aimed at a short-term increase in the market price of their company's shares (Stein 1988; 1989; see also von Thadden 1995). The said tendency becomes especially strong because the financial mediators acting as the (co)owners of the corporation are prone to rapidly changing (in a relatively short period of time) the composition of their portfolios[21], and therefore they are often interested in a short-term increase in the market price of shares.

These considerations can reflect some important tendencies in the development of corporate governance, but the development of the said tendencies inevi-

[21] The surveys indicate that in Great Britain, the share-holding financial establishments keep the. shares in their possession for approximately seven years (see The New Palgrave, vol.3, p. 450)

tably becomes contained within certain objective limits produced by those same market forces. The assumption that the financial markets possess some informational effectiveness means that share prices reflect practically all the existing information on the actual opportunities of a company's long-term development, and that any "opportunistic" actions of the management aimed at achieving a short-term effect solely and detrimental to the interests of long-term economic growth are unlikely to be capable of systematically displacing the market assessments of this company's fundamental characteristics (which, naturally, does not exclude the possibility of short-term manipulations with market price of the shares, to which the company management interested in short-term effects can resort).

Any empirical validation of such hypotheses looks rather difficult[22]. Nevertheless, certain estimates can indirectly point to the absence of a clear-cut regularity (tendency) according to which the stock market would underprice the shares of companies intending to carry out exceptionally large long-term investments (see, e. g., the article by Ghan, Martin, Kensinger 1990) investigating the floating of American securities, and also one of the studies of the stock market (Miles 1993)).

At the same time, from the standpoint of the theory of corporate governance, it can be apparently assumed that the more control and property are concentrated within the corporation, and, still more important, the more stable these structures of control, the greater opportunities are open for the conduct of a long-term investment policy.

Another specific problem is represented by the long-term tendency to gradually concentrate corporate property in the bands of *institutional investors* (II)

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[22] Not all the values presented in the hypotheses of "short-termism" can be observed in principle, and therefore the characteristic of this effect is often somewhat mystical. Thus, one of the most ardent proponents of the said concept, J. Stein, writes that in contrast with some other forms of protection against take-overs, the short-sighted strategy of the managers is practically invisible. It can take place "behind the scene" in a large number of firms never targeted for a take-over and any attempt at observing it in the pure state can be very difficult, and it is even more difficult to prove the existence of this tendency by presenting documents at a court hearing (see Stein 1988, p. 75).
The author himself makes a reference (p. 77) to the observation belonging to McConnel and Muscarella (MeConnel, Muscarella 1985) according to which the market price of the shares issued by US companies positively respond to the announcements of any increase in their capital investments. However, it is not difficult to demonstrate that such a reaction of the stock market can be absolutely compatible not only with the hypothesis of "short-sightedness" but also with the hypothesis of a normal assessment - and under certain preconditions - even with the hypothesis of long-sightedness of the market.

such as pension funds, social insurance funds, etc.[23]. According to the logic just described, the concentration of the corporate control in the hands of the largest investors automatically ensures better *opportunities* of improvement of corporate governance.

However, the specific character of investments carried out by pension and insurance funds does not always sufficiently fit the execution of the efficient owner's functions, especially when the activity of the corporation under consideration involves a significant risk. The II's preferences which are rigidly restricted by strict formal (and also implicit) regulations implying a timely and indisputable payment of pensions, allowances and insurance sums can contradict the other shareholders' quest for maximization of the firm's value. Moreover, the II themselves invariably turn out to be large organizations characterized by a complex structure and an equally complex system of management; therefore, the effectiveness of monitoring the decisions being taken by the managers of the controlled corporations would decline alongside that of the influence that can be exerted on them. The surveys carried out in the countries of Western Europe also indicate that large II only on rare occasions conduct active monitoring (Renneboog 2000).

The portfolio of shares possessed by II, as a rule, is significantly diversified (thus, in the USA, the pension fund CALPERS owns the shares of more than 2,000 firms - Prowse 1994). This also narrows the possibility of strict control over the quality of management in each of these corporations. Moreover, the managers of pension funds in their turn do not have any special stimuli to seriously examine the state of affairs in the companies under their control and to actively intervene in management (see Murphy, van Nuys 1993). All this strengthens the tendency to free-riding on the part of some II: thus, not only the numerous small shareholders but even a number of owners of rather large security portfolios often find themselves in the role of some "passive periphery" in the system of corporate control.

The pension and insurance funds do their best to avoid a serious drop in the price of the shares of the corresponding firm. In order to avoid losses resulting from such a floatation of prices, an II can simply resort to selling the shares of this firm[24]. Thus, there occurs a significant limitation (or even elimination) of the

[23] In the 1980s and 1990s, various II controlled in the USA up to one half of corporate property (Smith 1996).

[24]The traditional "Wall Street rule", before the 1980s a real guide to action, runs as follows: if an II finds the actions undertaken by the manager of a partially controlled com-

long-term reference points in the management of companies whose shares are placed in the said funds. At the same time, the control over the portfolio of shares, as it has been shown, is subjected to specific functional objectives, and as such cannot constantly correspond to the market criteria. Examination of financial investments of large US pension funds indicates that throughout the '70s and '80s, the rentability of their portfolio of market securities, as a rule, was significantly under the average (see Lakonishok, Shleifer, Vishny 1992).

Moreover, the investment policy of an II usually turns out to be very selective. Econometric estimates can prove that the probability that the II could invest in the shares of a certain firm increases in correspondence with the company's growth and also in relation to its ranking among those included in the list "Standard and Poors. 500" - see, e. g., Duggal, Millar 1999. In other words, II most often prefer to invest in the largest companies with a significant share of insiders' property and a more or less reliable system of corporate governance.

Nevertheless, in the past few years some II have begun to pursue a more active policy within partially controlled corporations (in Great Britain and the USA it was often done by the large banks managing by proxy the assets of the funds - see Davies 1997). They were trying, for example to coordinate the efforts of the shareholders dissatisfied with the actions of their company's management[25]. Apart from this, they objected in increasing frequency to the managers' attempts at preventing a takeover by every means: thus in 1990, 90% of state-owned and 83% of US private pension funds came out against the threats of greenmailing[26] - see Karpoff, Malatesta, Walkling 1996, p. 386. The activity of the II manifested in the 1990s, can conduce to the transition to a more effective corporate governance; but even the most favourable result (for example, if the corporate management is replaced) will preserve the tendency to evade the most risky investment projects attracting other shareholders.

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pany to be unsatisfactory, he would not use his shares for voting, but would rather try to get rid of them with minimum losses (Herman 1981, p. 146).

[25] On noting the tendency to a certain rise in activity of II, S. Wahal who has carried out an empirical investigation of this problem comes to a conclusion that the effectiveness of their efforts in the sphere of corporate governance remains rather low; the results of introduction of their suggestions as regards upgrading corporate governance are not reflected in the market price of the shares issued by the controlled companies (Wahal 1996, p. 20).

[26] For further details concerning the managers' strategy aimed at preventing seizures of corporate control, see below.

1.3.2. The external mechanisms

The external regulators of corporate governance directly reflect the action of the competitive market forces. Thus, a serious weakening of the firm's positions on the commodity market can stir up the internal control mechanisms (more energetic actions of the board of directors, more acute conflicts at the meetings of shareholders, etc.). The role of the regulation carried out by the commodity markets is apparently especially important in developing countries and the economies in transition still lacking a system of highly developed financial markets and that segment of the competition-based labor market which should be represented by highly-professional administrative cadres.

The bank-loan market can also play a significant role. The control exercised by banks relatively limits the "non-maximizing" actions of managers; thus, when choosing a project, it is more seldom that the firm can expect to get any bank loans and even any assistance of the banks in placing its securities. In the case of appropriation of large loans, a distinctive role in the system of corporate governance can be played by the monitoring carried out directly by the creditors (first of all, by large banks).

In certain theoretical models (see, e.g., Dewatripont, Tirole 1994; Hart, Moore 1995) the following circumstance is especially emphasized: the contract formulating the allocation of a bank loan (or an issue of private bonds) envisages the creditor's priority right to the property of the corporation should the latter become insolvent; this can prevent the managers from choosing unprofitable projects. In the case of an abrupt deterioration of a corporation's financial situation, the control on the part of the creditors who have accommodated the firm with short-term loans becomes especially rigid (Berglöf, von Thadden 1994)[27].

Bond debts can be a key factor of long-term control. Thus, referring to the inefficiency of corporate governance in US oil companies, M. Jensen (Jensen 1986) notes that the necessity of regular payments of interest on corporate bonds would inevitably limit the freedom of actions enjoyed by the CEOs, and respectively, the scope of wasteful projects of oil prospecting in the USA in the 1980s, Such a logic suggests that provided an effective system of creditors' rights enforcement does exist, the managers, at least in the early stages of the development of the capital market, should clearly prefer some other sources of financing capital investments.

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[27] The regulatory role of large creditors can be also strengthened by the proliferation of contracts envisaging a revision of loan conditions in the case of any serious deterioration of a firm's financial position, see the Gorton-Kahn model (Gorton, Kahn 1993).

The general conclusions made on the basis of a number of econometrical investigations can convincingly demonstrate that the structure of a corporation's capital exerts a substantial influence on the profitability of its operations (see, e. g., Ofek 1993). As far back as the early 1970s, the work of W. Baumol, P. Helm, B. Malkiel and R. Quandt showed that capital investments involving the participation of external sources of financing were securing higher incomes (Baumol, Helm, Malkiel, Quandt 1970). All other things being equal, the securities market also higher appreciates those companies whose liabilities have a relatively large proportion of borrowed funds (see Maloney, McCormick, Mitchell 1993). The results of another investigation can indicate that a significant share of borrowed funds in the balance of a corporate company, suggesting the creditor's monitoring and the managers' participation in the ownership of the firm, conduces to a considerable increase in the return on equities (see Denis, Denis 1993).

However, it should be noted that even this consideration should fit the more general schemes of the organization of corporate governance. It can be demonstrated that an excessive bond debt can exert a "deteriorating" influence not only on inefficient but also on rather promising projects (see, e. g., Stulz 1990).

It should be added that the internal and external mechanisms of corporate governance are not always characterized by an absolute coordination; conflicts can emerge not only between the interests of the shareholders and the managers, but also between the said groups on the one hand and the "external" creditors - the owners of corporate bonds - on the other. Thus, the fact that some corporations have introduced the plans of stimulating their employees through the use of share options has conduced to a certain improvement of the company's fundamental financial characteristics and a growth of share prices, but at the same time has resulted in a decline in the market price of the corresponding corporate bonds (de Fusco, Johnson, Zorn 1990).

The specific character of control exercised by the debt market proceeds from the fact that in a situation of a significant weakening of a corporation's position, the greatest danger can be posed not so much by the demands on the part of the largest bank (an attempt to arrange some "special" agreement with it can be made) as by numerous smaller creditors bringing things closer to the bankruptcy procedure. The dependence of the role played in corporate governance by debt liabilities on the number of creditors becomes especially clear in the theoretical models created by P. Bolton and R. Sharfstein (Bolton, Sharfstein 1990; 1996). In Japan, Germany and some other developed countries such situations clearly expose the conflict between the owners and/or centers of corporate governance

on the one hand, and the banks and other credit institutions finding themselves in the position of major creditors, on the other.

The theoretical assumption that the longer the "shoulder" of the financial lever, the less probable is inefficient corporate governance, is consistent with the results of those few investigations which have ever been conducted in this field (Gilson 1990; Lang, Ofek, Stul 1996). Some additional arguments in favour of the said hypothesis can be also found in the comparison of corporate governance exercised in the companies with a significantly lower level of concentration of corporate property and a corporate governance more reliant on control on the part of the banks[28].

The regulatory role of the market mechanisms increases under the conditions of a developed securities market. The Holmström-Tirole theoretical models (see Holmström, Tirole 1993;1997) help to reveal the special role played by noise traders: in the final analysis, their operations strengthen the informative functions of share prices and make more economically sensible the expenses incurred by the market participants on collecting and processing the corresponding information. Under the conditions of a liquid stock market, the costs of "passive" (indirect) monitoring carried out directly by the investors decrease, while the dependence of the decisions taken in the sphere of corporate governance on the response of financial markets increases (Tirole 1999, Sec. 2.4).

The functioning of the control market exerts an especially important influence on the system of corporate governance. The role of mergers and take-overs in assisting transition to an effective corporate governance has been considered in Section 2, and therefore it is suffice to note just the following: all the actions of the managers "not approved" by the capital market result in a decrease in the price of shares issued by the company in question, and in conditions when a substantial part of its shares becomes (as it can easily happen) an object of the market turnover, this significantly increases the probability of a subsequent (hostile) takeover (see Jensen, Ruback 1983; Mitchell, Lehn 1990; Hirshleifer 1998).

Nevertheless, a simple change in market prices, as a rule, is not sufficient to cause any radical changes in the system of corporate governance. Considerable experience accumulated in the course of the 20th century can indicate that nearly every more or less decisive reorganization of the state of affairs in a private company has been invariably preceded by crisis situations on the capital market

[28] For further details concerning these differences, see the next section; for the extensive data characterizing the influence exerted by the banks and other credit institutions on the effectiveness of corporate governance, see OECD 1995a.

and/or on the commodity markets[29]. Therefore, when developing new systems of management, the largest companies tend to form flexible structures capable of more efficiently adapting to the changing requirements on the part of the market.

The action of the internal and external mechanisms via which the disciplining influence of the markets is exerted reveals certain features of "specialization". Thus, a study conducted by R. Morck, A. Shlieifer and P. Vishny discloses a rather interesting regularity. In the situations when a corporation was significantly lagging behind other firms within a given branch, a radical renovation of the management of such a company was carried out, as a rule, by some "internal methods". But if the very branch to which most of the activity of this firm was oriented encountered serious difficulties (for example, relating to an unfavourable phase of the life cycle), the firm in question more frequently became the object of hostile takeovers (Morck, Shlieifer, Vishny 1989). In the latter case, there exists an especial clarity as regards the possible limits of the internal mechanisms' actions, the limits determined by the scantiness of information (and competence) possessed by the directors and other senior officers controlling the decisions concerning the company's general strategy of development.

To what extent can the modern market provide a means for an effective corporate governance? This question is the focal point of theoretical disputes. Some economists consider that the distribution of property forms on the basis of the activity of the market forces as an endogeneous result of a "competitive selection" preserving just the most effective organizational structures (see, e. g., Demsetz 1983, p. 584). In other words, in the course of the process of evolution, the activity of competing forces provides a means for transition to the "best" structures of property and corporate governance.

While not neglecting the important role of such mechanisms, other authors (see, e.g., Jensen 1986; Shlieifer, Vishny 1997) point to abundant evidence of more or less systematic violations of market discipline even in countries with a developed market economy and to an extremely high (clearly "non-optimal") level of the cost of delegating authority observed among the numerous large corporations in those countries.

The above-mentioned views can relatively well agree with one another: the fact is, many instances of inefficient corporate governance can be easily related

[29] Just one example: in 1990-91, one of the largest industrial companies of the world, the General Motors, encountered enormous losses (not less than 6,5 billion USD in total), but sacked its former top manager only in 1992 when starting a serious reorganization of its operations.

to the "imperfectness" of commodity markets, especially the labour and financial markets, and to the barriers erected in the way of the competition forces. But, as mentioned above, the structure of corporate governance, in fact, characterizes *an alternative* to the purely market relations of sale and purchase; the problems in question are apparently cannot be exclusively limited to the imperfection of certain markets.

Up to this point, we have primarily discussed those corporations whose shares are liquid and can become an object of market influence (regulation). However, in the USA, there exist millions of corporations whose voting shares belong to a limited number of shareholders. Such securities, naturally, have not been subjected to the listing procedure; not only are they not quoted on the stock exchanges and in the extra-exchange turnover, but in general they can only extremely rarely become an object of any commercial transactions. Such companies are usually called closely held corporations[30]. In such cases, the action of the mechanisms typical of the capital market inevitably becomes more limited.

It has already been mentioned that the existence of private benefits creates powerful stimuli enticing (large) shareholders to gain control over the corporation. However, on many occasions the participants in the ensuing coalition games can make use of an insufficient protection offered to the investors, which in its turn would lead to the expropriation of the assets and other counterproductive results (see Bennedsen, Wolfenzon 2000).

Closely held corporations can encounter situations which look somewhat paradoxical, that is a decrease in the share of one of the largest investors resulting from overcapitalization and/or from the involvement of new investors in the controlling coalition may check the processes of expropriation subverting the very existence of the company. When the number of shares concentrated in the hands of each of the large owners turns out to be insufficient to exercise control, the coalition-game models can offer numerous equilibria, and the functioning of the capital market becomes much less potent in providing a means for the system's transition to a "good" equilibrium (for example, an equilibrium which can prevent the company's expropriation).

[30] At the same time, the criteria of reckoning the shareholders in the closed circle of the "internal" owners (and, respectively, reckoning the corporation among the closely held) in certain instances can substantially differ from one another.

1.3.3. The capital market and the role of the "entrenched management'.

A classic manifestation of an insufficiently effective corporate governance is the so-called entrenched management (EM) phenomenon (Jensen, Ruback 1983). The means by which the higher managerial staff is striving to consolidate their position are very versatile.

In this connection it would be appropriate to note that the distinctive line itself between shareholders and top managers is rather arbitrary because the latter quite often possess a number of a corporation's shares. The data relating to different historic periods are not quite comparable, nevertheless it seems realistic to believe that the share of the stock belonging to the managers in American publicly traded corporations has been growing since the 1930s and by now has become rather substantial: according to one study it rose from 13% in 1935 to 21% in 1995[31]. The greatest growth of the insider share in the distribution of voting shares was noted in the communications, telecommunications, transport and services sectors.

To which extent does possessing shares make the managerial strategy closer to the interests of the other shareholders? Since the time when R. Stulz's theoretical model was first published (Stulz 1988) it has been most commonly believed that when a comparatively small part of the shares belongs to the CEOs the latter (as well as non-shareholding managers) directly feel their dependence on the holders of the strategic parcel of shares[32].

R. Morck, A. Shleifer and R. Vishny (MSV) studied in detail the strategic dependence between the characteristics of the functioning of largest American corporations (371 companies out of Fortune 500) and the size of the insider property. The results of the study demonstrated a good compatibility with R. Stulz's theoretical hypothesis of a non-linear character of this dependence. When the managers' share did not exceed 5% of total stock there was a statistically significant positive correlation of the efficiency of a company measured by Tobin's coefficient q[33] and the insider share whereas for the interval between 5% and

[31] It is noteworthy that the median price of manager-owned shares (in USD) grew during this period by 5.5 times whereas their median real income grew by less than 2 times (Holderness, Krozner, Sheehan 1999).

[32] Top managers directly own only a very small share of stock: in a sample of one thousand largest companies the median share of stock owned by the top managers of respective corporations was 0.2% (see Murphy 1992).

[33] The q value is defined as the ratio of the current value of a company as specified by the securities market to the replacement value of real capital owned by the company.

25% a considerable negative dependency was noted (Morck, Shleifer, Vishny 1988).

In a number of later studies J. McConnell and H. Servaes (MS) obtained (also on the basis of American data) somewhat different results. The negative influence exerted by the management's "entrenchment" reveals itself, according to their calculations, only in situations when the managerial staff possesses not less than 50-60% of the total of a corporation's shares (see McConnell, Servaes 1990; 1995). The authors could not reproduce MSV's results even when the special econometric methods utilized by MSV were applied (piecewise regression). Conclusions similar to the results of MS were also drawn by H. Short and K. Keasey who investigated the influence of managers' corporate ownership on the efficiency of British companies (Short, Keasey 1999).

One of the most important reasons for the discrepancies between the results obtained by MSV and MS was noted by S. Kole (Kole 1995). The point is that MSV studied a sample that included, as it was noted above, only the largest companies whereas the statistical sample utilized by MS consisted of over one thousand companies including many "medium-size" and by far not the largest companies. And in the companies not classified as large in Kole's as well as in MS's study a positive correlation of the Tobin coefficient and the share of corporate ownership belonging to the CEOs can be observed within a wider range than that in MSV's study. In a meaningful way this could be interpreted, for example, in the following way: in the largest corporations where the greatest degree of the dispersion of corporate property can be observed, the "threshold" beyond which a manager as a shareholder may exercise the mechanisms of corporate control becomes considerably lower.

The choice of the degree of diversification of a company's economic activity is usually categorized as one of those problems which reveal the conflict between the stock owners and the managers. It is presumed that the top administrative personnel is as a rule interested in an ongoing diversification because it increases the managers' influence and prestige (Stulz 1990) and makes them more "indispensable" as far as managing the company in question is concerned (Shleifer, Vishny 1989). However the "excessive" diversification of the operations of large-scale American companies in the 1980s-1990s in actuality resulted is considerable losses suffered by these same companies - see, e.g., Berger, Ofek 1995; Servaes 1996)[34] There exist very demonstrative results of econometric cal-

[34] From this it does not follow, of course, that the managerial policy was the only cause of excessive diversification.

culations that reveal a statistically significant and stable negative correlation of the degree of a company's diversification and the share of external owners in its active capital (see, e.g., Denis, Denis, Sarin 1997).

The development of this conflict once again revealed the specal role of "external" competition mechanisms in the functioning of the system of corporate governance. The tendency to curb excessive diversification and to "focus" the economic operations of some campanies that has become apparent since the second half of the 1980s was most often caused, as numerous calculations have shown, by the action of the market forces - a serious deterioration of a company's financial situation, buying-up of its controlling parcel of shares and attempts at its absorption. Within absorbed companies a radical replacement of the top administrative personnel and speedy reorganization were carried out thus limiting the corporation's sphere of activity or its more or less independent division to those areas where it was enjoying unquestionable competitive superiority.

When discussing the managerial means of "entrenchment" we, of course, are going to look at those top corporate managers who do not possess any strategic parcels of shares. Such a strategy is often based on manager-specific investments usually made at the expense of the corporation in question. If a corporation is gradually focusing its activity, say, in those areas where its CEOs possess greatest competence, experience and connections (including political), in order to be able to function successfully it would increasingly need the services of such managers[35].

An important means of consolidating the positions of the entrenched management can also become "implicit contracts" (Shleifer, Vishny 1989; Franks, Mayer, Renneboog 1995), cultivation of a special reputation, strengthening of the connections with a company's directors, etc. In practice, such methods become especially effective when coupled with "entrenchment" in the sphere of control: without possessing one half of the stock they utilize such methods as a multitiered "pyramid", crossholdings, shares with a comparatively large number of votes, etc.

[35] This can also be the reason for the well-know striving of long-employed managers to support those technologies which they have already mastered successfully or to preserve that range of clientelle which they have been cultivating, i.e. certain inertia that is characteristic of the entrenched management's strategy. The existence of an asymmetrical relationship when managers enjoy much readier access to the information on market development trends and on costs and sales is yet another factor enhancing the above-said tendency.

The greatest danger for the CEOs of large-scale companies is represented, as it was said above, by hostile takeovers. And the most obvious forms of "entrenchment" are represented by various means of protection against takeovers. Among these there are "poisoned pills"[36], "poisoned" options (for sale), recapitalization based on loans (LCO), "gold parachutes", a threat of a counter purchase of shares (greenmailing), etc.; a detailed overview of these means can be found in Weston a.o. 1990, Chapter 20.

In a situation of asymmetrical information the entrenched management can resort not only to concealment of the information on certain operations but also to "signal actions" informing raiders about diminished value of the assets of a potential candidate for takeover ("crown jewels")[37]or about an open redemption of a part of the company's own stock (Ofer, Thakor 1987, Bagnoli a.o. 1989)

Empirical studies can also show that such defensive measures were considerably diminishing the opportunities for successful takeovers (Walkling 1985; Pound 1988). Along with increasing aggressive pressure of raiders the inventory of possible means of defense was also becoming more versatile. A study of the data available has shown that the spectrum of "defensive" measures was becoming especially wide in those cases when managers did not own any substantial number of the shares of their corporation and were not provided with "gold parachutes" (Walkling, Long 1984).

The economic consequences of the management's "entrenchment" can be judged, in particular, by the financial markets' response. The results of many empirical studies can demonstrate that almost all measures taken against hostile takeovers, all other conditions being equal, result in a decrease in the market share price of the company in question. We are going to cite here just one of the most elaborate studies – that conducted by L. Gordon and J. Pound and involving over 600 corporations. The authors' calculations show that a comparatively larger number of various measures of protection against takeovers were resorted to by the most likely potential "victims" – "cash cows" – corporations with the largest current cash inflow; and in all the instances studied the protective measures always were associated with a lowered market value of the company (Gordon, Pound 1993).

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[36] By the early 1990s over 700 large-scale corporations in the USA were utilizing "poisoned pills" (Roe 1993) including more than a half of the companies on the list "Standart and Poors 500" (Danielson, Karpoff, Marr 1995).

[37] The theoretical models illustrating the connections between lowering company's assets and the decreasing probability of it to be chosen as a likely candidate for a takeover are described in Horshleifer 1998, Section 3.

It was already noted earlier in the text that the entrenched management – those administrators who do not possess a sufficient number of "their own" company's shares – are the most active advocates of protective measures. As for those CEOs who own large parcels of shares – they are far less eager to diminish the value of their property in such a way; one study has revealed a distinct and statistically significant negative correlation of approving "protective" amendments to a company's statutes and the share of insiders in the capital stock (McWilliams 1990).

As to how the financial market may estimate the economic consequences of the entrenched management's activity can also be demonstrated by the results of one study where a possible impact of the news of a sudden (unexpected) death of top managers on the movement of stock prices is investigated. The appearance of such information was usually followed by a rise (sometimes very considerable) in the market share price of the corporation in question (Johnson, Magee, Nagarajan, Newman 1985).

The especial "persistence" of the entrenched management in following the previously approved course of a corporation's development (see Williamson 1964) can be explained not only by the success of this strategy in the preceding period but also by the above-said smaller managers' inclination to take risks. In the theoretical models of corporate governance with the entrenched management it is usually presumed that the unfavorable consequences associated with a seriously undermined solvency of a company have a greater impact on the managers' than on the shareholders' situation (and, consequently, the managers' strategy is characterized by a comparatively greater reluctance to take risks). Therefrom can follow also the lower interest of the entrenched management in any radical transformation in the company's operations as well as their especially marked striving to increase cash inflow and liquid funds. The strategy of creating "economic empires" by means of incorporating commercial centers whereto the cash flows are directed ("cash cows") thus becomes especially popular.

The proportional distribution of net incomes between the dividends paid and the profit retained in such theoretical models most often is shifted toward the latter. The additional reserves can be used by the entrenched management, at least partially, for the purpose of further "entrenchment" or even for subsequent management buyouts, MBOs[38]. Placing barriers hindering the action of the disciplin-

[38] An analysis of a number of MBOs demonstrates that control takeover by a company's top managers in many cases represents a certain preventive measure on the part of the managerial team against the threat of a hostile takeover (Shleifer, Vishny 1988 b).

ing market mechanisms thus creates specific conditions for the "entrenched" managerial team to be able to extract rent.

Nevertheless the concepts where the role of the CEOs is regarded simply as a negative influence of the entrenched management reflecting their rent-oriented behavior seem to be somewhat schematic and one-sided. Quite often there can occur situations when it is the shareholders who do not want to take the risk associated, for example, with a radial restructuring of a company's operations or a long term of recoupment of certain investment projects. In these cases market regulation can be seen also: the special position of top managers enabling them to command material resources and cash flows may make it easier, as it was already mentioned above, to take over the control from the holders of the strategic parcel of shares (for example, with the help of MBOs).

The top managers' position in the corporate governance hierarchy also strongly influences the structure of a corporation's financial assets. Within the framework of the above-said assumptions as to the shareholders' and CEOs' attitudes toward risks it is rather easy to demonstrate that, all other conditions being equal, the entrenched management will attract less borrowed capital than, say, a company that is fully open to the disciplining market forces. One of the reasons of such "underuse" of borrowed assets is quite obvious: while trying to avoid additional control on the part of the creditors, the entrenched managers can limit debt liabilities of the firm and thus widen their means of taking independent decisions[39].

The empirical studies cited here (Stulz 1990, Jung, Kim, Stulz 1996) rather well correlate with the hypothesis according to which corporations with the entrenched management resort to using borrowed funds to a smaller degree. In many instances such firms prefer additional issue of shares though debenture issue could have been more profitable for shareholders (in many cases the need to issue new bonds and not shares was imposed directly by the demands to increase the firm's value). A refusal to issue bonds, in the researchers' opinion, depended primarily on the interests of the entrenched management.

However as soon as a corporation can detect a threat on the part of a raider its management in an attempt to preserve their position are forced to resort to the capital market: the size of the financial leverage in such situations increases rapidly. Recently a number of theoretical models have been suggested where a firm with the entrenched management resorts to increasing its indebtedness not be-

[39] For a review of the theoretical models of capital structure formation with different methods of corporate governance, see Harris, Raviv 1991.

cause this can result in additional benefits for the shareholders but only in order to prevent a hostile take-over (see, e.g., Zweibel 1996; Novaes, Zingales 1995). Noteworthy are also the results of empirical studies: in a sample of corporations studied by P. Berger, E. Ofek and D. Yermack the additional demand for borrowed funds appearing in face of a threat on the part of a raider comprised on the average 13% of the total liabilities (Berger, Ofek, Yermack 1997). The loans received from financial institutions or – much more often – resulting from bond sales are usually utilized for the redemption of a part of the stock or for recapitalization carried out on the basis of attracted loans[40].

On the other hand, recapitalization and other protective measures based on attracting borrowed funds expand the possibilities of monitoring carried out by large creditors. Thus the pressure on the part of those groups that are interested in more efficient business methods increases. Earlier in the text we have already mentioned that the known empirical studies confirm the stipulation that the probability of inefficient corporate governance, all other conditions being equal, becomes smaller to the same degree as the "shoulder" of a financial lever becomes longer. An analysis of statistical data offers a proof that a considerable increase of a financial lever – both after recapitalization based on utilizing borrowed funds (Denis, Denis 1993) and after failed attempts at hostile takeovers (Safieddine, Titman 1999) – resulted in a noticeable increase in the basic characteristics of the economic activity of the corporations in question.

Rounding up the discussion of this issue we should like to mention also the other side of the problem. The concept of entrenched management proceeds from an assumption that the holders of a large parcel of shares direct the activity of the general staff and managers of a company toward increasing the company's value; the more detailed the monitoring procedures the more effective (from the shareholders' point of view) should become the management's efforts. Nevertheless in many situations a "dense" control on the part of a large-scale owner is counterproductuve because it can stifle the managers' initiatives.

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[40] The relation between the measures by means of which the entrenched management attempts to prevent a hostile takeover and an increase in the financial leverage are most graphically revealed in the work by G. Garvey and G. Hanka. They showed that the approval of the so-called second generation of laws limiting the opportunities for hostile takeovers (1987-1990s) allowed American managers to immediately implement a series of measures aimed at decreasing the financial lever utilized by a company. In this connection an especially great reduction of the share of borrowed funds could be seen in those corporations where insiders were controlling less than 5% of corporate capital (Garvey, Hanka 1999).

This point becomes especially important if one takes into account the incompleteness of contracts with the managers; the salary scale range envisaged therein necessarily leaves out some of the circumstances that might influence the final results of their activity[41]. In such a situation excessively detailed monitoring procedures as well as additional bonuses or deductions from salaries may negatively influence the initiative of the managerial staff and to weaken the managers' incentives for specialized investments.

The question is not only (and maybe not so much) about the excessive intervention of an owner of a large parcel of shares in the sphere of such decisions which can and must be taken by a professional manager. Modern economics (see e.g., Cremer 1995; Burkart, Gromb, Panunzi 1997) accentuates the idea that the very introduction of additional "rules of the game" (apart from those outlined by the contract) can indirectly encourage some "opportunistic" actions or inertia on the part of the administrative personnel.

Just one example. By using a theoretical game model, K. Schmidt demonstrates that the managers of a state-owned enterprise who are relatively seldom facing the prospect of loosing their jobs because of inefficient management would spend less efforts (all other things being equal) than those of a private enterprise (Schmidt 1996). But the same logic implies that they would likewise spare their efforts at a private enterprise where the responsibility for managerial decisions should be carried by the owner who is especially vigilantly keeping an eye on the CEOs. And the role of the adjustment mechanisms can be played here (at the next stage) only by the ones of market regulation.

When the position of managers is interpreted strictly as that of ordinary employees, references to the discipline imposed by the labour market seem to be most natural. E. Fama especially emphasizes the influence exerted by the competition among managers and the role of the reputations established on the market of managerial services (see Fama 1980). As may be inferred from the research on the practice of decision-making in American corporations, the existence of "external" labour markets has a disciplining influence even on the behavior of the board of directors' members (see Gilson 1990; Kaplan, Reishus 1990).

In practice, the system of priorities adopted by corporations when recruiting CEOs tends to encourage those administrators who display career concerns. At the same time, a manager aiming at a rapid career growth would by no means always conform his actions with the principles of property maximization - see, e.g.,

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[41] The impact of unforeseen circumstances is reflected by the chance variable $\tilde{\varepsilon}$ in O. Hart's model discussed in Section 1.

Holmstrom, Ricart i Costa 1986. Most investigators of this problem agree that in real life the reputation effect quite seldom permits to substantially reduce agency costs.

The development of a scheme of the optimal stimulation as regards the administrative personnel occupies a special place in the theory of corporate governance[42]. There inevitably emerges a number of problems. To begin with, the elementary model "principal-agent" does not include any "intermediate links" whose role can be very significant.

The point is, that the distance between the decisions taken on a daily basis by the managers and the changes in the firm's value is extremely large, while the information on the CEOs' efforts and decisions most frequently has a technical character and cannot represent an object of daily attention of the shareholders. Therefore, the criteria and the schemes of material stimulation are most frequently developed inside of the firm by the managers of a higher level, and all the problem becomes, so to say, simply shifted to one level, while in the course of "upward promotion" the scope of the opportunities to take independent actions which simply cannot be envisaged in the incomplete contracts substantially widens[43].

Moreover, in the course of the development of a system of stimulation as regards the managers of different levels, there again emerge certain problems concerning the asymmetrical information and the CEOs' reluctance to take risk. Even the most favourable assumption (all members of the administrative personnel are neutral in respect to risk) leaves open the question of assessing the efforts of the managers of lower levels. It can be demonstrated (see Demski, Sappington 1992 as quoted in Garvey, Swan 1994) that in many instances it is more advantageous for the top-level managers (who singularly possess the relevant information) to diminish the efforts of their subordinates, thereby increasing their own rewards.

However there exist a number of social and political as well as organizational factors preventing direct and open payment of large sums of money to the

[42] It should be noted that the theoretical schemes of such a stimulation proceed from more or less realistic preconditions suggesting an imperfect functioning of the markets; if there were no barriers in the way of the market forces, any "discretional" actions providing additional stimulation of the managers would likely become senseless.

[43] A significant role in such an analysis can be played by the very definition of the "incompleteness" of a contract. If it is assumed that all the parties involved in a contract are acting rationally, usually it would be possible to agree on certain "rules of the game" coming into force on the emergence of some unforeseen circumstances. For further details regarding this problem, see Maskin, Tirole 1998; Hart, Moore 1998.

managers, and even more so – any considerable deductions from the salaries of less successful representatives of the administrative personnel. Calculations (see, e. g., Murphy 1985) indicate that the remuneration of the CEOs to a much greater extent depends on the size of the firm than on any changes in the market value of their shares. This remuneration also considerably varies in accordance with the branch and the degree of attention devoted to the firm in question by the mass media.

As far as the dependence of the remuneration on the firm's value is concerned, it apparently remains rather weak. Widely known are the estimates conducted by M. Jensen and K. Murphy, according to which the amount of a stimulating reward in American corporations is relatively modest: when the market value of shares was increasing by one thousand dollars, the top manager of the corresponding company was to additionally receive less than 5 cents on the average (Jensen, Murphy 1990)[44].

Thus, the systems of labour and payment organization oriented at the managers' interest in their firm's profitability should, firstly, give the employees the right to a certain part of the residual income (and envisage a significant material responsibility for losses) and, secondly, give them a sufficient freedom of initiative enabling them to act independently. As a means of softening the "short-sighted" strategies of the managers, various forms of contract optimization (for example, when the floating of shares in the current period is favourable, the dispersion of rewards in the subsequent periods will significantly increase) and a wide use of call options with a relatively long term of execution are suggested. The "investment" of the CEOs with call options can become an effective means of improving the quality of corporate governance only when the stock market and the markets of secondary financial instruments are sufficiently liquid.

The framework of the present study is too narrow to permit a more thorough investigation of the actual tendencies in the evolution of the systems of remuneration regarding the administrative personnel in developed countries; it should only be noted that the relations between the income of the CEOs and efficient functioning of private companies became much stronger in the second half of the 20th century. The estimates conducted by C. Hadlock and G. Lumer can indicate that

[44] Naturally, this does not mean that an optimal system of stimulation must envisage a complete "orientation" of the managers' reward at the market value of shares. On the contrary, the observed weak relations can be pointing to a growing awareness of the serious problems which inevitably emerge in situations when the employees' salaries are mainly regulated by the changes in the market share price. For a serious theoretical analysis of such systems revealing their typical internal limitations, see Paul 1992.

the elasticity of the growth in the income of the administrative personnel in relation to the profitability of private industrial companies in the 1980s-1990s was substantially higher than in the 1950s (Hadlock, Lumer 1996; see also Murphy 1985).

Until this point, the discussion has been focusing mainly on the role played in corporate governance by the system of corporate control and by the forms of organizing the managers' work based on it. Meanwhile, in the theory of firm there emerges an additional clarification of the role played by other "subjects" taking part in a firm's functioning, such as the bond holders, the banks furnishing credits to the firm and/or placing its securities, the trade unions and other representatives of the workers and employees, the supplier companies, the purchaser companies, etc. The list of such participants can be quite long. Apart from this, a certain influence on the structure of corporate governance is also exerted by political factors. Thus, one of the prominent experts in this field, M. Roe, believes that in the USA the strong democratic pressure, the populistic ideology and antitrust investigations all restrict the opportunities of influencing the strategy of management for large owners. The title of his book published in 1994 reads: "Strong Managers, Weak Owners" (Roe 1994). It is clear that the role played by the above-noted factors in the system of corporate governance can significantly change, to conform with certain specific conditions such as the traditions of economic development of a given country, the place of a particular branch in the system of economic relations, the distinctive features of social legislation, etc.

Section 2. Main trends and specifics of corporate governance in Russia.

2.1 Introductory remarks

A "transparent" and well-balanced model of corporate governance that implies equal guarantees, de jure ad de facto, of the rights of all types of investors (shareholders, creditors, etc.) forms one of crucial conditions of attraction of investment. On the macrolevel, model of corporate governance forms one of the basic institutional components of economic growth.

At the same time, it was just the late 1990s when the problem of corporate governance made really a hot issue. The process was fueled by such external factors noted elsewhere in the world as growing interest in corporate governance area in the USA over the 1980s (as the reaction to the wave of hostile captures of control blocks along with a simultaneous strengthening of institutional investors), the 1997-98 crisis and problems facing corporations in developing economies. The OECD Principles of Corporate Governance signed in 1999 was generalization of the OECD nations' experiences in this particular area, while the document itself has become a potentially model set of standards and procedures, particularly for transitional economies (OECD, 1999).

In light of the above, the revision of postulates of the Washington Consensus noted over the late 1990s formed an important motivation. The growing attention to corporate governance takes place in the context of information problems, institutional and legal infrastructure (Stiglitz, 1999). Apart form the orthodox liberalization and privatization, political, social and tax constraints of reforms, as well as property and management problems, eventually are earning recognition. Along with intensity of competition, property forms lead to cross-country differences in regard to reform paths at the enterprise level, while the quality of investment climate and the prevalence of soft budget constraints determine differences on the country level (EBRD, 1999, p.9).

Between 2000 through 2002 the issue of corporate governance arose among the most fashionable topics in Russia, too. Notorious for constant abuses of their stockholders rights in the late 1990s, Russia's biggest corporations urgently develop "corporate governance codes", create "departments of stockholders' interests" and introduce "independent directors" to their boards. The FSC developed a

draft “Code of Corporate Governance” (whose essence and status so far have remained vague in light of the effective law “On joint-stock companies”), while in 2000 several privately run entities offered to the market their competitive “corporate governance ratings”. Bureaucrats have mastered the term and gradually turn it into their regular saving fetish. At this juncture, there is a visible danger of castration of the essence of the term “corporate governance” and turning its concept into a slogan for some upcoming campaign.

That is why it should be the comprehension of socio-economic processes in Russia to underlie any proposals to improve the Russian corporate governance. To a significant extent the model of corporate governance is formed beyond the legal framework. At the same time, Russia witnesses a formal presence of components of all traditional models: a relatively dispersed property (but non-liquid market and loose institutional investors), a clear and steady trend to concentration of property and control (but in the absence of adequate financing and efficient monitoring), elements of overlapping property and emergence of different types of complex corporate structures (but with no gravitation to any particular one). Before changing anything, one should have a fairly clearly picture of as to whom, from whom, for what and to what extent he should protect in the frame of the national corporate governance model.

While considering key specifics of emergence of the national model of Russian corporate governance over the 1990s, one should single out the following ones:

- a non-stop process of redistribution of property within corporations;
- -specific motivations held by many insiders (managers and large stockholders) related to control over financial flows and stripping their firms of assets;
- a loose or untypical role played by traditional “external” corporate governance mechanisms (stock market, bankruptcy, market for corporate control);
- a considerable share of the state in joint-stock capital and consequent problems in the management and control areas;
- -the federate structure and an active role played by regional authorities as independent agents in the area of corporate relations (a very specific role of the agent operating within the frame of conflict of interests: both as an owner, as a regulator operating by using administrative levers, and as a commercial/economic agent);

- inefficient and/or selective (politicized) government enforcement (along with a relatively mature law in the area of protection of shareholders' interests).

2.2. The corporate sector and trends to redistribution of property.

In quantitative terms, it was in the course of privatization of the early 1990s when the corporate sector in the national industrial sector was emerging most intensively (Table 2.1.). By late '90s, the aggregate share of enterprises of private and mixed forms accounted for some 80% of the volume of the national industrial output (Table 2.2).

TABLE 2.1

Joint-stock companies in RF: some characteristics*

	1993	1994	1995	1996	1997	1998	1999	2000
The overall number of registered enterprises and organizations (SSREO), as Thos. units	1245	1946	2250	2505	2727	2901	3086	3273
In the industrial sector , Thos. units (as % of the total)	212 (17)	289 (14,8)	310 (13,7)	324 (12,9)	339 (12,4)	352 (12,1)	369 (12)	379 (11,8)
** companies-partnerships, as Thos. units	N/a.	748	895	1329	1480	1623	1819	1985
- incl. joint- stock companies***	N/a.	43130	51148	N/a..	N/a..	N/a.	N/a..	427000
Privatized (changed property form), annually****	42924	21905	10152	4997	2743	2129	1536	590
The number of privatized enterprises, annually	12052	5895	2087	864	365	229	140	Í.ä.
Joint-stock companies created in the course of privatization, annually	13547	9814	2816	1123	496	360	258	N/a..
Joint-stock companies, whose stock was fixed in the state or municipal property, annually	439	1496	698	190	84	142	101	N/a.
Joint-stock companies with "golden share", annually	204	792	429	132	58	28	42	N/a.

* The data on 2000 are given as of September 1, while on the other years- as of Jan. 1 of the consequent year. SSREO- the Single State Register of Enterprises and Organizations of all Property Forms
** Until 1996 ã. – "Joint-stock companies an partnerships"
*** For the period 1994-1995 only open-end joint stock companies are provided, while for 2000 – joint- stock companies of all kinds.
**** According to different estimates, in 1991 there were some
242, 000 public companies, including 30 000 large and mid-sized ones. In all between 1992-1999 privatization (change of property form) embraced 133, 201 enterprises, including some 32, 000 newly established joint- stock companies.
Source: Goskomstat of RF

TABLE 2.2

Allocation of industrial enterprises across property forms, as % of the number of enterprises and % of the overall volume of output

	1993	1994	1995	1996	1997	1998	1999
State and municipal property	19,4 (44,9)	8,9 (21,5)	7,7 (11)	4,4 (10,4)	4.4 (10,2)	5,1 (11,4)	5,2 (9,4)
private property	61,3 (9,3)	72,1 (15)	72,3 (18,9)	87,1 (25,2)	88,1 (25,8)	88,1 (27,0)	88,4 (29,6)
Mixed Russian property	17,3 (43,7)	16,5 (60,9)	16,9 (66,9)	6,0 (60,8)	5,5 (58,8)	5,6 (52,4)	5,1 (51,0)

* State property- the property belonging on the basis of ownership to RF (federal property) and Subjects of RF (property of the RF Subjects). Municipal property- the property belonging on the basis of ownership to urban and rural settlements and other municipal entities. Private property is any property of citizens and legal entities, except single kinds of property that may not be owned by them in compliance with the law. The rest (up to 100%)- the property with foreign participation, property of public associations, etc.

In general, the current process of reallocation of property implies two parallel basic trends: the rise of managers (in their capacity of stockholders or agents actually controlling an enterprise) and the growing "invasion" of outsider stockholders. The process of property reallocation takes places against the background of further concentration of property. It was the conflict between old managers desperately fighting to retain their positions and potential "invaders" that formed a basic conflict during the past period. This was noted at the majority of Russian enterprises, though due to different reasons (financial flows and profit, absorption and reselling, accounting, export orientation, land sites and other real estate,

market segment or sectoral specialization being of interest to a foreign company of the similar profile, etc.)[45].

It is concentration of dispersed stock of privatized enterprises that (similar to many other transitional economies) has become the most common process. It took very different forms: buying stocks on the secondary market (from employees, investment institutions, brokers, banks), lobbying specific deals with stock packages still held by federal and regional authorities (residual privatization, trust, etc.), voluntary or compulsory incorporation into holdings or financial-industrial groups by administrative means, legalized dilution of state-owned packages, conversion of debts into securities, sales of accounts receivable, trust and loan-for-shares schemes, purchases of promissory notes, manipulations with dividends on privilege stock, etc.

The period between 1993 to 1996 became notorious for wildest violations of corporate law caused by struggle for control: crossing out an undesirable stockholder from the register, voting at shareholder general meetings by simple rising hands rather than according to the 'one share-one vote' principle, solving conflicts using power structures (including government ones), etc.

Since 1996, with enforcement of the law "On joint-stock companies" and a whole range of other statutory documents, one has noted the beginning of a gradual transition from the wildest to quasi-legal procedural technologies of corporate control and reallocation of joint-stock capital: manipulations with procedures of calling and convention of general meetings of stockholders, preservation of the composition and closeness of board of directors, breaking transparency procedures, and various manipulations in the course of placements of securities, etc.

Though the legislative base of corporate governance was undergoing constant development over the late 1990s, to a significant extent corporate risks have remained there nowadays, too (Table 2.3). In view of this, it should be noted that Russia has not appeared an exception, for many of the aforementioned risks are inherent to other developing and transitional economies.

[45] Nevertheless, one should note the problem of thousands of "dead" enterprises that has become especially hot lately. Suh enterprises are of no interest to both managers and potential foreign stockholders. There are no banckruptcy proceedings as well, because in Russia this particular mechanism is related mostly to the purpose of capturing (maintenance) of control.

TABLE 2.3

Main risks related to corporate governance in Russia

Risk	Significance of risk ("+++"- as maximal rate)	Unique risks for Russia	Existence in other developing economies
Dilution of authorized capital	+++	No (but more visible and aggressive)	Korea
"Stripping off assets and transfer prices	+++	No (but a more wide outspread))	Indonesia, Malaysia, Korea, Mexico
Information disclosure	++	Yes (substantially worse than in other countries)	-
Mergers and reorganizations	++	No (but conditions often appear arbitrary and non-transparent)	Indonesia, Malaysia, Korea
Bankruptcy	++	No (but often used as a method of absorption or stripping of assets)	Practically everywhere
Attitude (behavior) by managers	++	No (though a poor concept of corporate governance appears typical of many companies)	A great number of examples in all the countries
Restricting possession of stock and voting powers	+	No (restrictions appear fairly rare in Russia)	Korea. Mexico, Thailand
Registrar	+	No (rare cases)	India (partially)

Source: Brunswick Warburg

The whole number of biggest companies witnessed delays with the stage of consolidation, due to specifics of privatization (for instance, the "double" privatization in the oil sector) and the ongoing conflict between the parties concerned (federal and regional authorities, natural monopolies, largest banks and industrial enterprises), intense lobbying, and because of the government's retaining control over large stock packages. This process was implemented in the form of loans-for-shares auctions of 1995, the redemption of stock packages previously used as collateral between 1997 to 1998, oligarchic wars in 1997, etc. It was both the 1996 presidential elections and longer-term financial and economic interests of competing groups that served as catalysts to the aforementioned processes.

In a number of cases, the sequence of establishment and privatization of many largest holding structures, primarily vertically-integrated ones, has formed an independent source of conflict between their stockholders. Specifically, in the oil sector the process of institutional transformations kicked off with the begin-

ning of establishment of single mining corporations and their consequent privatization in 1992-93. Consequently, the state-owned packages were consolidated in the respective holdings (the same trends in a number of sectors were also characteristic of the period between 1999-2000 - see below), and a new privatization of already created structures was held between 1995 through 1997. Upon getting majority control in the noted holdings, the "second -wave" buyers inevitably entered in a clash with the "first-wave" ones who formed the group of minority stockholders. According to some estimates, in the oil sector alone, that caused at least a 3-year delay with the creation of "efficient owners". It was just LUKoil that was likely to appear an exception, as it accomplished the transition to single share as early as in 1995. The conflict of two privatizations proved to be one of the symbols of the 1997-99 Russian corporate wars era and formed a constant source of destabilization in the property rights area.

Underlying a well-known conflict between management and small foreign stockholders in RAO UES Russia of 2000 also was the property structure that objectively emerged yet in the mid- 1990s. It is known that RAO's stockholders are the government as an owner of the control block (long-term strategic interest along with a strong social factor, but also the awareness of the need in a radical technical and technological reconstruction), minority stockholders (short - term interests related to the company's market quotations), and stockholders - representatives of its labor collective (specific interests related to maintaining jobs and salaries). Conflicts associated with the latter group have their own specifics[46], however, they also appear related to relationship between RAO and regional authorities (social interests and control over regional electricity structures). Though at this point it is a non-optimized property structure that fuels potential conflicts, a certain compromise may be reached through developing yet absent principles of corporate governance.

It is dilution of a share of "alien" stockholders, both in a Board of Directors and a company's authorized capital, in favor of largest shareholders (holding) that has become the most widely practiced method of getting rid of them. This can also imply derivative vehicles: public stocks, convertible obligations, splitting of stock or their consolidation, transition towards single stock, etc. In holdings, should an outsider stockholder enjoy the veto right (having over 25% of the voting stock), an additional issue becomes subject to so-called transfer prices and

[46] As an analogous example, one can refer to the strike of employees of OAO "AvtoVaz" in response to the announced plan of the company's restructuring and transformation into holding in 2000.

re-allocation of assets between the mother and daughter companies without account of small stockholders' rights.

Also falling within the category of abuses of stockholders' rights are widely spread operations of AO's managers on "siphoning" their company's assets off to their personal companies and into accounts in Russia and abroad, or, at best, unbelievably high compensations to themselves (with wages to ordinary employees-stockholders unpaid for months and/or dividends not paid, either[47]). Underlying such operations is an unstable situation in the corporate control area that compels managers to arrange for "golden parachutes" for themselves.

Despite the above problems, the late 1990s witnessed a certain stabilization (regulation of the structure) of property rights. Indeed, there was the transition from their amorphous and dispersed structure to emergence of clear (formal, based upon property right) or implicit (informal, based upon real power within a corporation) poles of corporate control. According to FSC estimates (with all their obvious conditionality, though), in 1996 the struggle for control was over at 25% of Russian corporations, while in early 1998 - at 50%. However, the 1998 financial crisis has changed this picture radically.

2.3. The 1998 financial crisis: qualitative shifts and a new destabilization.

The financial crisis of 1997-98 has renewed notably the process of both reallocation and consolidation of joint-stock property[48], with several most common trends emerged as follows:

1. The crisis of the privatization process (from the perspective of budget revenues). The lost price orientation in the conditions of the slump of market capitalization fueled the consequent process of spontaneous mass sales of small non-liquid packages and transition to the model of "unique" direct

[47] As recent practice showed, the information on management's compensations has proved to be among most hardly available data. At the same time, non-payments (delayed payment) of dividends appear quite typical, while paying dividends (usually minimal ones)on privilege stock serves just for the sake of preventing their conversion into ordinary voting ones.

[48] Reallocation of property (and partciculary the market for corporate control) undoubtedly forms a normal and efficient mechanism of corporate control and control over managers exercised in the frame of legal civilized procedures, should they result in a company's rising efficiency . However, the existence of such a result in Russian conditions (and the most of other transitional economies) is not at all granted.

sales. Budget revenues from privatization were secured by 1-2 large deals. While the state remained ignorant in this regard and the prices of residual packages remained low, there emerged favorable conditions for consolidation of control by managers and large stockholders.

2. The crisis on the national stock market. A sharp downfall in prices in the secondary market allowed completion of the process of consolidation of corporate control in a number of sectors at minimal costs. While on the stage of rapid growth of the market over 1996-97 many stockholders had to limit themselves only with portfolio investment or, at best, with a blocking package, in a crisis state the further concentration of a joint-stock capital appears logical. This was fueled both by the mass "flight" of foreign investors and eagerness of some holders (especially financial institutions) to improve their financial state through sales of their packages. Some sectors (with a favorable price situation in commodity markets, especially in the wake of the depreciation of the Ruble) witnessed the strengthening of managers' positions and supplanting of foreign investors as most characteristic trends[49].
3. The crisis of financial - industrial groups (primarily those of the banking origin). The 1998 financial crisis both revealed a loose credibility of the FIG model emerged over the late 1990s and dissipated illusions about the expediency of using banks (at least in the form they existed as of the moment of the crisis) as a nucleus of corporate control in the real sector. The post-crisis

[49] According to available estimates, in 1999 the average annual market price for oil accounted for USD 19/barrel, while according to SCC statistics, the average annual producer export price made up just 13 USD. The overall annual capital flight in the oil sector roughly acounted for USD 7.5-8 bn. As of October 1999, capitaliztion of the sector accounted for some USD 4-5 bn. At the same time the outflow of foreign investors once again intensified between winter to spring 1999. Overall it meant a new modification of property structure in the sector (given that at a certain moment the amount of exported capital proved to be sufficient to acquire the whole sector).
The analogous process was also characteristic of the metallurgical sector (that also experienced a sharp intesification of property reallocation in 1999-00. Given that in the oil sector the mobilization of resources to consolidate control becam possible thanks to the price rise since March 1999, in the metallurgical sector the sources of resources for consolidation (reallocation) of property were related to a sharp fall in costs in USD equivalent after August 1998 along with the maintenance of stable prices. So, the following features became characteristic for this particular process; supplanting of foreigners, acquisition at very low prices (which was impossible in 1996-97), insiders' (managers and co-owners-partners) active role), and an active use of such instruments as bankruptcy and debt schemes.

period witnessed such typical moves as compulsory sales of enterprises' stock, attempts to get rid of non-liquid an unprofitable assets, voluntary settlements of loans using industrial companies' stock, arrest of stock packages for debts or sales of single packages in the frame of official bankruptcy procedures.

Against the background of the crisis that battered heavily many largest banks and industrial groups, it appeared quite logical that federal natural monopolies and those "autonomous empires" that had emerged around large corporations have strengthened their positions, as initially they had focused on "self-sufficiency" and did not suffered so badly from the financial crisis. Naturally, such strengthening can also take place to a significant extent at the expense of the former rivals' assets and influence.

4. Regionalization of property reallocation. In the post-crisis conditions, regional authorities' attempts to establish control over enterprises located in their regions have become more visible and successful. Specifically, one witnessed a notable renewal of the processes of casting regional holding structures under the auspices of local authorities, attempts to revise privatization deals won by representatives of the "Center" (nationwide/federal groups), other regions, or foreign investors, return of earlier trusted regional companies' stock packages, attempts to cancel new stock issues that changed the structure of the given region's corporations in favor of "aliens".

At the same time, a new wave of conflicts related to abusing stockholders' rights has arisen since 1997. The crisis fueled the use of additional issues and derivative papers, debt schemes (securitization of debts), bankruptcy instruments (with the enforcement of a new law of March 1, 1998) for the sake of reallocation of property. The problem is that documents required for registration of issues of stocks and obligations often balance on the verge between compliance with the law and a full ignorance of it. Because of defects of the national corporate and privatization law, this effectively illegal instrument was implemented in legal forms. The period between 1998 through 1999 also witnessed the abusing of stockholders' rights associated with reorganization of joint- stock companies. Those were primarily attempts to supplant single stockholders to new companies with unfavorable financial situations.

According to FSC, the most typical abuses by issuers ere as follows:

- violation of procedures of carrying out a register of stockholders (should that be exercised by the issuer himself);

- violation of requirements regarding introduction to statutory documents of amendments related to changes in face-value of the Russian notes and price scale;
- breaking procedures of purchasing the stock placed by an issuer;
- absence of annual publication in printed media of annual report, accounting balance, balance of profits and losses, and the list of affiliated entities;
- violations in the course of paying dividends;
- issuing and circulation of securities non-registered in a duly way.

The registrars' data speak about renewal of a large-scale reallocation of property in the corporate sector in 1998-99: first, between autumn 1998 through 1999 they did not experience any decline in the overall volume of re-registration of transactions involving stocks; secondly, in 1999 the number of registrars that serviced over 500,000 owners of personal CDs practically fell to zero level (against 20 in 1998). It is also worth noting that according to the 1999 results, there were some 19,000 security issues registered in RF (in 1998- 20,000), however, the number of cases involving closed subscription doubled, while those of open subscription fell 7-fold (compared with 1998).

The data available on 2000 also testify to substantial changes in the structure of Russian companies' join-stock capital (Table 2.4)[50]. It was 1998 that indeed formed the qualitative breaking point. A sharp fall in the share of insiders (employees) alongside with the rise in the share of outsiders reflects, first, processes of the post-crisis property concentration (particularly including those related to a sharp downfall in stock quotations) and, secondly, the fall in the officially registered managers' share from the average 12-16 % in 1996 to current 7-8%[51]. The latter is related either to a direct transfer of stock to outsider stockholders (sales or reclamation on debt), or to expansion of the practice of informal control on the part of managers (assigning the existing stock to, or fixing the acquired stock with affiliated structures).

[50] The structure of stock property in the largest Russian AOs is no doubt different from a typical one, with such characteristic features as high shares of holdings' (including public ones) particpation, a substantially lower share of employees of all types, and a relatvely high share of different kinds of non-residents

[51] See: Radygin, Entov, 1999, pp. 65-66

TABLE 2.4

Changes in property structure of mid-sized and large Russian AOs, 1994-2000, as % of their authorized capital*

	1994	1996	1998	2000
Insiders	60-65	55-60	50-55	30-35
Outside stockholders	15-25	30-35	35-40	50-55
Government	15-20	9-10	5-10	10-12

*The data of the table was prepared solely to highlight the most significant qualitative trends (based on IET's and other organizations' surveys). They may not be used for the purpose of any strict empirical estimates. The table does not take into account the largest AOs (holdings), enterprises of strategic importance (whose stock packages have been fixed in the government property), and sectoral differences. Usually an actual share of insiders (managers) has been higher, should affiliated structures associated with outsider stockholders be considered.

Despite a gradual concentration of stock ownership and the rise in outsider stockholders' share in AOs' capital, their role in managing AOs has so far been inadequate to their growing share in the companies' capital. With the share of outsider stockholders in an AO's capital rising, their capacity, particularly including the use of protective legal mechanisms, undoubtedly will be growing.

In view of this, the problem of representation of outsider stockholders in AOs' governing bodies becomes increasingly important. Russian AOs have a considerable stratum of stockholders whose participation in their capital so far has not implied their representation in any management body. To the greatest extent this is true for employees- stockholders of an AO and outsider stockholders- physical entities, while to the least extent - to commercial banks and industrial enterprises (suppliers and buyers alike). The latter is not a surprise at all, for the noted groups enjoy far greater possibilities to insist on their stockholder rights by employing financial and trade-economic levers or simply by playing the role of management-friendly stockholders.

The data on a typical Board of Directors of 1995-96 also allow conclusion that the share of outsider stockholders in this body was far from controlling one (2 seats from the average 7 ones, with 5 seats forming the quorum). Between 1995 to 1996, the overall number of seats in boards of the surveyed AOs held by outside stockholders accounted for 31% of the total number of seats in Boards of Directors. In 1996 only 39% of the surveyed AOs practiced cumulative voting in the course of elections to their boards. The situation undoubtedly was better in those AOs where several relatively large stockholders had succeeded to establish a common majority control: in such AOs, 4-5 large stockholders (each of them

owing 16% of stock on average, altogether controlling the average 65% of stock) have had 50% of seats on average in the respective boards. In 25% of AOs with the set majority control the overall share of large stockholders is under 50% of the number of seats in their board of directors, with cumulative voting in the course of elections to their boards practiced in 43% of such AOs in 1996[52].

By the late 1990s the problem of representation of outsider stockholders in board of directors has not lost its urgency. Even the years of 1999 to 2000 witnessed situations when an owner of the control block failed to take part in a board of directors. According to the 1999 sample by the Bureau of Economic Analysis, the aggregate share of insiders in the structure of boards of directors was over 57%, while their share in the respective property structure stood below 50% (Table 2.5).

The Russian reality is such that the problem of efficiency of boards' operations appears dual: on the one hand, considering the non-liquid market for corporate securities, this particular body of AO becomes especially important in the system of representation (coordination, conciliation) of stockholders' interests and monitoring managers' performance. On the other hand, in practice the role played by the body is far from optimal: in the overwhelming majority of companies their boards exercise just formal functions compared to those of general directors. Evidently, as long as the relationship pattern ("controlling stockholder" = "majority in the board of directors" = "director general") is concerned, a little can be done to meet other stockholders' interests. Most likely, it is extending control powers of boards of directors and enhancing transparency of their actions that would ensure increase of their efficiency.

TABLE 2.5

The average structure of board of directors of AO in 1999*

Representatives of:	As % to the number of members of Board of Directors	Representation rate	
		Average rate	Number of AOs
Labor collective and management	57,4**	1,92	254
Federal authorities	3,2	0,97	48
Regional and municipal authorities	5,7	1,75	44
Foreign investors	2,1	0,55	43
Russian banks	2,1	2,06	32
investment companies an funds	9,1	0,74	124
Industrial enterprises	15,0	1,47	117
large stockholders- physical entities	5,4	0,25	207

[52] See: Afanasyev, Kuznetsov, Fominykh, 1997; Blasi, Kroumova, Kruse, 1997

* The average number of members of a Board of Directors is 7 to 9. The average representation rate is computed by dividing the share of the particular group of stockholders in the Board into its share in the joint- stock capital across the AOs where the latter was over 0.5%.
** Of whom 38% are representatives of management, 19.4% - labor collective
Source: BEA, 2000, pp. 11-12

As concerns foreign investors (both in "typical" and the largest AOs), the main problem here still is identification of investment's origin. In many cases one can note it is just a repatriation of earlier exported capital.

The government's share in joint-stock capital of the most of companies (except strategic sectors and a few largest AOs) actually did not play a key part. Given that management and a part of the largest stockholders can be attributed to "active" groups of stockholders, it is the state and ordinary employees at enterprises that fall within the group of "passive" stockholders. An actual stability of the government's share (averaged some 9-10% in 1996) highlights stagnation in the privatization process of the late 1990s. At the same time, some rise in the government's share can be explained by a vigorous renewal of regional bankruptcy practices resulted from private enterprises' debts on compulsory payments and their assignment to the state property. These trend are likely to be medium - run and will be in place over upcoming years too.

It is a common recognition that it is the division of functions of owner and manager that forms characteristic feature of large joint-stock companies (as a fundamental trend) and brings to life the problem of corporate governance[53]. However, in Russia, putting aside the biggest holdings with a significant governmental participation, the situation still appears more complex and contradictory.

The mass privatization, indeed, has led to dispersion of property, and the former (Soviet) managers de-facto were in control over national corporations over the early 1990s. However, at the same time, due to various reasons, the

[53] It was yet in 1924 that T. Veblen noticed the transfer of control from owners to managers-engineers (Veblen, 1924).I in 1926 J.M. Keynes argued that in the course of expansion of a large institute there should arise the moment when capital owners (ie stockholedrs) found themselves nearly completely separated from management (Keynes, 1926). A. Berle and G. Means provided classical description of problems of dispersion (division) of property and transfer of control to managers (Berle, Means, 1932). Between the 1960s through the 1990s agent problems were analyzed in every detail by O. Williamson, W. Baumol, F. Fama, M. Jensen, W. Meckling, S. Grossman, O. Hart, A. Shleifer, etc. See also Section 1 of the present paper.

standards of corporate governance (as regulation of agent problems) have so far failed to form an element of the incorporation and privatization program.

The first corporate conflicts of mid-1990s reflected a growing concentration of joint-stock property. Managers actively pursued the "entrenchment" strategy and acquired stock in their companies and struggled against really outsider investors for the right of control using the whole arsenal of legal and illegal means. At that time one could note the struggle between new stockholders and old "entrenched" managers. According to the 2000 IET survey, 71% of the surveyed mid-sized and large enterprises underwent changes of their directors general over 1992-99.

The struggle between managers and new outsider stockholders (the significance of the classical agent problem of relationship between owner and manager) should not loose its urgency and intensity over the years to come. Nonetheless, in the late 1990s and nowadays many Russian corporations experienced a more distinctive specific process of convergence of managers' functions and those of controlling (outsider) stockholders.

While managers gradually are also becoming stockholders in a corporation, in the course of consolidation of control outsider stockholders begin to function as managers. Many Russian mid-sized and large corporations witness an actual convergence of the figures of "manager" and "controlling stockholder" (an authorized representative of a group of stockholders whose relation to them is dictated by a whole complex of economic and extra-economic interests rather than his fee/formal contract). Obviously, this is a compulsory situation caused by two factors:

- -because of the ongoing process of reallocation of property none of the companies has succeeded in completion of building a reliable corporate control system;
- the existence of 'shadow' corporate finance ("gray" and "black" cash-based settlements, tax dodging, stripping of assets, etc.).

Consequently, the current owners (controlling stockholders) cannot ignore operative control over the situation, nor they are able to assign it to hired managers, for they may run a risk of loosing both property titles and control over financial flows. Though with the noted functions converging, the chain of agent relations (and the respective costs) shrinks, such a situation leads to a notable complication of the problem of corporate control from the perspective of objects of protection (Table 2.6.). The most of conflicts slide move towards the plane of relationship between:

- managers as stockholders - all other stockholders;

- controlling stockholders (including their managerial function)- all other stockholders;
- -controlling stockholders (including their managerial function) - new rivals seeking control.

TABLE 2.6

Models of corporate control and potential objects for protection

The control is in hands of:[54]	Property type	Main object for protection	Main challenges to corporate governance
(1) Hired managers not holding a stock in AO (or a minor one)	Dispersed or there are several roughly equal stockholders with no relation between them	All stockholders	- monitoring of managers and their responsibility - passive attitude and rights of all the groups of stockholders
(2) Managers that have become stockholders (with control block) and retaining their managerial functions	Concentrated (directly or through affiliated structures)	All other types of stockholders	-managers' responsibility - responsibility (transparency) of controlling stockholders, as well as - restricting possibility of "blackmailing" on the part of other stockholders - protection of minority stockholders' rights
(3) Outsider stockholder (an alliance of stockholders with CB) that:	Concentrated (directly or through affiliated structures)	Minority owners (stockholders)	Responsibility (transparency) of controlling stockholders, as well as
(a) replaced managers			- provision of monitoring of management
(b) keeps managers			-preclusion of the risk of managers' opportunist behavior
(в) exercise managerial functions			- protection of other stockholders' rights, but a simultaneous restriction of possibility of their "blackmailing"
(4) Main creditor (a group of creditor)	Any	All stockholders. A part of creditors	The use of the institution of bankruptcy solely to capture control (stripping off assets thus causing losses to other stockholders, etc.)

[54] See also: Dolgopyatova , 2000.

2.4. The government policy in 2001-02 and necessary improvements

One cannot reckon that there has not been any progress in Russia's movement towards market economy and democratic values over the 1990s. At the same time, in addition to heavy financial crises, investment hunger and regular property-related scandals, the nation also experienced a chronic failure to complete institutional reforms, the system of soft budget constraints and hierarchic trade-offs between the government and large corporations, the kaleidoscopic stages of property reallocation, inefficiency of current practices of protection of property rights, inefficient and corrupt public administration system, government enforcement as a measure of selective effect, and private enforcement as a type of criminal "negotiations"[55].

As noted above, with the emergence of the corporate law in the late 1990s, one can argue that some stabilization has arisen in the property rights area, and the struggle has shifted to the legal field. This notwithstanding, corrupt judges and public institutions introduce their "corrections" to results of the struggle in which counterparts to a significant extent use quasi-legal - on the verge of violation of the law - methods (or loopholes in the law).

The progress in single key areas (a progressive corporate law since 1996, potentially efficient bankruptcy mechanism since 1998 etc.) was limited by the above constraints. So the noted mechanisms failed to exercise their respective functions in full.

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[55] The 2000 Economic Freedom Indices by the Heritage Foundation provides evaluation of investment climate in 161 countries worldwide. Russia is ranked the 121st among others, thus falling into the group of "mostly non-free countries" (together with practically all other Eastern European and CIS countries, that, however demonstrated better results). Russia's index in 2000 was 3.7 (in 199- 3.5, 1998- 3.35), which means that situation worsened. It is property rights and the existence of obstacles to free movement of capital that play a substantial part in calculating he index. Specifically, the 2000 estimates were influenced by quotas for foreigners' participation in the authorized capital of RAO UES Russia (5%), Gasprom (20%), airspace companies (25%); restrictions for foreign insurance companies, defects of the legal and judicial aspects of protection of property rights (including independent solving of commercial disputes), taxation, and corruption. Interesting, China is ranked the 100th in the same list. This allows, at least at the level of unexpected ideological solutions, interpretation of this particular survey in a sense that a solid legal system proves to be more important for economic growth than a type of political system.

2.4.1. Legal innovations

A long process of debating and blocking new amendments to the law "On joint stock companies" is over. Federal law # 120-FZ of August 7, 2001, "On introduction of amendments to the federal law "On joint -stock companies" became effective as of January 1, 2002.[56] The most significant innovations therein in the area of protection of stockholders' rights are as follows:

- -it is specially stipulated that stockholders have a right for liquidation of their own stock without other stockholders' and the company's consent(Art.2);
- the possibility of restricting the conduct of closed subscription in an open-end joint-stock company (in its charter documents or in legal acts of RF);
- according to Art. 39, the closed subscription can be carried out only following to the respective decision of a general meeting of stockholders with a quorum of 3/4 of votes (with a possibility to introduce a greater number of votes sufficient to pass such a decision);
- placement of ordinary stock through open subscription (if over 25% of the earlier placed ordinary shares is placed) requires analogous procedures;
- the law introduced the provision on stockholders' preemption in regard to stock placed through open subscription (before that, it could be possible if the respective provision was stipulated in an AO's charter);
- the law also introduces the provision on preemption in regard to stock placed through closed subscription for the stockholders that voted against that or did not take part in the voting;
- the stockholders realizing their preemption (within 45 days starting from the notification date) enjoy the right to pay for placed additional stock in cash, even if the decision on the placement provides that payment should be made by non-monetary means;
- -the law introduced prohibition on conversion of ordinary stock into privileged one, obligations and other securities.

So, for the first time ever upon the period of incorporation and mass privatization of the early 1990s there appeared mechanisms introduced by legal means that counteracted the most notorious way of abusing stockholders' rights over the

[56] Art. 48 and 49- as of the dateof their official publication - August 9, 2001. The full text of the amended law is available in: "Zhournal dlya aktsionerov", 2001 # 9, pp.-3, 9-40. See also: Gulyaeva, 2001

1990 s- that is, diluting outsiders' shares via new issues. In view of this, it is worth recalling the background of the debate on the noted amendments. These measures have been developed yet since 1997. The first draft was passed by the Duma on June 2, 2000, but later on it was torpedoed effectively by a few largest companies' lobbyist efforts. The next draft of amendments also failed to pass the Duma in late 2000. So, what has changed since then?

Most likely, the answer lies in the economic area. The period between 2001 to 2002 signifies completion of the process of property consolidation (transition to single stock, increase in firms' share in their daughter companies nearly up to 100%, legal formation of holdings in the form of ZAO, OOO, etc.). In such a situation, such an instrument as dilution has lost its importance. As a result, minority stockholders are granted with legal means to protect their interests right at the moment the field for its application is increasingly narrowing, while still there are numerous technical ways to avoid this innovation. On the whole the emphasis the new draft law puts on formal protection of minority stockholders just strengthens the sensation that the noted amendments have been somewhat late.

Nonetheless, as the enforcement of the law was postponed until January 1, 2002, it became very beneficial for many companies that had failed to accomplish various schemes to be prohibited by the new law. Specifically, Sibneft and TNK have brought to an end their conflict regarding rights for ONACO by the means of an additional issue and refusal to small stockholders to enjoy their preemption right on the placed stock (i.e. thus initiating dilution of their stakes in the company). In December 2001 TNK holding reorganized itself by the means of consolidation of its daughter mining companies' stocks (rather than affiliation by means of single share). This should lead to a compulsory redemption of the newly appeared -4- stock as well as, according to TNK estimates, to the contraction in the share of small stockholders to less than 10%. In September 2001, YUKOS oil company initiated the decision of the Board of Directors of Angarsk oil-chemical plant on stock consolidation (with the 1,000.000 rise in their face-value). YUKOS has also used this instrument in regard to its other daughter companies (OAO "Bryansknefteprduct", Novokyubyshevsky oil refinery, "Voronezhnefteproduct", and "Orelnefteproduct" . Though YUKOS's policy on Angarsk oil-chemical plant gave a rise to small investors' claims (primarily concerning traditional stripping of assets, increase in accounts receivable, and transfer prices), the lack of liquidity of the plant's stock and a possibility of their exchange for YUKOS's stock (whose quotations lately have showed a substantial rise), apparently, exclude any other reasonable options for portfolio investors. On

the whole, it is worth noting that in the majority of cases a company offers to small investors non-discriminatory financial conditions of exchange (redemption) (if one abstracts from the fact of compelling them to such an exchange). This also can be viewed as a progress in the area of protection of small investors' rights achieved over 2000- 2001.

The law tackles the problem of transparency with a great deal of caution, and the new draft suggests a decision analogous to the aforementioned situation with the solution to the problem of dilution of shares (Art.91). The right for access to accounting papers of AO and minutes of its collegial executive body's meetings was granted to stockholders that together own at least 5% of voting shares (while earlier - 10%). The law also provides a mandatory conduct of the AOs' register by a specialized registrar, should it stockholders outnumber 50.

Between 1998 to 2001 it was reorganization that has become one of the most frequently used channels to "pull out" outsiders. The new draft of the law provides that:

- the stockholders of an AO reorganized in the form of dividing or singling out that were against the reorganization or did not take part in the voting have a right to receive a stock in each newly created company in proportion to their share in the original AO;
- -an AO can be transformed both in LLC and production cooperative and a non-for-the-profit partnership (following a unanimous decision of its stockholders).

The positive effect of the first innovation is very big. Apparently, the time has come to introduce amendments to the Civil Code of RF and/or to develop a federal law "On reorganization of economic companies". The other innovation appears of equal importance, which is explained by an objective process of the transformation of OAO created in the compulsory way during the mass privatization stage into other organizational-legal forms more acceptable for concrete enterprises from the perspective of their size, sectoral specifics, functions, etc. In the longer run one would need a more developed legal regulation of the respective options with account of protection of interests of all the agents involved in corporate relations.

Identification of large deals and procedures of their conduct appears not less important than regulation of reorganization procedures. For the first time ever Art. 78 attributes loan, credit, collateral, and guarantee for large deals. At the same time a general meeting and a board of directors make a decision on approval of such a deal rather than on its implementation.

As concerns authorized capital, the law provides that its increase by means of placement of additional stock may take place at the expense of the AO's property (i.e. capitalization). At the same time raising an authorized capital by means of increasing the face-value of stocks is possible only at the expense of the AO's assets (Art. 28).

Yet another problem in the area of authorized capital is the problem of split stocks that between 2000 to 2001, along with consolidation of stock, has formed a new instrument to supplant outsiders. This problem has not yet been resolved,- on the contrary, its urgency has grown after the decision was made on a stockholder's preemption with regard to additional stock placed by the company. The new draft of the law reads that the split stock grants rights in a volume corresponding to the respective part of the whole stock which it accounts for. Given that such an approach appears fairly acceptable to pay dividends, a voting according to the "one stock-one vote" principle would pose obvious difficulties (although the summing up of split stock may become possible).

The law preserves a certain dualism in the area of an AO's dividend policy. The decision to pay dividends may be taken just once a year (and not quarterly, as before). Nonetheless, the general meeting still enjoys no powers to exceed the amount of dividends recommended by a board of directors. Consequently, a decision by a general meeting on paying dividends turns into a pure formality.

One of the crucial challenges facing both the corporate law and other branches of the law is creation of obstacles to establishment of "one-day" AOs with "bubble" capital, thus securing a real base to ensure compensations for losses bore of the company's creditors that once had relied upon the size of its authorized capital. This helps improve the level of protection of creditors as financial investors in an AO. It is likely that the new draft of the law has made a step back, as since January 1, 2002, 50% of a company's stock allocated during its establishment should be paid within 3 months starting from the moment of its state registration (while earlier - by the moment of the registration).

Consequently, the expediency of future introduction of a number of amendments is visible already today:

- to prohibit joint-stock companies to carry out any transactions not related to their establishment until their authorized capital is fully paid by their founders;
- to tighten the procedure of payment of stock: the stock should be paid in full within 3 months upon the state registration of a company, while additional stock should be paid in full against its placement;

- -to introduce the mandatory attraction of an independent appraiser in all the cases when stock is paid with non-monetary means and to hold founders, members of the board and the independent appraiser responsible for increasing the value of assets used to pay for the stock.

A whole range of innovations concerns AO's governing bodies:

- the law sets a clear procedure of suspension of Director General's powers;
- Board of Directors is granted with the right to introduce, in a number of cases, amendments to an AO's charter and to approve a registrar;
- -the right of the Board of Directors to pass a decision on raising the company's authorized capital through placement of additional shares may be provided only in the Chapter (and such a ruling should be unanimous);
- -the right on making decisions on participation in other organizations was excluded from the list of the Board's competencies;
- it is only physical entity that may become a member of the Board of Directors (Art. 66), while passing the vote is prohibited in principle;
- - the "exclusive competence of the general meeting" (Art. 48) is abolished in favor of the rule, according to which the matters falling under the general meeting's competence may not be assigned to the Board of Directors and an executive body, while the meeting is no longer restricted by the prohibition of consideration of matters not falling under its competencies;
- the approval of internal regulatory documents falls within the general meeting's list of competencies;
- the possibility of a mixed form of the meeting is excluded, as the law has set two options in this regard: the meeting and absentee ballot.

From the perspective of protection of large shareholders' rights (whose interests are represented in a Board of Directors), it is important to note an innovation that concerns the possibility of a temporary dismissal of executive directors without convening an early stockholder meeting (Art. 69). This particular provision becomes effective in the situation when establishment of an executive body is subject to the general shareholder meeting. Should it be stipulated in a Charter that the establishment of an executive body falls within the functions of a Board of Directors, then an early termination of the executive body's powers is possible at any moment, as per the respective decision passed by the Board. The new version of the law also attempts to tackle contradictions arising due to the effects of the obsolete Labor Code (and, consequently, courts' verdicts following its guide-

lines). Specifically, the law reads that the relationship between the given AO and its executive body (Director General, etc.) are subject to the RF labor law to the extent the latter does not contradict the law on AO.

Nonetheless, the problem of protection of large stockholders' rights to a far greater extent is associated with process aspects of the law.

2.4.2. Protection of issuer and large stockholders from corporate blackmailing

The new draft law imposes a number of constraints on chances for corporate blackmailing. However, the analysis of legal capacity of such a protection did not reveal efficient protective methods[57]. This does not mean, however, that the law needs special amendments in this respect - such a protection should be based primarily on legal proceedings.

Among innovations of 2000-01 there was an application of Art. 49 of the law "On joint-stock companies" that allows a stockholder (including an owner of a sole share) to bring his appeal to the court against decision(s) of the general stockholder meeting that caused him potential harm. Most often this method is used to prohibit holding the next meeting (which is to pass decisions crucial to the given AO or to change its management) on the grounds that a Board of Directors calling for such a meeting is not legitimate. Clearly, such a conflict is generated by rivals or one of actual sides involved in the given intra-corporate conflict rather than a formal plaintiff that posses a sole stock. At the same time, enjoying the formal right to bring the case to the court, an owner of a sole or a few stocks is unlikely to suffer an actual damage.

Among numerous examples of this kind are: lawsuits against OAO "Krystal" (change of the company's Director General), RAO "Norilsk Nickel" (the way the voting was arranged at a meeting on the company's restructuring), OAO "Polymerstroymaterialy" (the attempt to ignore the court's verdict just complicated the conflict situation), RAO "Gasprom", the prohibition to RAO "Mosenergo" to hold an early meeting (change of Director General), a jurisdictional asset freeze of a stock package of OAO "Severstal", the prohibition to OAO "Transneft" to export LUKoil's oil, etc.

In September 2001, Mr. A. Volsky, then President of the Russian Union of Entrepreneurs and Industrialists (RUEI), submitted a letter to the Supreme Court of RF requesting, first, to limit the possibility for stockholders-physical entities to

[57] The law introduces reduced (6 months) time limits to appeal to the court regarding a general meeting's ruling, etc.

bring lawsuits to the courts of general jurisdiction located in the area of their residence, thus to assign such trials to arbitration courts located in the area of a company's registration, and, secondly to prohibit the courts of general jurisdiction to impose a jurisdictional freeze on companies' assets.

From the formal perspective, this should ensure elimination of a legal collision in which an arbitration court and a court of general jurisdiction (the latter acting following a lawsuit brought by a physical entity) may render opposite verdicts. In the course of a trial the stock concerned is under arrest. From economic perspective, this is a trivial capture of property, which results in uncertainty of the given AO's operations, destabilization, and reallocation of property rights. The seriousness of the problem is evident. That is why the Plenum of the Supreme Court of RF introduced a temporary measure (until the enforcement of the new Arbitration-Proceess Code of RF and the Civil-Process Code of RF): the Plenum" did not recommend" to the courts of general jurisdiction to render verdicts on banning stockholders meetings following lawsuits brought by stockholders-physical entities[58].

At the same time, the possibility of an actual modification of the federal law by the aforementioned decision of the Plenum of the Supreme Court of RF followed the RUIE President's letter (as precedent) puts a big question mark about the need in the new Arbitration Process Code (passed in the first reading in spring 2001) in principle. Another problem is closely related to systemic corruption, or more specifically - to a mere turning of the parties concerned for the same purpose to arbitration courts[59].

2.3.4 The Corporate Governance Code

In view of the above innovations of 2001 and their potential for development, the popular idea of adoption of a national Corporate Governance (Behav-

[58] The draft Arbitration ... Code of RF contains a provision that provides a comprehensive list of lawsuits falling under arbitration courts' competencies with participation of citizens that are not individual entrepreneurs. Specifically, the list comprises disputes between a stockholder and a joint-stock company that arise from the given economic company's operations (except labor disputes). For more details, see: Gros, 2001, pp. 54-68

[59] At the same time, the refusal from jursidctional measures leads to an evident peril of 'watering' of the capital by the defender in the course of a trial. Should the court's verdict be the provision of jurisdictional. measures, the defender's resort may well become bringing a counter- lawsuit to secure possible losses casused by the noted court's verdict (See: Finansovaya Rossia, 2001, # 37, p.3)

ior) Code does not seem a priority one[60]. The current OECD Corporate Governance Principles that generalize the best practices of corporate governance would suffice as some ideal for corporations operating in the current Russian conditions.

Companies that are going to follow recommendations of the Code would enjoy a formal advantage of building their positive image in the eyes of foreign investment community. In this sense, the Code forms some routine, though formal, signal to potential investors about situation in the country. According to a recent survey by McKinsey on 200 largest investors worldwide (that together manage the USD 3.25 tn.-worth assets), 75% of them puts the quality of corporate governance on the same level with financial and economic performance, while speaking about transitional economies, the former factor becomes a priority. From the perspective of stock prices, 80% of investors are ready for 'extra" charges for the quality of corporate governance, even considering that capitalization premium caused by that finds itself within the range of 20% (the nations with the mature corporate culture) to 50% and more (developing markets)[61].

Anxious to pursue the noted objective, between 2001 to 2002 many largest national corporations have already adopted their own codes that are unlikely to differ from the noted one. Furthermore, the corporations will be borrowing its single provisions to the extent they would appear, first, interested in them due to a whole complex of reasons and, secondly, in the course of consolidation of corporate control. As the experience of 2000-01 shows, it is because of the growing consolidation of control as a whole and particularly that of their daughter companies' assets that a number of companies began to enhance formal transparency and openness towards their small stockholders. At this point, it is undoubtedly consolidation that appears the primary reason. So "washing away" of small stockholders thus is becoming the condition of improving the quality of their protection.

The only plausible form of the noted Code is recommendation. However, it does not seem feasible that companies undergoing corporate conflicts or facing the threat of a hostile absorption would comply with both recommendation and even legal provisions. This means in principle 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 overall problem of protection of investors' rights.

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[60] Kodex corporativnogo povedeni. materialy dlya obschestvennoy diskussii. M., FKTSB (FSC), 2001

[61] See: www. mckinsey.com/features/investor_opinion/index.html

On the other hand, any efforts to ensure the compulsory use of the Code as an external lever of corporate governance (in this particular case - through the securities market) will not become efficient over the foreseeable future. For instance, the requirement to secure accession to exchanges' listings only against compliance with the Code is not credible as a mass, standard instrument, because of the illiquid and very narrow market. This conclusion is objectively based upon, first, a clear trend to concentration of joint-stock capital, and, second, the process of "closing" the open-end joint-stock companies established in the privatization era.

So, the objective boundaries of the Code's effects are clear. One can agree with some analysts that estimate that the Code would be determining the destiny of the national securities market and the inflow of long-term investment only at 5 to 10% (Mirkin, Losev, 2000). Nonetheless, its the educational function may prove to be useful yet at the current stage, while its effectiveness will depend on observance with the following principles:

- strictly recommendation essence implying no penalty for non-compliance with its provisions (in the law and ministerial acts);
- refusal from duplication of the corporate and the conjunct law;
- selection of viable (in Russian realities) provisions of the Code in the course of accumulation of positive practices and their introduction to the law.

2.4.4. The government as a factor of uncertainty

Political stability emerging in Russia in the wake of the 2000 presidential elections undoubtedly has contributed greatly to the lowering of risks in the area of corporate governance. However, there still are the former problems as well as newly arising ones in the area of government negative influences on the corporate sector.

First, the practice of using the government (its agencies) as an instrument in the struggle for control over a company and/or of pressure on rivals is still there. The uncertainty in this area still remains a serious factor contributing to the current high risks in the sphere of corporate governance.

Second, the process of emergence and strengthening of the new power also gives rise to new destabilizing factors related to modification of actual poles of control in the economy. A tough political struggle around reorganization of the largest natural monopolists (RAO Gasprom, RAO UES Russia, and the Ministry of Railway Transportation to a significant extent reflects these very processes.

The government policy of "equal distancing" of large capital from the power (even as long as its upper- the most demonstrative- stratum is concerned) has a direct impact on the noted processes.

First, it has been so far groundless to reckon that at the moment when consolidation (return) of assets and re-orientation of the largest natural monopolists' and state-owned holdings' financial flows is over, while their management appointed by the current President most likely would receive green light to expand into private sector and build their own groups, the declared "equal distancing" principle would discontinue to impact the scene. The probability of such a scenario (a "state capitalism" in its nutshell, with favors granted to a narrow circle of personally loyal supporters) requires certain protective actions on the part of private groups.

At the same time the apparatus the government began to use broadly over 2000-01 to impact corporations raises certain doubts. The state agencies' actions (the Federal Tax Police vs. LUKoil, The Accounting Chamber of RF vs. TNK, the General Prosecutor's office vs. Sibneft and Norilsk Nickel), with all their searches and filing criminal cases indeed proved to be much ado about nothing

Considering an actual organization of property structure and financial flows in the largest national corporations[62], the development and completion of cases on tax dodging appears one of the very few efficient methods of exercising state pressure on the corporations and their principals (beneficiaries). At this point, just three comments arise: first, there is a need in a radical solution to the problem of tax reform (i.e. elimination of objective economic reasons for the most of tax crimes - perhaps, a single mass debt restructuring as a substitution for tax amnesty); secondly, the judicial purity of legal methods and trustworthiness of facts allowing to launch a criminal investigation; and thirdly, a key issue, what final objectives the initiators of the noted selective cases pursued, given that the violations in questions are systemic.

As well, the government pursues its "property-in-exchange-for-freedom" policy that lately has proved to be quite successful. The arrest of SIBUR management in winter 2000 perfectly fits this particular pattern just by its form rather than essence, because stripping of assets in favor of some "group" appears sufficiently evident. At this point, another problem is likely to arise: the conflict between the legal area (i.e. essentially legal possibilities to strip of assets) and methods of their return (the need for pressure by using various articles of the Criminal Code of RF as the case shows no prospects of being brought to the

[62] See: Radygin, Sidorov, 2000

court). The same method (filing a crime) has proved to be necessary to ensure reshuffle in the Ministry of Railway Transportation.

In a broader context, the problem lies in vagueness of final objectives: either this really is kick-off for an anti-corrupt action and efficient prevention of various forms of stripping of assets, or this is an ongoing trivial reallocation of property and suppression of rivals (in favor of pro-government groups and/or in the frame of elementary use of "administrative lever" by all the agents that have this possibility).

Second, there arises an evident counter-trend on the part of private capital: that is, to secure an "equal distancing" at a maximally safe distance, particularly by means of legal fixing abroad of property rights for their consolidated assets. The establishment of TNK-International by Alfa Group and Renova, alongside with the registration of Millhouse Capital managing company by the "Abramovitch Group" are likely to become the first signs of eagerness to ensure "safe transparency".

Another safeguard for large groups is to secure an absolute access to regional executive power resources (A. Khloponin in Taymyr AO, R. Abramovitch in Chukotk, V. Shtyrov in Yakutia, V. Lisin in Lipetsk Oblast (potentially), A. Vavilov in Gorny Altay (failure).

Third, the transition from a clear and direct policy aimed at privatization of the 'administrative resource" to an emphasized loyalty to federal authorities and demonstration of large businesses' "social responsibility". However, the latter has so far been attempted by a very few companies: more specifically, SUAL-holding, the second Russian aluminum giant, concluded an agreement on social partnership with authorities of the region of its location, while some other corporations initiated an increase in the government share or assigned certain assets under the government control (for instance, Interros group, in its move to reorganize "Permskye Motory" into "Permsky Center Dvigatelestroyenia" controlled by the government.

A whole range of large companies have found themselves involved in trials that formally were economic, however with a huge political resonance harmful for a plaintiff company (Gasprom-NTV, LUKoil - TV6).

The state represented by the executive power, in turn, is increasingly expanding - particularly, even regardless of motives- its economic activities. The process takes part along 6 main mutually related directions:

- reshuffles in the largest natural monopolists and strategic companies with the government stakes (Gasprom, Ministry of Railway Transportation, MIC,

Ministry of Nuclear Power, daughter companies of Rosspirtprom, the State Investment Corporation, etc.);

- reorganization (primarily, merger) of the existing and creation of new holding companies in strategic sectors (consolidation of regional monopolists in the sector for communication into 7 inter-regional companies of "Svyazinvest" holding, to operate in the frame of 7 federal super-regions, 5 integrated structures in the airspace sector; OAO "Industrial Concern Antey", etc.);
- return of earlier withdrawn (privatized, used as a collateral) assets (the former Gasprom's assets - enterprises of SIBUR, Itera group, etc., stock packages of OAO "Novorossiysk Steamship" and "North-West Steamship", etc.);
- fixing of single segments of public property with the presidential Administration (creation yet in 2000 of a federal state unitary enterprise to run the property located abroad, etc.);
- attempts to revise the 1992 provisions on dividing tiers of property and shares held by the Federation in companies' capital (ALROSA);
- establishing control over main financial flows and their concentration in state-owned banks. The nationalization of financial flows is used as a substitute for deprivatization of industrial assets. Having an exclusive access to the biggest and cheapest financial resources - that is, the population's savings and the Bank of Russia's resources, Sberbank of RF and Vneshtorgbank issue credits to the largest national companies[63]. In light of this, the discussion on privatization of Vneshtorgbank held between 2001 to 2002 is very illustrative.

A tough political struggle around reorganization of the largest natural monopolists (RAO Gasprom, RAO UES Russia, and the Ministry of Railway Transportation) in 2000-01 has led to relatively modest results:

- matters related to the further privatization of the federal natural monopolists were assigned (as per a new draft law on privatization) to the Federal Duma;
- concepts for reorganization of RAO UES Russia and MRT were adopted;

[63]See: Grigoryev, 2002, p.21. In view of this, interstingly, there is an indirect analogy - with an opposite sign and in new conditions - with the scheme of privatization of financial flows without privatizing an enterprise itself that has been practiced vigorously since the early 1990s.

- RAO Gasprom underwent a reshuffle among the top management (resignation of R. Vyakhirev in May 2001, change of financial managers, launching criminal cases on -7- in January 2002, etc.) and MRT (filing a criminal case against ex-minister N. Aksenenko on abusing administrative powers, followed by his resignation in January 2002).

The latter result was likely to be sufficient, as long as the "restructuring" of both sectors is concerned. A real plan of Gasprom restructuring debated over two years that by its ideology should have been close to the scheme of reorganization of RAO UES Russia has so far been non-existent. Furthermore, according to A. Miller (statements made in January 2002) there is no need in restructuring in principle. So, most likely, the issue of restructuring as a process of creation of several competing gas companies (rather than a mere getting rid of non-profile assets) has been closed. Once can view the need for returning assets to RAO and regulation of financial flows (regardless of extra-economic challenges facing the new management) prior to any restructuring as a certain argument backing the above decision.

In summer 2001 the government approved the Ministry of Railway Transportation (MRT) restructuring program. The program provides an establishment of OAO "Russian Railways (the project has been cherished since 1993) and depriving MRT of its economic functions. The main production capacities, including infrastructure (electricity transmission lines, etc. accounting for 90% of the balance sheet assets in the sector), should be assigned to a newly created OAO. At the same time, in January 2002, the Federal Security Agency raised their objections, as they viewed the MRT's infrastructure as a strategic object that should form an independent federal public unitary enterprise. So, in January 2002, the draft law on privatization in the railway sector was recalled from the State Duma.

The actual reorganization of RAO UES Russia kicked off in 2002. According to the earlier approved program, the main purpose of that should become attraction of investment resources to the sector. From institutional perspective, by 2010 the whole system should be divided into the "monopolist" (electric network, electricity dispatching systems)" and the "competitive" (electricity generation, sales, service) parts. It is also provided that an electricity wholesale trade market would be established and the transition to market tariff mechanisms for heating and electricity will be accomplished[64]. In late 2001 (as a pilot project) the Trade System Administrator was established. That is an exchange to sell electricity (supplied by generating companies that have to deliver up to 15% of their output to it) at a free price. In 2002, the UES Russia's Board of Directors made a decision on establishment of the

[64] For more details, see: Rubchnko, 2002, p.32

Federal Network Company with authorized capital topping Rb. 121 bln., while it is envisaged that the Federal System Operator (Dispatcher) company should be established shortly. The reform of the generating companies (AO-energo=s) is directly related to problems in the corporate governance area.

First, to ensuring an elementary manageability of 72 AO-energo=s the holding would need a substantial reallocation of assets and enlargement of generating structures in the sector. Reorganization (merger, absorption or splitting of concrete AO-energo=s) will lead to a notable intensification of the market for corporate control and give rise to corporate conflicts on the whole.

The effective Russian law contains no provisions as to efficient procedures of protection of stockholders' rights in the course of absorption. This would bring about additional confusion to already extremely messy and difficult complex of problems arising in the frame of seeking a common balance of interests between stockholders of all types, managers, and regional authorities. The envisaged reform suggests formation of another additional agent - that is, managing companies (and, consequently, a broad spectrum of non-regulated problems associated with trust).

Secondly, there exists an obvious - and indeed strategic -problem. Clearly, it will be acquisition of energy capacities that will become the next logical step by newly formed vertically-integrated groups (with metallurgical "nucleuses"). This will be an unquestionable result of singling out and possible sales of generating companies within the frame of RAO UES Russia's restructuring. So, the metallurgical groups would obtain an unlimited influence on the national economy. It also appears important that the property control over the whole complex "electricity-coal-metallurgy" exercised from a single center allows an efficient re-direction of financial flows from all the links of the chain towards export and "optimization" of tax policy.

Likewise the federal natural monopolists, the reorganization of private groups highlights legal innovations in the area of reorganization, mergers, and absorptions, while specifically the insolvency law still requires a radical improvement.

Level of regulation of (control over) "economic concentration" (in terms of anti-trust law) and operations of actually controlling owners (and their managers) that can be carried out at the expense of other groups of stockholders (dividends, transfer pricing, lowering of export prices, taxes, capital exportation, etc.) still poses a serious and pressing problem.

The most recent (2001-2002) practices by government authorities and trends to their property expansion, establishment of control over main financial flows in the economy, and - more broadly- to securing businesses' dependence upon government institutions, and building "state capitalism" (despite decisions on deregula-

tion and plans of further privatization) make especially hot issues out of protection of property rights, judicial reform and efficient enforcement.

On the whole, the trends to struggle over control and redistribution of property (both due to objective processes in a transitional economy and numerous subjective factors) should be there over the upcoming years. This would fuel instability in the area of property rights and require a tightening of the policy of protection of investors' (stockholders') interests. Consequently, the priority will remain unchanged: that is, formation of a strict legal field of such a reallocation. The table containing concrete recommendations in this regard is given in the Conclusion.

In longer term prospect, one should take into account the worldwide trend to unification of corporate governance models (mutual borrowing of different components and mechanisms). In a certain sense, this proves the view on a legal formation of a corporate governance level (legal apparatus) as a secondary phenomenon just based upon actual economic processes, particularly, globalization.

In applied terms, it means that as of this very moment it appears inexpedient (impossible) to ensure such a legal formation of a "national model" of corporate governance that would match one or another classical sample (that themselves become increasingly eroded). From the government viewpoint, the fundamental task is to consider corporate governance in the context of protection and guarantees of property right (investors' rights, stockholders' rights) and provision of the balance of interests (rights) of all the participants in corporate relations. In this context, corporate governance is viewed as a crucial institutional condition of investment/economic growth.

Should there be no infrastructure and political will **to exercise the law (enforcement),** formation of legal field to ensure a civilized change of owners turns into a senseless enterprise. With account of the complex of economic and institutional challenges accumulated over the 1990s, it becomes inevitable that the state would intensify its regulation (moving from declarations of intent and development of legal provisions to a direct interference into the most serious conflicts) in this regard.

The uncertainty in the above area is still a key factor ensuring the maintenance of high risks related to corporate governance and investing in Russia. Consequently, the judicial reform (the ideal of which should be an independent and transparent court where - and only where- prosecutor in his polemics with counsel for the defense has to prove the necessity of one or another legal proceedings ruled out only by the court), procedural time limits on privatization deals, a clear law on nationalization currently form an objective indicator of the government's actual intents.

Section 3. Some regional features of legal control in the corporate sector.

3.1. Protection of shareholders' and Investors' rights

It is noteworthy that any regional legislative document, with extremely infrequent exceptions, contains references to Federal laws, presidential decrees and other federal documents. Nevertheless, among these on can quite clearly single out a group of documents, directly associated with the federal legislation (as a rule it's all kinds of Interpretations, Informative Letters etc.). Below follows a short analysis of documents first of all associated with the federal laws "On Joint-Stock Companies", "On Protection of Investors' Rights and Legitimate Interests at the Equity Market" as well as the presidential decree "On Measures to Ensure Shareholders' Rights".

After the Federal Law "On Joint-Stock Companies" was passed in December of 1995, the majority of regions issued their own legal normative documents on realisation of provisions of the Law.

In this way according to the Decree of the Head of Administration of Khabarovsk kray joint-stock companies' charters shall comply with the standard Charter of joint-stock companies defined by the Decree of the President of the Russian Federation as far back as on July 1, 1992, nr. 721 "On Organizational Measures to Turn State-Owned Enterprises, Voluntary Associations of State-Owned Enterprises into Joint-Stock Companies", enacted by the Decree of the President of the Russian Federation of November 16, 1992, nr. 1392 "On Measures to Implement the Industrial Policy in Carrying-Out Privatization of State-Owned Enterprises"[65].

The Decree also containes an instruction to the financial department of the kray administration to register emission of extra shares by partially state-owned joint-stock companies only on results of examinations performed by the state property committee of the kray. Registration of joint-stock companies' charters in case the company in question has state-owned shares in its capital, is supposed to

[65] See the Decree of the Head of Administration of Khabarovsk kray of June 10, 1996, nr. 269 "On Particular Features in the Legal Status of Joint-Stock Companies Established in the Process of Privatization on the Territory of Khabarovsk kray in Connection with Enactment of the Federal Law "On Joint-Stock Enterprises"

be performed by heads of municipalities only after they have received an approval from the state property committee of Khabarovsk kray. It also ruled to adopt corresponding regulations to define registration procedures and introduce changes and additions to joint-stock companies' charters established in the process of privatisation of municipal enterprises.[66].

On the territory of Moscow legal normative documents related to federal laws were issued by the State tax authority in the city of Moscow. In particular, in one of its Letters the tax authority explains certain provisions in the Federal Law "On Joint-Stock Companies" and the Civil Code and informs that "should there be registered facts of failure to bring constituent documents of joint-stock companies to conformity with provisions of the Federal Law "On Joint-Stock Companies" in due time, tax rating authorities are entitled to demand from these companies corresponding measures to change constituent documents, in case of failure to comply with this demand they are entitled to call senior executives of these joint-stock companies to account pursuant to the Administrative Code[67].

The State Authority in Vologda oblast also issued its letter with Interpretations, in which it informs about the adoption of the law "On Joint-Stock Companies" and explains some of its provisions[68].

Besides, joint-stock companies registered on the territory of Moscow were informed about the requirement to bring their constituent documents to conformity with the federal law "On Joint-Stock Companies" by the Chief Department for the city of Moscow of the Central Bank of the Russian Federation[69].

Sometimes legal normative documents concerned joint-stock companies in certain branches. For example, pursuant to the Order of the pharmacy committee of Moscow government, joint-stock companies that hadn't brought their documents to conformity with provisions of the federal legislation were not supposed

[66] Ibidem

[67] Letter of the State Tax Authority in the city of Moscow of September 19, 1997, nr. 13-06/23149 "On bringing constituent documents of joint-stock companies in conformity with the Federal Law «On Joint-Stock Companies"

[68] Letter of Interpretations by the tax authority in Vologda oblast of May 21, 1996 "On special features in establishing joint-stock companies".

[69] Letter of the Chief Department for the city of Moscow of the Central Bank of the Russian Federation of February 21, 1996, nr. 28-1-7/150

to receive new licenses and prolong old ones, the same concerned accreditation certificates[70].

In Kirov oblast joint-stock companies received a deadline – July 1, 1996 – to bring their constituent documents in conformity with the current legislation (i.e. the law "On Joint-Stock Companies") and get them registered. Documents not registered by that date are declared invalid. State bodies of the oblast were commissioned to render assistance to joint-stock companies, especially emphasized was the role of the Securities and Stock Market Commission under the oblast government, which was charged to "provide control of registers of owners of registered securities issued by joint-stock companies and to ensure shareholders' rights[71]. The same date was targeted for bringing in conformity constituent documents of joint-stock companies in several other regions of Russia: in Belgorod oblast[72], Lipetzk[73] and Nizhni Novgorod oblasts[74]. According to the Decree by the Administration of the city of Rostov-on-Don all joint-stock companies were obliged to hold stockholders meetings (regular or extraordinary) on this issue[75].

The problem of bringing joint-stock companies' charters in conformity with the legislation will emerge again on January 1, 2002 when federal law nr. 120-FZ of August 7, 2001 "On Introduction of Changes and Additions to the Federal Law "On Joint-Stock Companies" will inter into force[76].

Some legal normative documents related to the law "On Joint-Stock Companies" were issued later. As a rule, these are municipal documents.

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[70] Order of the pharmacy committee of Moscow government of July 21, 1997, nr. 97 "On measures to implement the Federal Law "On Joint-Stock Companies"

[71] Kirov oblast administration order of April 15, 1996, nr. 481 "On bringing constituent documents of joint-stock companies in conformity with the Federal Law "On Joint-Stock Companies"

[72] Decree of the head of Belgorod oblast administration of May 12, 1996, nr. 272 "On measures to bring activities of joint-stock companies on the territory of the oblast in conformity with the Federal Law "On Joint-Stock Companies"

[73] Decree of the head of Lipetzk oblast administration of April 26, 1996, nr. 185 "On measures to implement the Federal Law of the Russian Federation of December 26, 1995, nr. 208-FZ "On Joint-Stock Companies"

[74] Order of the head of Nizhni Novgorod oblast administration of January 16, 1996 "On measures to ensure implementation of the Federal Law "On Joint-Stock Companies"

[75] Decree by the administration of the city of Rostov-on-Don of February 27, 1996, nr. 286 "On measures to ensure implementation of the law of the Russian Federation "On Joint-Stock Companies"

[76] At present corresponding regional legal documents are either not available or lacking.

For example, the head of administration of the city of Tyumen issued a corresponding order as late as in May 2000, having stressed in it the requirement to "implement provisions of article 6 of the Federal Law "On Enactment of Part One of the Civil Code of the Russian Federation", and "pursuant to article 53 of the Charter of the city of Tyumen" all enterprises were ordered to bring their constituent documents in conformity with the Code within August 31, 2000[77].

Legal documents concerning the federal legislation in many cases contain descriptions of violations of Russian legislation. For example, according bo the information distributed by the press-centre of the Office of Public Prosecutor in Primorsky kray in 1997, by the results of an investigation into compliance with the shareholders' rights protection legislation was stated that "some managers, having forgotten that their companies' owners are shareholders, are not willing to comply with decisions taken by general meetings, act arbitrary, ignoring legal methods to uphold their positions, create conflict situations that affect interests of production". Then follows a specification of concrete instances when shareholders' rights were violated and the statement that "by results of investigation the office of the public prosecutor of the kray have issued official statements addressed to the managers in question containing demands to eliminate the violations and restore the infringed rights of shareholders[78]..

In Belgorod oblast in a decree by the head of oblast administration it was said that "several joint-stock companies in their activities allow serious drawbacks leading to instability in their operations. There is an inflow of complaints about neglects of legitimate shareholders' rights, violation of procedure of stockholders' meetings and about other issues associated with joint-stock companies' activities affecting shareholders' interests… There are cased of illegitimate purchase of large share holdings lacking the required notification of the Ministry of Finance of the Russian Federation or the required authorization (consent) issued by the State antimonopoly policy and support for new economic structures committee, etc"[79].

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[77] Order of the head of administration of the city of Tyumen of May 18, 2000, nr. 1878 "On bringing constituent documents of enterprises of all ownership types in conformity with the current legislation»

[78] Information bulletin of the Office of Public Prosecutor in Primorsky kray of August 6, 1997, nr. 40-2-97

[79] Decree of the head of administration of Belgorod oblast of May 12, 1996, nr. 272 "On measures to bring activities of joint-stock companies on the territory of Belgorod oblast in conformity with the Federal Law "On Joint-Stock Companies"

According to the Decree of the Administration of Krasnodar kray issued in August of 2001 "the majority of joint-stock companies that are registered on the territory of Krasnodar kray don't comply with requirements of Federal Laws "On Equity Market" of April 22, 1996, nr. 39-FZ, "On Joint-Stock Companies" of December 26, 1995, nr. 208-FZ, "On Protection of Rights and Legitimate Interests of Investors at the Equity Market" of March 5, 1999, nr. 46-FZ, as well as Resolutions by the Federal Securities Commission… There are cased of discrepancy in the current legislation and constituent documents of joint-stock companies, gross violations of inscribed stock register procedures, lack of shareholders' access to obligatory available information"[80].

To enhance capabilities of local government bodies to control the existing situation at the equity market and to improve the investment situation in the kray, the Kray securities and stock market commission is instructed to take the required measures, to work out as quick as possible a programme of measures to ensure that joint-stock companies comply with the equity legislation, to engage representatives of the prosecution in the kray in investigations, as well as to take measures to establish a unified information database on the equity market participants acting on the territory of the kray. Heads of towns and communities were obliged to take measures to receive in the manner prescribed by the law information about equity market's participants registered on territories of municipalities and to provide this information to the equity department of Krasnodar kray, as well as to establish within the framework of local self-government bodies subunits to attend to the stock market subjects acting on corresponding territories. Also suggested was taking measures to eliminate violations of the equity legislation including "enforced liquidation of joint-stock companies that have failed to bring their constituent documents to conformity with the current legislation according to the prescribed procedure"[81].

According to the Decree of the Administration of the city of Kostroma the registration chamber has done on the whole a good job in bringing constituent documents of companies in conformity with the Federal Law. Though this work is impeded by a lack of interplay with State tax bodies in exposure of a number of joint-stock companies and cooperatives that have stopped operations. As a result of it "more, than a half of closed-down joint-stock companies have not

[80] Decree by the Administration of Krasnodar kray of August 30, 2001, nr. 812 "On measures to reinforce control of implementation of the equity market laws by joint-stock companies in Krasnodar kray»
[81] Ibidem

brought their constituent documents in conformity with the current legislative provisions and have not produced them for the chamber for them to be reregistered.[82].

According to the Decree of the Head of administration of the city of Ekaterinburg in this city as of December 25, 1995 there were registered 4415 joint-stock companies. Of these as of July 1, 1996 only 807 joint-stock companies brought their constituent documents in conformity with the Federal Law of the Russian Federation "On Joint-Stock Companies". Pursuant to the Federal Law of the Russian Federation nr. 65-FZ of June 13, 1996 "On Introduction of Changes into the Federal Law "On Joint-Stock Companies" the deadline for bringing constituent documents of joint-stock companies in conformity was extended until July 1, 1997. As per July 1, 1997 constituent documents were brought to conformity with the Federal Law "On Joint-Stock Companies" by 1386 joint-stock companies. 3029 of joint-stock companies had not brought their constituent documents in conformity with the abovementioned law. Due to this not all of constituent documents are acknowledged as legitimate. Heads of municipalities, managers of structural sub-units in towns and communities administrations, heads of municipal institutions and enterprises are prohibited after July 1, 1997 to conclude contracts with, issue licenses to or perform any other actions in favour of joint-stock companies with invalid documents. Bank officials, other state or private enterprises' managers working with joint-stock companies that had been registered in Ekaterinburg before January 1, 1997 were recommended to pay attention to the fact that their counterparts' charters and state registration certificates bore the mark testifying that these documents conformed to the Federal Law "On Joint-Stock Companies"[83].

In a later Decree by the Head of the city of Ekaterinburg it is said that "the term for bringing constituent documents of joint-stock companies (joint-stock associations) in conformity with the law "On Joint-Stock companies"" expired on July 1, 1999. The said document states that "there are 21909 associations and joint-stock companies (79.8% of those due) that have not brought their constituent documents in conformity with the law "On Joint-Stock Companies"", as well

[82] Decree by the Administration of the city of Kostroma of April 8, 1997, nr. 1112 "On performance of activities prescribed by federal laws "On Joint-Stock Companies" and "Manufacturing Cooperatives"

[83] Decree by the Head of the city of Ekaterinburg of July 17, 1997, nr. 519 "On results of implementation of the Federal Law of the Russian Federation nr. 208-FZ of December 26, 1995 "On Joint-Stock Companies"

as that "2459 joint-stock companies have not brought their constituent documents in conformity with the law "On Joint-Stock Companies" (59.1% of those due, while the term expired on July 1, 1997)". Due to this the state registration department of the city of Ekaterinburg is empowered "to take to the abovementioned juridical persons measures, envisaged in the legislation". Representatives of communities' administrations are prohibited "from making contracts with, issuing licenses to and performing any other kind of actions" with respect to such companies. It is also one again recommended to "bank managers, other private or state enterprises' managers working with joint-stock companies registered in Ekaterinburg to pay attention to the fact that their counterparts' charters and state registration certificates of limited societies and joint-stock companies bear the mark testifying that these documents conform to the Federal Law and to conformity of other juridical persons with organizational and legal forms prescribed by the Civil Code of the Russian Federation.[84].

Hence, it is quite clear that in spite of a considerable quantity of legal normative documents issued in different regions and bearing relation to the federal legislation, the requirements contained in federal laws are not really met by many economic units and even governmental authorities (who are specifically prescribed to refrain from relations with companies that lack documents that correspond to legally accepted norms).

In one of the decrees of Moscow government it is stated that one of the most common law offences is a lack of an initial or a subsequent share issue registration. In connection with this a more stringent control of companies' activities is suggested. In particular, it is suggested that Moscow registration chamber while making registrations of changes and additions to constituent documents of joint-stock companies demands the following: in case the authorized capital stock is increased – the decision to float shares and a report on issue results registered by Moscow regional department of the Federal Securities Commission of Russia; in case the authorized capital stock is decreased – the decision to float shares and a report on results of the share issue registered by Moscow regional department of the Federal Securities Commission of Russia or a notification of shares' cancellation (if the total number of shares is being decreased), issued by Moscow regional department of the Federal Securities Commission of Russia; in case of changing the nominal share value and/or the number of shares while the authorized capital stock remains the same – the decision to float shares and a report on

[84] Decree by the Head of the city of Ekaterinburg of June 30, 1999, nr. 614 "On the results of bringing constituent documents in conformity with the legislation"

their issue, registered by Moscow regional department of the Federal Securities Commission of Russia. At the same time Moscow registration chamber and Moscow regional department of the Federal Securities Commission of Russia were commissioned "to ensure a monthly exchange of official information and data on magnetic media": Moscow registration chamber – on joint-stock companies registration data, changes in their constituent documents; and Moscow regional department of the Federal Securities Commission of Russia – on registration of shares issued by joint-stock companies[85].

According to the Decree of the Government of the Republic of Yakutiya the Ministry of Justice shall provide the Republic securities commissionwith information about all joint-stock companies of both open-type (OAO) and closed-type (ZAO (AOOT, AOZT)) forms registered on the territory of the Republic of Sakha (Yakutiya), at the same time the Ministry of Finance is charged "to check the registered joint-stock companies against registered stocks issued by joint-stock companies" [86].

As a sample of legal normative documents describing the registration procedure on the territory of a subject of the Federation one can use the Letter of Instructions signed by the chairman of the Registry Chamber of Moscow oblast, describing in detail the complete procedure including the process of entering on the Register, required documents and their detailed description, registration terms, reason for rejection of applications, etc. Also according to this document information services are provided to private persons and organizations in the following ways:

- "a) printing in "The Registry Gazette" information on registered juridical persons;
- b) giving information contained in the Unified state registry of juridical persons for Moscow oblast by issuing official letters containing abstracts of records concerning juridical persons in question registered by the Registry or certifying null information on them;

[85] Decree by Moscow Government of November 11, 1997, nr. 791 "On changing the procedure for registration of joint-stock companies in the city of Moscow"

[86] Decree by the Government of the Republic of Sakha (Yakutiya) of October 15, 1997, nr. 1328 "On protection of investors' rights"

- c) making copies and duplicates of constituent documents of a juridical person registered by the Registry Chamber to its incorporators (participants) against their written applications[87].

In St. Petersburg there were adopted approximate patterns for charters of closed-type two-tier joint-stock companies (ZAO), as well as for three-tier ZAOs and three-tier OAOs (open-type), which are recommended for use by joint-stock companies as models.

In the middle of 1990s several regions adopted legal normative documents to implement requirements contained in the Decree of the President of the Russian Federation "On Measures to Ensure Shareholders' Rights" signed in October 1993. An interesting decree in this connection was issued by the State Assembly of the Republic of Mordoviya (RM) in May 1995. That was a peculiar reaction to the information provided for the Assembly by the Property Fund of the RM on results of annual stockholders meetings and observance of the current legislation on protection of shareholders' rights by joint-stock companies. A considerable number of violations connected in particular with late notification of shareholders about forthcoming meetings and frequent cases of holding offices of the chairman of the board of directors and director general simultaneously when control bodies of joint-stock companies were formed. Among other things it was suggested in the decree "to ask the Public Prosecutor's Office of the Republic of Mordoviya to take public prosecution measures to joint-stock companies having more than 1000 shareholders who have not entrusted the shareholders' registries to the specialized registrar in violation of the Decree of the President of the Russian Federation "On Measure to Ensure Shareholders' Rights" of October 27, 1993, nr. 1769 [88].

In many regions and cities were established funds for protection of investors' and shareholders' rights. As an example let us look at the Charter of one these funds established in the city of Obninsk. The sole founder of this fund was the Administation of the city.

The principal tasks and aims of the Fund's activities are:

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[87] Letter of Instructions on the state registration procedure for juridical persons, enacted by the order of the chairman of the Registry Chamber for Moscow oblast on April 22, 1999, nr. 19Pr

[88] Decree by the State Assembly of the Republic of Mordoviya of May 19, 1995, nr. 156-I "On measures to ensure observance of the current legislation on joint-stock companies"

1. "1. To locate juridical persons going into liquidation or banks and commercial credit companies that have got into difficulties, to interact with them on a contractual basis to protect the city's investors' and shareholders' rights.
2. To interact with federal and oblast Funds to protect investors' and shareholders' rights.
3. To form, accumulate and increase the Fund's means and property to make entitlement payments to private persons damnified by banks and commercial credit companies that have their activities on the territory of the city, using means, transferred to the present Fund pursuant to its Charter.
4. To build up information database and keep records of investors and shareholders having suffered from violation of their rights by banks and commercial credit companies.
5. To build up information database and keep records of juridical persons and private entrepreneurs that violate legislation that controls activities on the financial and the stock market.
6. To keep, control and participate in realization of means and properties, to ensure its participation in control functions to secure proper conditions of keeping and realization of means and properties, assigned for restoration of rights of investors and shareholders, infringed a results of unlawful acts by banks and commercial credit companies, as well as pursuant to the aims of the Fund to ensure distribution of means received by selling the abovementioned properties and other property transferred to the Fund in accordance with the established procedure.
7. Provide assistance to liquidation commissions, banks and commercial credit companies in their activities to repay debtors debts, in cases of exposed violations in the cause of financial and economic activities that have caused losses for investors and shareholders of the city.
8. To systematically publish in the mass media of the city information on activities of the Fund and its charter tasks performance.
9. To provide control of sales of property and distributions of money means distrained according to executive proceedings[89].

The fund is obliged to annually publish "a report on use of its property and provide access to study the mentioned report". The Fund can own "land, building, constructions, structures, housing, transport means, equipment, money means in roubles and foreign currencies, securities and other property required to mate-

[89] The Charter of the Fund for protection of investors' and shareholders' rights adopted by the Decision of the City Assembly of Obninsk on September 27, 1996, nr. 10-10

rially ensure the Fund's activities listed in its Charter. The Fund can also own publishing houses, mass media that can be established or acquired at the cost of the Fund's means in accordance with its charter objectives". The Fund uses its means on the following principles:

1. "1. Total receipts of money means and property are distributed to all offended investors and shareholders that are registered in the database proportionally to sums of debts.
2. The Fund's administration is entitled to take a decision to make priority repayments of debts to natural persons on their deposits/investments not exceeding the initial deposit sum of 3 minimum amounts of remuneration of labour defined in the Russian Federation that belong to certain categories of natural persons (the Great Patriotic War participants, disabled war veterans and disabled workers of the 1st group, etc).
3. It is not allowed to use more than 3% of total Fund's assets to ensure its functioning, on administrative costs, development of its material and technical basis, transport expenses, payments for other works and services related to the Fund's activities"[90].

It should be noted, though, that nearly all of these funds were either reorganized or liquidated lately. To give several examples, in the Altay kray the Kray Fund for protections of investors' and shareholders' rights was reorganized in May of 2001 into a kray state institution "The Altay Kray Fund for Protections of investors' and shareholders' rights"[91], while in Krasnoyarsk kray the corresponding fund was liquidated in August 2001 in connection with insufficiency of its assets "to reach its objectives"[92].

According to the Decree of the Head of the Republic of Mordoviya on protection of investors' and shareholders' rights "with the aim to implement the Decree by the President of the Russian Federation of April 26, 1995, nr. 416 "On measures to ensure investors' interests and bringing entrepreneur activities of juridical persons performed at financial and stock markets without corresponding licenses in conformity with the legislation of the Russian Federation" and the Complex programme of measures to ensure investors' and shareholders' rights

[90] Ibidem

[91] Decree by the Altay kray Administration of May 21, 2001, nr. 316 "On reorganization of the kray fund for protection of investors' and shareholders' rights into kray state institution "The Altay Kray Fund for protection of investors' and shareholders' rights"

[92] Decree by Krasnoyarsk kray Administration of August 17, 2001, nr. 583-P "On liquidations of Krasnoyarks regional public and state fund for protection of investors' and shareholders' rights"

enacted by the Decree of the President of the Russian Federation on March 21, 1996, nr. 408, and to create a system to protect investors against abusive entrepreneurs at financial and stock markets in the Republic of Mordoviya it is ruled to establish a State commission for protections of investors' rights at financial and stock markets of the Republic of Mordoviya[93].

Pursuant to the Regulations enacted by this decree the commission is entitled "to arrange for investigations of upholding of investors' rights in the process of activities of juridical persons at the financial and the stock markets of the Republic of Mordoviya, to summon high and other executive officials of the Republic and local governments as well as juridical persons to hearings about ensuring investors' and shareholders' rights, make requests about and receive required documents from executive bodies of the Republic of Mordoviya and local administrations, to send information to federal executive bodies, executive bodies of the Republic of Mordoviya and local governments for them to make decisions on applying sanctions to those banks, other lending agencies and commercial credit companies that infringe investors' rights; to send corresponding documents to law-enforcement organs in cases when breach of laws of the Russian Federation by banks, other lending agencies and commercial credit companies is detected; to make statements to the Head of the Republic of Mordoviya on bringing to account those executive officials in the Republic that don not provide appropriate performance of their assigned responsibilities to protect the rights of investors at the financial and the stock markets of the Republic of Mordoviya[94].

In Stavropol kray a Decree by the Governor is effective. His Decree envisages measures to implement the Decree of the President of the Russian Federation of September 11, 1997, nr. 1009 "On regional and local funds for protection of investors' and shareholders' rights" and the Decree by the President of the Russian Federation of November 18, 1995, nr. 1157 "On certain measures to protect investors' and shareholders' rights"[95].

In Kemerovo oblast an administrative decree is effective. It orders the joint-stock companies registered in the oblast "with the number of investors exceeding

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[93] Decree by the Head of the Republic of Mordoviya of March 23, 1998, nr. 66 "On certain measures to protect rights of investors and shareholders"

[94] Regulations for "The state commission for protection of the rights of investors at the financial and the stock markets of the Republic of Mordoviya", enacted by the Decree of the Head of the Republic of Mordoviya of March 23, 1998, nr. 66

[95] Decree by the Governor of Stavropol kray of April 23, 1998, nr. 256-r "On measures to protect investors' and shareholders' rights in Stavropol kray"

five hundred that had not entrusted prior to publishing of this decree their registers of investors and holders of securities for keeping and in custody of a specialized registrar having a license to keep registers of holders of registered securities issued by the Federal Securities Commission to place them in custody and for keeping with specialized registrars within a month after the present decree is published". A deadline for other companies is not given.[96].

In Penza oblast there is an effective Decree which insists upon observance of provisions of the Federal Law "On Equity Market", "On Joint-Stock Companies", resolutions by the Federal Securities Commission , including registering of paper issues on time to provide control authorities with all required reports, etc.[97]

In Saratov oblast there is also a requirement to entrust register keeping to licensed registrars: for joint-stock companies with the number of shareholders exceeding 500 in a month's time without fail, with the number shareholders not exceeding 500 – recommended[98].

According to the Decree by the Cabinet of the Republic of Adygeya of June 29, 1999 "On protection of investors' and shareholders' rights in the Republic of Adygeya", city and municipal administrations of the Republic are obliged each quarter to provide the Ministry of State Property of the Republic of Adygeya with information about registered and liquidated joint-stock companies. "At registration of changes in the charter of a joint-stock company related to an increase (decrease) of its authorized capital stock, changes of nominal value and (or) the number of shares in case authorized capital stock remains unchanged, the following documents shall be provided: the decision on capital issue, a report on issue results registered with the Rostov regional department of the Federal Securities Commission of the Russian Federation; notification about annulment of shares (in case the number of shares is decreased) issued by the Rostov regional department of the Federal Securities Commission of the Russian Federation.

Legal normative documents similar to the abovementioned were adopted in practically all regions of Russia. Thus, one can make a conclusion that regional and municipal authorities basically do respond to new federal laws, though not always quick enough. But nevertheless, regional authorities don't exercise a close

[96] Decree by the Administration of Kemerovo oblast of August 1, 1997, nr. 666-r "On transfer of the procedure of keeping registers of holders of securities by joint-stock companies to specialized registrars on the territory of the oblast"

[97] Decree by the Administration of Penza oblast of May 25, 1998, nr. 594 "On measures to observe the legislation that controls securities issues by joint-stock companies"

[98] Decree by the Governor of Saratov oblast of September 18, 1996, nr. 31 "On keeping registers of joint-stock companies"

control of execution of federal legal normative documents and those of their own. This is testified by a great number of registered infringements by joint-stock companies in their activities.

3.2. Antimonopoly control

The number of regional and municipal legal normative documents related to different aspects of antimonopoly control is not big, the majority of them either deals with interpretations of provisions of corresponding federal laws or contain nothing more than references to their articles.

As a typical example one can quote two documents prepared by the Securities Commission of the Republic of Bashkortostan. The Letter of Information quotes some of provisions in the Decree by the Federal Securities Commission of September 30, 1999, nr. 7 "On the procedure of registration of affiliated persons and giving information on joint-stock companies' affiliated persons"[99]. Also an earlier Explanatory Letter dealt with the same Decree of the Federal Commission[100], which also contains an elucidation of the "affiliated person" notion pursuant to the text of the Law of the Russian Federation "On Competition and Restrictions on Monopolistic Activities at Markets of Goods".

Provisions of the same Decree by the Federal Securities Commission as well as the Federal Law "On Joint-Stock Companies", the Federal Law "On Competition and Restrictions on Monopolistic Activities at Markets of Goods", the Federal Law "On Equity Market" and the Federal Law "On Protection of Rights and Legitimate Interests of Investors at the Equity Market" are elucidated also in the Letter of Commentary by the Regional department of the Federal Securities Commission in the Republic of Tatarstan[101].

The Central department of the Central Bank of the Russian Federation for the city of Moscow informed that "lending agencies organized as joint-stock companies that have floated issued securities by way of public subscription are

[99] Notification by the Securities commission of the Republic of Bashkortostan of February 6, 2001

[100] Explanatory Letter by the Securities commission of the Republic of Bashkortostan of March 10, 2000 "On the procedure to register affiliated persons and provide information about affiliated persons of joint-stock companies

[101] "Information Disclosure in form of a list of affiliated persons", Commentary by the Regional department of the Federal Securities Commission in the Republic of Tatarstan of January 25, 2001 registered in the Ministry of Justice of the Republic of Tatarstan on December 7, 1999 as nr. 46

obliged each quarter within 30 days since the end of the corresponding quarter provide lists of affiliated persons as of the last day of the quarter. Other lending agencies organized in the form of joint-stock companies shall annually within 30 days since the end of the financial year provide the registry authority with a list of affiliated persons as of the last day of the financial year"[102].

Also effective in Moscow are the Temporary regulations for registration of activities termination by juridical persons according to which "in cases prescribed by the legislation when a juridical person terminates its activities it shall provide the registration authority with a statement issued by an antimonopoly authority"[103], the same concerns also reorganizations of juridical persons in forms of annexation and amalgamation.

In Vologda oblast elucidation for provisions in the Federal Law of May 6, 1998, nr. 70-FZ "On introduction of changes and additions to the Law of the RSFSR "On Competition and Restrictions on Monopolistic Activities at Markets of Goods" was given by the Vologda regional department of the State Antimonopoly Committee of the Russian Federation[104].

According to the Regulations for state registration of juridical persons and private entrepreneurs in the city of Lipetzk, at state registration of new juridical persons, introduction of changes to constituent documents or reorganization of a juridical person "a preliminary consent of the corresponding antimonopoly authority in cases envisaged in articles 17 and 18 of the Law of the Russian Federation "On Competition and Restrictions on Monopolistic Activities at Markets of Goods" or other governmental bodies" is required[105]. Similar wordings contain

[102] Letter of the Central department for the City of Moscow of the Central Bank of the Russian Federation of October 26, 2000, nr. 28-4-18/516 "Elucidation on the issue of giving information about affiliated persons of lending agencies organized in the form of joint-stock companies"

[103] "Temporary regulations on the procedure of registration of activities termination by juridical persons registered in Moscow, and unified registration of information about transition of rights and liabilities by way of succession", enclosure to the Decree of the Government of Moscow of August 25, 1998, nr. 666

[104] "New feature in the legislation on affiliated persons", letter of elucidation by the Vologda regional department of the State Antimonopoly Committee of June 16, 1998

[105] "Regulations for state registration of juridical persons and private entrepreneurs on the territory of the city of Lipetzk" adopted by the City Council of deputies of Lipetzk on April 11, 2000 (enacted by decisions of the City Council of deputies of Lipetzk on April 17, 2001, nr. 33)

also the Regulations for the procedure of registration and liquidation of juridical persons effective in the city of Kurgan[106].

In Ekaterinburg at reorganization of a juridical person in form of amalgamation or joining "a written consent of a federal antimonopoly authority is required (in cases of registration of amalgamation of proprietary organization (unions or associations), profit-making organizations established as a result of an amalgamation), if their assets holdings according to the latest balance exceed one hundred thousand minimum amounts of remuneration of labour)", at splitting or detachment – fifty thousand minimum amounts of remuneration of labour[107].

Sometimes provisions of federal laws are given more explicit explanations. For example, according to the Law adopted in the Republic of Komi in 1996, "in cases when the total book assets of incorporators of an economic society exceed 100 thousand minimum amounts of remuneration of labour or one of them is an economic subject entered into the registry of those economic subjects whose share at the market of certain goods exceeds 35%, or the future owner is a group of persons that controls activities of this given economic subject, a preliminary consent of the Komi regional department of the State committee of the Russian federation for antimonopoly policy and support of new economic structures is required to do the following:

- for a person (group of persons) to buy voting stocks (shares) in the authorized capital stock of an economic society, which gives this person (group of persons) the right to manage more than 20% of the mentioned stocks (shares). The above requirement does not concern incorporates of economic societies at their foundation;
- for one economic subject (a group of persons) to acquire or get in use basic production assets or intangible assets of another economic subject if the book value of the property in transaction exceeds 10% of the book value of production and intangible assets of the economic subject that sells them;
- for a person (group of person) to gain rights that allow to define conditions for business activities of an economic subject or perform its managerial functions.

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[106] "Regulations for the procedure of reorganization and liquidation of juridical persons on the territory of the city of Kurgan", an enclosure to the Decree of the Administration of the city of Kurgan of December 9, 1997, nr. 95 (enacted by Administrative decree of the city of Kurgan nr. 10 on March 1, 1999)

[107] Letter of Instructions "On the procedure of liquidation and reorganization of juridical persons on the territory of the city of Ekaterinburg", an enclosure to the order of March 24, 2000, nr. 182

The Komi regional department of the State committee of the Russian federation for antimonopoly policy and support of new economic structures shall be informed in accordance with the current legislation in a notification by incorporators (one of incorporators) within 15 days since the date of the state registration (introduction of changes to the state registry) about establishment of proprietary organizations in case the total value of the incorporators' assets exceeds 100 thousand minimum amounts of remuneration of labour".

The Komi regional department of the State committee of the Russian federation for antimonopoly policy and support of new economic structures shall be informed in a notification by incorporators (one of incorporators) within 15 days since the date of amalgamation or joining (introduction of changes to the state registry) of proprietary organizations in case their book value of total assets exceeds 50 thousand minimum amounts of remuneration of labour"[108].

These provisions are almost literal quotations from the Regulations for state registration of juridical persons and private entrepreneurs in the city of Ulan-Ude[109], as well as form the Instructions effective in the city of Astrakhan[110].

Almost as the only local initiative remains a draft law worked out by the legislative assembly of Krasnodar kray, which contains among other things the following paragraph: "should an enterprise having as an affiliated persons its own incorporator (or incorporators) have arrears of obligatory payments, information about that shall be given to rating authorities for them to take a decision on investigation of the financial and economic activity in the last three years with the aim to reveal reasons that led to these arrears[111]. In the explanatory note to the draft law it is said that «this is necessary to control activities of enterprises having arrears of payments that have affiliated persons, who are incorporators of new en-

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[108] The Law of the Republic of Komi "On introduction of changes and additions to the Law of the Republic of Komi "On attracting investments to the economy of the Republic of Komi" adopted by the Council of State of the Republic of Komi on March 14, 1996

[109] "Regulations for state registration of juridical persons and private entrepreneurs" adopted by the session of the City Council of deputies of Ulan-Ude on May 27, 1999, nr. 397-47

[110] "Instructions about the unified procedure of state registration and registration of termination of economic subjects' activities in the city of Astrakhan", an enclosure to the Administrative Decree of the city of September 8, 1995, nr. 2171 (enacted by Decree of February 28, 1997, nr. 629)

[111] Draft Federal Law "On Introduction of Changes and Additions to the Law of the RSFSR "On Enterprises and Private Business", an enclosure to the Decree of the Legislative Assembly of Krasnodar kray of February 29, 2000, nr. 442-P

terprises, so that check-ups of financial and economic activities can be arranged when applications for registration of new enterprises are handed in" to avoid possible misuse in bankruptcy proceedings.

As for financial and industrial groups and holdings, the majority of legal documents in legislative bases of regions deal only with concrete financial and industrial groups. For example, the Administrative Decree of Voronezh oblast concerns establishing on the basis of the financial and industrial group "Soyuzagroprom" of joint-stock company "Soyuzagroprom" with the controlling interest in state property[112]. In the explanatory note enclosed to the 1998 report of the St. Petersburg regional department of the Ministry of Antimonopoly Policy the activities of the City Bank of St. Petersburg are viewed with respect to the fact that the bank is a co-incorporator of the "St. Petersburg fuel company" holding, and it is stated that "a new system of relations between the bank and its clients is being developed, namely "a bank-enterprise", which is opposite to the existing one at the level of corporative closed banks"; also discussed is the establishment of the ZAO "Bankers' House (Bankirsky Dom)" holding on the basis of three banks that had invested their respective share holdings[113].

There are very few exceptions, and all of them were adopted in the beginning of the 90s. For example, the Decree by the Government of Moscow dealing with the concept of financial and industrial groups formation[114], was adopted in 1994. It ensured implementation on the territory of the city of the Decree of the President of the Russian Federation of December 5, 1993, nr. 2096 "On Formation of Financial and Industrial Groups in the Russian Federation" and the Decree of the Government of the Russian Federation of August, 25, 1993, nr. 1536-R "On Establishment of Inter-departmental Commission to Promote Organization of Joint-Stock Industrial Companies and Financial and Industrial Groups". The document contains a legal basis for financial and industrial groups, their aims and objectives, formation principles, etc, as well as forms of economic partnership of

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[112] Decree by the Administration of Voronezh oblast of May 15, 2000, nr. 437 "On measures to promote state control of activities of the agroindustrial complex of the oblast and maintenance supplies"

[113], Explanatory note to the 1998 report of the St. Petersburg regional department of the Ministry of Antimonopoly Policy and Support of Business, enclosure to the information from the Antimonopoly territorial department of St. Petersburg of January 15, 1999, nr. OB-99

[114] Decree by the Government of Moscow of June 14, 194, nr. 488 "On basic principles of approach to the concept of formation of financial and industrial groups in the city of Moscow"

governmental bodies of Moscow in formation of financial and industrial groups, types of tax allowances and method to promote them.

In the Republic of Tatarstan in the same year of 1994 there were adopted Temporary regulations for holdings. It is said in the document that it will remain effective until "a new specialized legislation of the Republic of Tatarstan on holding companies is adopted" (such a legal normative document has not been adopted, yet), and it is valid for all companies "whose state property share in total assets at the moment the holding company is established exceeds 25%".

The document defines aims for establishing holdings (including the aim of "keeping state control of the most important branches of economy of the Republic of Tatarstan" and "gradual reduction of the role of the state in managing the economy and decrease of state-owned property in privatised enterprises"), it gives basic definitions, grounds and conditions for establishing holdings (e.g. holding companies can be established "when big enterprises are being restructured and some of their departments are singled out as legally independent daughter enterprises", as well as "when share holdings of legally independent enterprises are being united"), it defines requirements to published accounts, as well as restrictions on establishing holdings (for example, "establishing a holding company is not allowed when this can lead to monopolization of production of certain types of goods also with respect to the common economic zone of the Russian Federation), etc.[115]

Territorial departments of the Ministry for antimonopoly policy of the Russian Federation exist in practically all of regions of Russia (in certain cases one territorial department works for two subjects of the Federation simultaneously, for example, in Tyumen and Kurgan oblasts, Volgograd oblast and the Republic of Kalmykia, Moscow and Moscow oblast and others, this being an exception to the rule), but even in spite of this, antimonopoly control at the level of regions is still scanty.

An evidence of this, in particular, is the small number of regional legal normative documents on these issues, as well as subject-matters of these documents. Many regions' legislations completely lack legal normative documents on issues of antimonopoly control. In those subjects of the Federation where corresponding documents work, they contain however actually nothing but wordings from federal laws giving more often than not no comment on them. Most underdeveloped

[115] Temporary regulations for holding companies established in the process of privatisation of state-owned and municipal enterprises in the Republic of Tatarstan, enacted by the Decree of the Cabinet of the Republic of Tatarstan on October 4, 1994, nr. 478

is the legislation on financial and industrial groups, holdings and big corporations. With the exception of the two abovementioned documents (both issued in 1994) the legislative base contains nothing more.

Moreover, antimonopoly control in regions often contradicts the federal legislation. In this way, in 1998 in St. Petersburg there were detected features of infractions of the antimonopoly legislation of the Russian Federation in a whole series of documents (including three Decrees by the Governor), as well as in many actions by the administration. All in all investigations of executive authorities' malpractice in 1998 were started on the basis of "25 applications (including 13 cases of unjustified impediments to perform economic activities), there were started 12 prosecutions, 8 injunction were delivered prescribing to stop the malpractice"[116].

Due to this one can make a conclusion that a feeble regional legislation on the issues of antimonopoly control is not at all caused by an active use of federal laws in subject of the Federation, but a weak interest of local authorities to the questions of antimonopoly policy.

3.3. Some conclusions

It is evident that different spheres of corporative legislation are represented in legislatives of regions by legal normative documents of different quality. They differ only in their quantity, but also in quality, depending on the variety of issues and problems that the documents deal with.

The highest emphasis in regions is placed on different aspects of state participation in economic societies, less developed are legal norms related to issues of shareholders' rights protection and bankruptcy proceedings, while problems of antimonoly control are practically not attended to.

The high priority of issues of state participation in economic societies is confirmed not only but a large number of corresponding legal normative documents and the variety of their issues, but also by the fact that in preparation of exactly this group of documents legislative bodies played a rather active part. In return, documents of other groups were worked out by exclusively executive bodies.

Corporative legislation is developed to a varied degree in different regions. Among the subjects of the Federation that focus their attention on these issues one should name first of all the Republic of Tatarstan, the Republic of Bashkor-

[116] Explanatory note to the report by the St. Petersburg territorial department of the Ministry for antimonopoly policy and support for business of January 15, 1999, nr. OB-99

tostan, the Altay Republic, Moscow, Moscow oblast, St. Petersburg. On can conjecture that authorities of these regions strive for a highest possible control of enterprises and business activities.

On the other hand in the republics of Northern Caucasia as well as in a number of oblasts of Central Russia (including Belgorod, Oryol, Kursk, and other oblasts) corporative legislation is totally undeveloped, which can testify to the effect that regional authorities leave these issues unattended.

Moreover, there is an evident relation between the development degree of corporative legislation in a certain region and that of its municipalities. As examples of this one can name Bashkortostan and its capital Ufa, Rostov oblast and the city of Rostov-on-Don, Yakutiya and the city of Yakutsk, Buryatiya and its Ulan-Ude. The only exceptions here are Tatarstan and the Altay Republic. As for the first one, one can assume that authorities of this subject of the Federation strive for the highest possible control of all spheres of the corporative law, including those that usually are under the jurisdiction of municipal officials. As for Altay, it is as simple as that: the number of economic societies working on its territory is negligible and there is no need in a developed municipal legislation.

Making an analysis of regions' legislations[117] we didn't find any direct contradictions to the federal corporative legislation. Nevertheless, the analysis gives the impression that authorities of subjects of the Federation easily evade its provisions when this is needed, just by reacting too slowly to new federal laws. For example, the Federal Law "On Joint-Stock Companies" was passed in December of 1995. In some regions legal normative documents that deal with its provisions were enacted already in the spring of 1996, and later in several others (for example, in Moscow – in September of 1997, in Tyumen – in 2000), while many subjects of the Federation still have not adopted corresponding documents.

Approximately the same situation is typical of legal normative documents dealing with protection of shareholders' and investors' rights. The Federal Law "On Protection of Rights and Legitimate Interests of Investors at the Equity Market" was passed in March of 1999, but the majority of regional normative documents dealing with this aspect of the corporate law were adopted in 1998, which means that their adoption was a response to the presidential Decree "On Measures to Ensure Shareholders' Rights" signed as far back as in 1993. In a certain sense one can speak of inactivity in regional lawmaking.

[117] Documents that had become invalid were not taken into account, as well as invalid variants of documents.

In the same context one can view the policy currently pursued by the federal centre to unify regional legislations (as a matter of fact, to bring them to conformity with the Constitution of the Russian Federation and federal legislation). Regions' response to this aspect of the federal centre's policy undoubtedly varies, though the tendency to demonstrate their loyalty to the federal government is present. Let us have a look at just two examples.

On the one hand many regional officials were bound to give an adequate response to the requirement of the federal centre about unification of federal and local laws. For example, President M. Shaimiyev of Tatarstan in the spring of 2001 reversed the moratorium on sales of shares of 21 enterprises that had been valid for 9 years and was of strategic importance for the economy of Tatarstan. This prohibition was related to a special privatisation procedure in the republic, when vouchers were supplemented with "individual privatisation deposits" for the population of Tatarstan, which could be exchanged for shares of local enterprises. Simultaneously there was imposed a prohibition for alienation of shares bought by employees of enterprises using local vouchers. Nevertheless this unification of 2001 was quite formal, as far as de facto the prohibition could easily be evaded (through an agency contract with an authorized body of the republic, issuers' special partnerships and using different "shadow" schemes). As a justification to cancel the moratorium used by the securities commission of the republic was the need to remove inequality in rights of owners of shares of the same issue, which, anyway, had been evident from the very beginning.

On the other hand regional authorities (as well as a number of big private groups, which is often the same) were quite negative to the property expansion of the federal centre and its aspiration for establishing control of key financial flows. A glaring example of that is the reaction of ex-president of Yakutiya M. Nikolayev to the federal centre's attempts to establish a property and financial control of ZAO "ALROSA", Russia's monopolist in diamonds.

At present shares in the joint stock of "ALROSA" are distributed in the following way: 32% belong to the Russian Federation, 32% to Yakutiya, 23% to employees, 8% to administrations of uluses (municipalities), 5% to the Fund for social guarantees to armed forces personnel under the Government of the Russian Federation. According to our information, the centre planned to increase its share in "ALROSA" making it a majority holding and to transfer lease receipts from the local to the federal budget (among other things, by a transfer of assets of the former NPO "Yakutalmaz" to federal property with the aim to lease them later on behalf of the federal centre, and not by Yakutiya). In answer to that Yakutiya planned to transfer share holdings belonging to the republic (including share

holdings in ALROSA) to asset management by the "Sakhainvest" fund (with a formal number of shareholders of about 200 000), which in aggregate would have made the federal expansion more difficult. After the December 2001 elections in Yakutiya this plan will hardly stand, especially because M. Nikolayev was superseded by an ex-president of ALROSA, V. Shtyrov, who was quite loyal to the plans of the centre.

In its turn, the federal centre intervenes with regional property collisions through President's representatives in federal super-regions. For example, in January of 2001 the President's representative in the Uralsky super-region, having established the fact that the state property in the subjects of the Federation in the Uralsky super-region is administered poorly and 50% of state-owned enterprises in the super-region were unprofitable, suggested a considerable reduction of property rights that belong to regional administrations. He suggested, in particular, to take territorial functions of the Ministry of State Property away from regional executive authorities, introduce more stringent requirements to state representatives in joint-stock companies, introduce legal norms about withdrawal of "superfluous" immovable property from day-to-day management, establish an institution for professional asset management of state share holdings, replace representatives of regional administration in registers by representatives of the Ministry of State Property.

Already by July 2001 the proposals had become even more radical, than before. In particular, to effect a reconciliation of the conflict about joint-stock companies "Karabashsky medeplavilny kombinat (brass works)" and ZAO "Karabashmed'" the President's representative office in the Uralsky super-region suggested to transfer a part of shares of the ZAO to government property.

It is quite possible that a more detailed analysis of documents relating to concrete enterprises and companies (including decisions by arbitration tribunals) would uncover a considerable number of violations of federal legislation. This thought is indirectly supported by reports of authorities and arbitration tribunals filed in regional legislative archives that registered a great number of violations of Russian laws and by-laws. For example, in 1998 in St. Petersburg indications of violation of the antimonopoly law of the Russian Federation were present in a whole series of documents worked out by local government bodies (including three Decrees by the Governor), as well as in many activities of the administra-

tion (all in all cases of malpractice by executive bodies in 1998 were studied based upon 25 applications)[118].

One can make a supposition that law-making activities of regional authorities directly depend on the activity of territorial departments of federal ministries on their respective territories. This is testified by the fact that among reviewed legal normative documents there were not found documents worked out by territorial departments of the Ministry for Antimonopoly Policy (in contrast to documents prepared, for example, by tax administrations or the Federal Securities Commission bodies), while it's namely these aspects of corporative law that are the least developed in regions.

Namely because of this federal authorities should place a higher emphasis on corporative legislation in regions (in addition to their requirements for unification), which, no doubt, needs a serious revision.

[118] Explanatory note to the 1998 report of the St. Petersburg regional department of the Ministry of Antimonopoly Policy and Support for Business, enclosure to the information from Antimonopoly territorial department of St. Petersburg of January 15, 1999, nr. OB-99

Section 4. Empirical study of features of regional property patterns, corporate governance and financial behaviour of enterprises.

4.1. Database description

4.1.1. Characteristics of the selection of analysed enterprises

In compliance with the theoretical approach, in the course of the project there was worked out a method of sampling observation of Russian industrial enterprises[119]. The principal purpose of this research was getting data that would allow an estimation of relation between economic performance showings of privatised enterprises in processing industries and parameters of property patterns, corporate governance, characteristics of their environments. The questionnaire was worked out in 1998-1999, was proved during two pilot researches (in 1998 and 2000)[120]. By results of the first pilot research there were made substantial changes in the initial text of the questionnaire. The basic research included 437 industrial enterprises, chosen at random from the initial block of data, which is describe below. For the present research the size of the sampling was diminished to 395 enterprises by their respective locations.

Considering the key point of the research (privatised enterprises of processing industries), the authors didn't aim at getting a representative sample of the whole of Russia's industry. Partially it was explained by the need to establish

[119] To make the research described in this unit of the paper the database of Russian enterprises of the Bureau of Economic Analysis (BEA) was used (see BEA, 2001). Accordingly, a most general description of the primary base given below, is based upon the abovementioned source, though in view of specific aims of the present research an original sampling of regions and enterprises was required. Due to this the sampling described below is quite different from the initial one, its formalization in table form required certain calculations and was performed by the authors of the present research.

[120] The 1998 financial crisis and the period of financial instability in Russian economy that followed made the authors to review the initial research term (the beginning of 1999) and to postpone realization of the project by one year.

certain quotas (by sizes, branches, etc.) with the end to ensure the possibility of statistical assessment of such factors as the branch of the enterprise or its size. The principal purpose – studying the process of adaptation of industrial enterprises to new economic conditions of the of the 90s – predetermined (considering the restriction on the total number of studied enterprises) certain sampling features that follow below:

4.1.2. Description of the questionnaire[121]

Information was gathered by way of direct (face time) interviewing of industrial enterprises' managers. As a rule the respondents were chief executives (directors, directors general), vice-directors in questions of economics, finance or production. Composition of the respondents is given in Table 4.1. In the majority of cases quantitative data were filled out separately from the bulk of data by accountants, planning departments, or other corresponding departments of enterprises.

TABLE 4.1

Breakdown of Respondents by their Appointments[122]

Region		Respondents' Offices			Total
		Director	Deputy Director	Other high executives	
Moscow	Number of observations	23.00	6.00	7.00	36.00
	% within the region	63.89	16.67	19.44	100.00
	% of total number	5.82	1.52	1.77	9.11
Moscow oblast	Number of observations	24.00	3.00	14.00	41.00
	% within the region	58.54	7.32	34.15	100.00
	% of total number	6.08	0.76	3.54	10.38
St. Petersburg (with the oblast)	Number of observations	32.00	0.00	13.00	45.00
	% within the region	71.11	0.00	28.89	100.00
	% of total number	8.10	0.00	3.29	11.39

[121] The Questionnaire is given in Appendix 1.

[122] The "Director" category combines respondents that held offices of Director General, Executive Director, Director, acting as Director and so on. In three cases respondents held posts of the president of the company, in one case – of the chairman of the board of directors. The "Deputy Director" category means deputy of the highest executive of the company or (only in one case) Chief Engineer. The "Other" category means, as a rule, Heads of economics departments, planning departments, Assistant Directors.

TABLE 4.1 CONT`D

Nizhni Novgorod	Number of observations	46.00	2.00	16.00	64.00
	% within the region	71.88	3.13	25.00	100.00
	% of total number	11.65	0.51	4.05	16.20
Samara	Number of observations	24.00	2.00	13.00	39.00
	% within the region	61.54	5.13	33.33	100.00
	% of total number	6.08	0.51	3.29	9.87
Ekaterinburg	Number of observations	32.00	3.00	15.00	50.00
	% within the region	64.00	6.00	30.00	100.00
	% of total number	8.10	0.76	3.80	12.66
Perm	Number of observations	32.00	2.00	10.00	43.00
	% within the region	74.42	4.65	23.26	100.00
	% of total number	8.10	0.51	2.53	10.89
Novosibirsk	Number of observations	27.00	2.00	11.00	40.00
	% within the region	67.50	5.00	27.50	100.00
	% of total number	6.84	0.51	2.78	10.13
Krasnoyarsk	Number of observations	28.00	2.00	8.00	37.00
	% within the region	75.68	5.41	21.62	100.00
	% of total number	7.09	0.51	2.03	9.37
All Regions	Number of observations	268.00	22.00	107.00	395.00
	%	67.85	5.57	27.09	100.00

Source: the author's calculations

The list of questions included in the questionnaire reflects the problem structure as it is formulated above. The questions are arranged in five principal groups as follows:

- by indicators of economic and financial activities of the enterprise (production turnout, distribution of costs, degree of use of fixed production assets and personnel resources, structure of settlements, assets and liabilities, etc);
- by indicators of conversion (what kind of conversion arrangements were made and when);
- by indicators of market positioning (structure of the market, business rivals);

- by property structure and indicators of corporate governance (fixed capital pattern, indicators of concentration, the structure of the board of directors, etc);
- by financial conditions (restrictions): availability of sources of external financing, structure of settlements, etc;
- the group of control variables (region, branch, date of privatisation, legal form of ownership).

In cases, when it was feasible and expedient it was inquired about year-for-year information for 1997-1999, which should afford an opportunity to view changes in industry that happened as a result of the 1998 crisis. The list of questions is based on the principle of repetition of questions most important for the analysis. In other words, when it proved possible each of the conceptual variables – efficiency, productivity, financial situation, etc. – was defined by several indicators (on the quantity scale, interval and/or the nominal scale), which allowed making estimates. For a number of questions, which (from experience of the pilot researches) could not be answered in detail, different answers were acceptable. For example, information about property structure was asked for separately in different categories of respondents: employees, managers, former employees. In cases, when no answer was given, an answer about a total share of insiders or even total share of all these three categories was acceptable.

4.1.3. Structure of the sample by regions

The choice of Russian regions that the research dealt with was based on the two basic criteria. The planned sample size provided no opportunity to do a representative sampling in all subjects of the Russian Federation. At the same time many researches point out that regional differences in the present conditions for activities of Russian enterprises, the investment and business climates can be substantial.

As a palliative decision we chose to select regions in four larger geographic and economic zones: the Centre (including the North-West, represented by St. Petersburg and Leningrad oblast), the Volga regions (including both the Volga belt and Volga-Vyatka economic zone), the Urals and, finally, Siberia (Western and Eastern). All in all 13 cities and oblasts were studied[123]: Moscow, Moscow

[123] The number of regions in each of these macro-zones was determined by the need to follow quantitative and branch quotas.

oblast, St. Petersburg, Leningrad oblast, Saratov oblast, Nizhni Novgorod oblast, Volgograd oblast, Chelyabinsk oblast, Ekaterinburg oblast, Perm oblast, Novosibirsk oblast, Krasnoyarsk kray, Omsk oblast. No restrictions on studied enterprises' location within the regions were set. Enterprises of the sample were located for the most part in the main cities of oblasts and krays.

There is no doubt that such a regional pattern of sampling does not allow making the correct analysis of specific features of regional policies. It is known that within a singe macro-region there exist considerable differences in economic dynamics and regional economic policies among subject of the Federation (Tatarstan, Ulyanovsk, Nizhni Novgorod can qualify here). Nevertheless, in many cases the geographical location of the region itself, the distance to the Centre can be an independent factor of its economic development and define features of enterprises' behaviour. The final sampling pattern by regions is given in table 4.2.

TABLE 4.2

Distribution of Enterprises of the Sample by Regions

Region	Number of Enterprises	%
Moscow	36	9.11
Moscow oblast	41	10.38
St. Petersburg (and Leningrad oblast)	45	11.39
Nizhni Novgorod	64	16.20
Samara	39	9.87
Ekaterinburg	50	12.66
Perm	43	10.89
Krasnoyarsk	37	9.37
Novosibirsk	40	10.13
Total	**395**	**100.0%**

4.1.4. Choice of branches

Initially the scope of enterprises was limited to processing industries: chemical industry (together with petrochemical and pharmaceutical industries), engineering industry (including metal-working), timber industry (together with woodworking and pulp and paper industry), building materials industry, light and food industries (with flour-milling and groats industry). It should be noted that

For the present research 9 cities and oblasts were chosen:: Moscow, Moscow oblast, St. Petersburg (with Leningrad oblast), Saratov oblast, Nizhni Novgorod oblast, Ekaterinburg oblast, Perm oblast, Novosibirsk oblast, Krasnoyarsk kray.

branches of metallurgy were excluded from the list on purpose. The exclusion was determined by the following. First, in these branches it is impossible to separate mining enterprises from processing enterprises using the two-digit branch codes. Second, concentration of production in these branches of Russian industry is very high. Production is mainly concentrated at very big enterprises, which we excluded from the study by reasons, which we will tell about below. This means, that it would have been practically impossible to do a sampling of enterprises of metallurgy that would be representative of the whole of this industry. Moreover, metallurgical enterprises in Russia are as a rule export-oriented (up to 80-95% of the produce), which makes them incomparable to other enterprises of the sample.

Following the above restrictions quotas in sampling of enterprises dealt only with six branches to get an approximately equal number of enterprises in each branch. In practice it turned out to be quite difficult to get this kind of parity (to fulfil the quotas for some branches, such as the chemical industry, being restricted by the sizes of enterprises and the number of regions). Sampling distribution by branches is given in table 4.3.

TABLE 4.3

Sampling Distribution by Branches

		Region										
Sector	Industry code		Moscow	Moscow oblast	St. Petersburg (with the oblast)	Nizhni Novgorod	Samara	Ekaterinburg	Perm	Novosibirsk	Krasnoyarsk	All Regions
Chemical	13	Number of observations	6.00	10.00	2.00	5.00	3.00	6.00	4.00	2.00	3.00	41.00
		% within the sector	14.63	24.39	4.88	12.20	7.32	14.63	9.76	4.88	7.32	100.00
		% within the region	16.67	24.39	4.44	7.81	7.69	12.00	9.30	5.00	8.11	10.38
		% of the total	1.52	2.53	0.51	1.27	0.76	1.52	1.01	0.51	0.76	10.38
Machine building	14	Number of observations	6.00	6.00	14.00	12.00	12.00	15.00	9.00	15.00	7.00	96.00
		% within the sector	6.25	6.25	14.58	12.50	12.50	15.63	9.38	15.63	7.29	100.00
		% within the region	16.67	14.63	31.11	18.75	30.77	30.00	20.93	37.50	18.92	24.30
		% of the total	1.52	1.52	3.54	3.04	3.04	3.80	2.28	3.80	1.77	24.30

TABLE 4.3 CONT`D

Timber	15	Number of observations	2.00	5.00	9.00	10.00	2.00	6.00	16.00	4.00	9.00	63.00
		% within the sector	3.17	7.94	14.29	15.87	3.17	9.52	25.40	6.35	14.29	100.00
		% within the region	5.56	12.20	20.00	15.63	5.13	12.00	37.21	10.00	24.32	15.95
		% of the total	0.51	1.27	2.28	2.53	0.51	1.52	4.05	1.01	2.28	15.95
Building Materials	16	Number of observations	4.00	2.00	5.00	7.00	11.00	9.00	6.00	9.00	4.00	57.00
		% within the sector	7.02	3.51	8.77	12.28	19.30	15.79	10.53	15.79	7.02	100.00
		% within the region	11.11	4.88	11.11	10.94	28.21	18.00	13.95	22.50	10.81	14.43
		% of the total	1.01	0.51	1.27	1.77	2.78	2.28	1.52	2.28	1.01	14.43
Light Industry	17	Number of observations	13.00	13.00	5.00	15.00	6.00	3.00	2.00	7.00	3.00	67.00
		% within the sector	19.40	19.40	7.46	22.39	8.96	4.48	2.99	10.45	4.48	100.00
		% within the region	36.11	31.71	11.11	23.44	15.38	6.00	4.65	17.50	8.11	16.96
		% of the total	3.29	3.29	1.27	3.80	1.52	0.76	0.51	1.77	0.76	16.96
Food Industry	18	Number of observations	4.00		8.00	9.00	5.00	8.00	5.00	3.00	8.00	50.00
		% within the sector	8.00		16.00	18.00	10.00	16.00	10.00	6.00	16.00	100.00
		% within the region	11.11		17.78	14.06	12.82	16.00	11.63	7.50	21.62	12.66
		% of the total	1.01		2.03	2.28	1.27	2.03	1.27	0.76	2.03	12.66
Other Industries	19	Number of observations		5.00	2.00	6.00		3.00	1.00		3.00	20.00
		% within the sector		25.00	10.00	30.00		15.00	5.00		15.00	100.00
		% within the region		12.20	4.44	9.38		6.00	2.33		8.11	5.06
		% of the total		1.27	0.51	1.52		0.76	0.25		0.76	5.06
Total		Number of observations	36.00	41.00	45.00	64.00	39.00	50.00	43.00	40.00	37.00	395.00
		% within the sector	9.11	10.38	11.39	16.20	9.87	12.66	10.89	10.13	9.37	100.00
		% within the region	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
		% of the total	9.11	10.38	11.39	16.20	9.87	12.66	10.89	10.13	9.37	100.00

Source: the author's calculations

It follows from table 4.3. that in our sample enterprises of the engineering industry are more numerous, than enterprises of other branches. Nevertheless, the numbers of enterprises in all branches are sufficient to define the specific factors of a given branch using a statistical analysis.

4.1.5. Size groups

To ensure a better comparability within the sample size limits for enterprises with respect to the number of employees were between 100 and 5000 employees as of the end of 1999. Small-scale enterprise with the number of employees smaller than 100 were excluded due following reasons:

- special regulations in taxation and accounting valid for them made them incomparable with medium-sized and big enterprises;
- in spite of the fact than in a long-term outlook small business is an important element of institutional structure of market economy, in Russia this category of enterprises accounts for a mere 4% of industrial output;
- small business units had been subjects of numerous inquiries and their behaviour had been studied quite well; small business research methods require sampling of a much bigger scale, which was unfeasible within the framework of our research.

The upper limit of 5000 persons follows from the following reasoning. First, such big enterprises in the majority of branches are not numerous and fulfilling the quota of superbig enterprises sufficient for a statistical analysis when the number of regions in the research was limited would have been quite problematic. Second, each superbig enterprise has a rule a number of specific features, unique for this enterprise (for example, an enterprise can be the backbone of a city), which define peculiar features of its behaviour, its special relations with federal and regional authorities, natural monopolies, etc. To a certain extent such an enterprise is not subjected to influence of economic environment, it rather moulds it to its own needs. Statistical analysis methods are of little use in a standard characteristics research of such enterprises.

The size sampling strategy for this research, which is also true of the branch pattern of sampling was imposed by the requirement of a more or less uniform distribution of all studied enterprises by their size categories: 100-500, 501-1000, 1001-5000 employees. As follows from table 4.4, the total sample of chosen enterprises meets this requirement.

TABLE 4.4

Distribution of Chosen Enterprises by their Sizes as of 1999*

Region		100-500	501-1000	>1000	Total
Moscow	Number of observations	8.00	15.00	11.00	34.00
	% within the sector	23.53	44.12	32.35	100.00
	% within the region	6.02	12.10	9.65	9.16
	% of the total	2.16	4.04	2.96	9.16
Moscow oblast	Number of observations	4.00	17.00	18.00	39.00
	% within the sector	10.26	43.59	46.15	100.00
	% within the region	3.01	13.71	15.79	10.51
	% of the total	1.08	4.58	4.85	10.51
St. Petersburg (with the oblast)	Number of observations	10.00	14.00	16.00	40.00
	% within the sector	25.00	35.00	40.00	100.00
	% within the region	7.52	11.29	14.04	10.78
	% of the total	2.70	3.77	4.31	10.78
Nizhni Novgorod	Number of observations	23.00	17.00	19.00	59.00
	% within the sector	38.98	28.81	32.20	100.00
	% within the region	17.29	13.71	16.67	15.90
	% of the total	6.20	4.58	5.12	15.90
Samara	Number of observations	16.00	15.00	8.00	39.00
	% within the sector	41.03	38.46	20.51	100.00
	% within the region	12.03	12.10	7.02	10.51
	% of the total	4.31	4.04	2.16	10.51
Ekaterinburg	Number of observations	13.00	17.00	18.00	48.00
	% within the sector	27.08	35.42	37.50	100.00
	% within the region	9.77	13.71	15.79	12.94
	% of the total	3.50	4.58	4.85	12.94
Perm	Number of observations	21.00	10.00	7.00	38.00
	% within the sector	55.26	26.32	18.42	100.00
	% within the region	15.79	8.06	6.14	10.24
	% of the total	5.66	2.70	1.89	10.24

TABLE 4.4 CONT`D

Novosibirsk	Number of observations	21.00	9.00	10.00	40.00
	% within the sector	52.50	22.50	25.00	100.00
	% within the region	15.79	7.26	8.77	10.78
	% of the total	5.66	2.43	2.70	10.78
Krasnoyarsk	Number of observations	17.00	10.00	7.00	34.00
	% within the sector	50.00	29.41	20.59	100.00
	% within the region	12.78	8.06	6.14	9.16
	% of the total	4.58	2.70	1.89	9.16
All Regions	Number of observations	133.00	124.00	114.00	371**
	% within the sector	35.85	33.42	30.73	100.00
	% within the region	100.00	100.00	100.00	100.00
	% of the total	35.85	33.42	30.73	100.00

Source: the author's calculations
* The average value equals 918.23
** Information on 24 enterprises is not available

4.1.6. Date of establishing and form of property

As the main subject of this research is the behaviour of Russian industrial enterprises after they got privatised, changes in property structures and corporate governance of former state-owned Soviet enterprises, the sampling included only those enterprises that had existed prior to 1992. New enterprises founded after the beginning of market reforms were excluded from sampling. To a considerable extent this restriction was an immediate consequence of size quotas. A preliminary analysis showed that the number of new enterprises in processing industries with the number of employees exceeding 100 persons is quite small. Having the number of branches and regions limited, making a representative sampling of such enterprises turned out to be practically impossible.

The initial purpose of the research excluded from the study completely state-owned enterprises that hadn't undergone privatisation. At the same time enterprises having mixed interests, even in cases, when the control packet of shares belonged to federal or regional governments, were included into the studied sample with no restrictions. The aggregative property pattern of the final sample as of the moment of privatisation and as of the beginning of 2000 is given in Table 4.5.

TABLE 4.5

Distribution by Main Shareholders Types (>50% shares)

As of the Moment of Privatisation						
Region		Insiders	Outsiders	Govern-ment	Exclud-ing the control-ling in-terest	Total
Moscow	Number of observations	21.00	2.00	2.00	7.00	32.00
	% within the region	65.63	6.25	6.25	21.88	100.00
	in % of all regions' total	6.67	0.63	0.63	2.22	10.16
Moscow oblast	Number of observations	22.00		5.00	10.00	37.00
	% within the region	59.46		13.51	27.03	100.00
	in % of all regions' total	6.98		1.59	3.17	11.75
St. Petersburg (with the oblast)	Number of observations	25.00	3.00	2.00	7.00	37.00
	% within the region	67.57	8.11	5.41	18.92	100.00
	in % of all regions' total	7.94	0.95	0.63	2.22	11.75
Nizhni Novgorod	Number of observations	31.00	5.00	2.00	8.00	46.00
	% within the region	67.39	10.87	4.35	17.39	100.00
	in % of all regions' total	9.84	1.59	0.63	2.54	14.60
Samara	Number of observations	22.00	2.00	2.00		26.00
	% within the region	84.62	7.69	7.69		100.00
	in % of all regions' total	6.98	0.63	0.63		8.25
Ekaterinburg	Number of observations	27.00	5.00	3.00	6.00	41.00
	% within the region	65.85	12.20	7.32	14.63	100.00
	in % of all regions' total	8.57	1.59	0.95	1.90	13.02
Perm	Number of observations	17.00	5.00	3.00	5.00	30.00
	% within the region	56.67	16.67	10.00	16.67	100.00
	in % of all regions' total	5.40	1.59	0.95	1.59	9.52
Novosibirsk	Number of observations	21.00	4.00	1.00	8.00	34.00
	% within the region	61.76	11.76	2.94	23.53	100.00
	in % of all regions' total	6.67	1.27	0.32	2.54	10.79
Krasnoyarsk	Number of observations	24.00	3.00	4.00	1.00	32.00
	% within the region	75.00	9.38	12.50	3.13	100.00
	in % of all regions' total	7.62	0.95	1.27	0.32	10.16

TABLE 4.5 CONT`D

All Regions	Number of observations	210.00	29.00	24.00	52.00	315.00
	% within the region	66.67	9.21	7.62	16.51	100.00
	in % of all regions' total	66.67	9.21	7.62	16.51	100.00

Note: data for 80 enterprises of the sample are not available

TABLE 4.5 CONT`D

As of January 1, 2000						
Region		Insiders	Outsiders	Govern-ment	Excluding the con-trolling interest	Total
Moscow	Number of observations	19.00	5.00	1.00	6.00	31.00
	% within the region	61.29	16.13	3.23	19.35	100.00
	in % of all regions' total	5.71	1.50	0.30	1.80	9.31
Moscow oblast	Number of observations	13.00	5.00	3.00	17.00	38.00
	% within the region	34.21	13.16	7.89	44.74	100.00
	in % of all regions' total	3.90	1.50	0.90	5.11	11.41
St. Petersburg (with the oblast)	Number of observations	17.00	16.00		5.00	38.00
	% within the region	44.74	42.11		13.16	100.00
	in % of all regions' total	5.11	4.80		1.50	11.41
Nizhni Novgo-rod	Number of observations	36.00	10.00		4.00	50.00
	% within the region	72.00	20.00		8.00	100.00
	in % of all regions' total	10.81	3.00		1.20	15.02
Samara	Number of observations	12.00	10.00	1.00	5.00	28.00
	% within the region	42.86	35.71	3.57	17.86	100.00
	in % of all regions' total	3.60	3.00	0.30	1.50	8.41
Ekaterinburg	Number of observations	14.00	24.00	3.00	4.00	45.00
	% within the region	31.11	53.33	6.67	8.89	100.00
	in % of all regions' total	4.20	7.21	0.90	1.20	13.51
Perm	Number of observations	11.00	13.00	2.00	7.00	33.00
	% within the region	33.33	39.39	6.06	21.21	100.00
	in % of all regions' total	3.30	3.90	0.60	2.10	9.91
Novosibirsk	Number of observations	23.00	7.00	1.00	7.00	38.00
	% within the region	60.53	18.42	2.63	18.42	100.00
	in % of all regions' total	6.91	2.10	0.30	2.10	11.41

TABLE 4.5 CONT`D

Krasnoyarsk	Number of observations	17.00	7.00	1.00	7.00	32.00
	% within the region	53.13	21.88	3.13	21.88	100.00
	in % of all regions' total	5.11	2.10	0.30	2.10	9.61
All Regions	Number of observations	162.00	97.00	12.00	62.00	333.00
	% within the region	48.65	29.13	3.60	18.62	100.00
	in % of all regions' total	48.65	29.13	3.60	18.62	100.00

Note: data for 62 enterprises of the sample are not available

4.1.7. Privatisation

As was already pointed out, the sample does not include not privatised enterprises. Table 4.6. gives distribution of enterprises in the sample by the year of privatisation.

TABLE 4.6

Distribution of Enterprises by the Year of Privatisation

Region		The Privatisation Year												Total
		1986	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	
Moscow	Number of enterprises			2.00	1.00	13.00	9.00	5.00	1.00	1.00				32.00
	% within the region			6.25	3.13	40.63	28.13	15.63	3.13	3.13				100.00
	% of the total			0.53	0.27	3.48	2.41	1.34	0.27	0.27				8.56
Moscow oblast	Number of enterprises	1.00			4.00	18.00	6.00	5.00	1.00	4.00				39.00
	% within the region	2.56			10.26	46.15	15.38	12.82	2.56	10.26				100.00

TABLE 4.6 CONT`D

	% of the total	0.27			1.07	4.81	1.60	1.34	0.27	1.07				10.43
St. Petersburg	Number of enterprises			1.00	3.00	20.00	12.00	4.00	1.00	1.00		1.00		43.00
	% within the region			2.33	6.98	46.51	27.91	9.30	2.33	2.33		2.33		100.00
	% of the total			0.27	0.80	5.35	3.21	1.07	0.27	0.27		0.27		11.50
Nizhni Novgorod	Number of enterprises		1.00	1.00	4.00	21.00	20.00	4.00	2.00	1.00	3.00			57.00
	% within the region		1.75	1.75	7.02	36.84	35.09	7.02	3.51	1.75	5.26			100.00
	% of the total		0.27	0.27	1.07	5.61	5.35	1.07	0.53	0.27	0.80			15.24
Samara	Number of enterprises			1.00	2.00	14.00	10.00	4.00	6.00					37.00
	% within the region			2.70	5.41	37.84	27.03	10.81	16.22					100.00
	% of the total			0.27	0.53	3.74	2.67	1.07	1.60					9.89
Ekaterinburg	Number of enterprises				2.00	25.00	16.00	3.00	1.00				2.00	49.00
	% within the region				4.08	51.02	32.65	6.12	2.04				4.08	100.00
	% of the total				0.53	6.68	4.28	0.80	0.27				0.53	13.10
Perm	Number of enterprises		1.00		2.00	19.00	11.00	3.00	1.00	1.00	2.00	1.00	1.00	42.00

TABLE 4.6 CONT`D

	% within the region		2.38		4.76	45.24	26.19	7.14	2.38	2.38	4.76	2.38	2.38	100.00
	% of the total		0.27		0.53	5.08	2.94	0.80	0.27	0.27	0.53	0.27	0.27	11.23
Novosibirsk	Number of enterprises			1.00	1.00	16.00	10.00	8.00	3.00	1.00				40.00
	% within the region			2.50	2.50	40.00	25.00	20.00	7.50	2.50				100.00
	% of the total			0.27	0.27	4.28	2.67	2.14	0.80	0.27				10.70
Krasnoyarsk	Number of enterprises				4.00	11.00	11.00	5.00	2.00	1.00	1.00			35.00
	% within the region				11.43	31.43	31.43	14.29	5.71	2.86	2.86			100.00
	% of the total				1.07	2.94	2.94	1.34	0.53	0.27	0.27			9.36
All Regions	Number of enterprises	1.00	2.00	6.00	23.00	157.00	105.00	41.00	18.00	10.00	6.00	2.00	3.00	374.00
	% of the total	0.27	0.53	1.60	6.15	41.98	28.07	10.96	4.81	2.67	1.60	0.53	0.80	100.00

Note: there are no data for 21 enterprises of the sample available
Source: the author's calculations

4.1.8. Some conclusions

The above estimates allow making certain conclusions with respect to particular features of the selected data received:

- On the whole the sample is uniformly distributed by size groups and branches of industry.
- The sample is also distributed more or less evenly by studied regions with the exception of Nizhni Novgorod, which turned out to have the largest share in the sample (16.2% of the total sample), in

other regions there were studied from 9.1 to 12.7% of enterprises of the total sample.

- The average size of studied enterprises is larger, than the average for industry, which is explained by the sampling strategy and fixing quotas for size groups.

4.2. Set of methods for an empirical analysis of regional data

4.2.1. Choice of Model for the Analysis

The chief specific character of the research is its regional aspect of influence of certain characteristics of the privatisation processes and enterprises' property patterns (for example, breakdown of enterprise's shares, specific features of certain aspects of corporate governance, the year of privatisation) on the efficiency of its activities.

As far as we presuppose that character of this influence can vary, depending on in which region the enterprise is located and to which sector it belongs[124], there was made a regression analysis of relations both for the whole of the database (unbalanced panel for three years – 1997, 1998, 1999 – and 395 observations in one year in nine regions – Moscow, Moscow oblast, St. Petersburg and Leningrad oblast, Ekaterinburg, Krasnoyarsk, Nizhni Novgorod, Novosibirsk, Samara, Perm – and seven branches), and for each of the regions separately.

Analogous to a number of researches made in countries of Eastern Europe (see, for example, Claessens, Djankov, 1997) our model was specified as a variant of modified production Cobb-Douglas function:

$$\frac{Y_{i,t}}{L_{i,t}} = Ae^{\alpha_3 R_{i,t}} \left(\frac{K_{i,t}}{L_{i,t}} \right)^{\alpha_1} \left(\frac{M_{i,t}}{K_{i,t}} \right)^{\alpha_2}, \qquad (1)$$

[124] Analogous researches for East European countries (see, e.g. Claessens, Djankov, 1997; Frydman, Gray, Hessel, Rapaczynski, 1999) got results that confirmed the fact that there existed differences in activities' efficiency depending on the country and the sector belonging of enterprises. The number of regions in each macro-zone was set depending on the size and branch quota requirements.

where $\frac{Y_{i,t}}{L_{i,t}}$ is a real value added[125] per one employee of company *i* in year *t*, $K_{i,t}$ – capital value of company *i* in the year of *t*, $M_{i,t}$ – material costs of company *i* in the year of *t*, $R_{i,t}$ – use of equipment facilities by company *i* in the year of *t*, $L_{i,t}$ – average number of company *i's* employees on pay-roll in year *t*. Thus the $\frac{K_{i,t}}{L_{i,t}}$ ratio is the capital ratio, while the $\frac{M_{i,t}}{K_{i,t}}$ ratio is the material costs to one unit of fixed capital ratio. The chief suppositions about coefficients' values in the model are: $0 < \alpha_1 < 1$, $-1 < \alpha_2 < 0$ and $0 < \alpha_3 < 1$. Thus, we assume the existence of a positive dependence of real value added per one employee on capital ratio and the level of equipment facilities use and a negative influence of material costs amounts per one unit of fixed capital on real value added per employee.

As far as the purpose of the present research is identifying of relations of parameters that characterise the effect of privatisation, property patterns, specific features of corporate governance and activities efficiency of enterprises, in choosing the specific model we proceeded from the approach suggested by Claessens, Djankov (1997). The chosen specific model corresponded to the model (1) taken as increment of logarithm (i.e. in fact the model of growth rates) and included additional variables that characterise specific features of privatisation and enterprise's property pattern. In other words, we assumed that the A-coefficient in the model (1) can be factorized as a product of fixed time effects and a set of specific factors that characterise a certain enterprise. Hence, we were viewing the following model specification[126]:

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[125] This showing was adjusted to eliminate influence of observations, when variables got values contrasting to the background of the total sample: 2.5% of the highest and 2.5% of the lowest values were replaced respectively by the highest and the lowest values in the sub-samples consisting of 95% of central observations.

[126] As a result the research views only regressions in unbalanced panels with fixed time effects. It should be noted that models with chance effects in our case cannot be technically estimated, as far as data only for two years are available, which is less, than the number of parameters viewed in the model.

$$\Delta \log \frac{Y_{i,t}}{L_{i,t}} = c_t + \alpha_1 \Delta \log \frac{K_{i,t}}{L_{i,t}} + \alpha_2 \Delta \log \frac{M_{i,t}}{K_{i,t}} + \alpha_3 \Delta R_{i,t} + \beta \cdot X + \varepsilon_{i,t}, \quad (2)$$

where X is the column vector of additional variables, β is the row vector of corresponding coefficients, c_t is the fixed time effect.

The aggregate of additional variables can be roughly divided into five groups as follows:[127]:

- Dummy variables that characterise the effect of privatisation;
- Variables that characterise distribution of share capital among different types of owners (shares of owners of different types in the share capital);
- Variables that characterise the governance pattern at the enterprise (shares of different groups (insiders, outsiders, the government, etc) in the board of directors;
- Dummy variables that refer the enterprise to a certain group;
- Regional dummy variables included into regressions that were estimated for the whole database.

All given variables are independent of time individual characteristics of enterprises.

4.2.2. Special features of studying panel data

It should be noted that in view of the specific character of data (the sample of enterprises includes data for three years, but as far as the regressions are estimated using logistic differences, we actually have a sample for two years, i.e. T=2), studying the models a possible correlation of in-time random errors can be neglected. Presence of autocorrelated random errors means that these errors in regressions for each of enterprises are described, for example, by the autoregession of the p-order, and to estimate it correctly one should have rather long time series, which in our case were lacking. Due to the same reason there is no need viewing the problem of presence of unit roots in panel data, as far as the notion of time invariance presupposes that data time series are quite long (i.e. $T \to \infty$)[128].

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[127] A complete list of all variables is given in appendix 2.

[128] For more detail about tests for unit roots in panel data see in Banerjee, 1999; Maddala, Wu, 1999; also in Maddala, Kim, 1998, pp. 133-139.

Using panel data for regression development on the one hand allows enlarging the sample size and correspondingly using and taking into account more information on changes in time and space for more complete models definition[129]. On the other hand the probability of breaking the condition in Gauss-Markov theorem gets stronger, including the condition of random errors homoscedasticity (several ways to estimate panel regressions in cases of random errors homoscedasticity presence are given by Baltagi (1995) in chapter 5).

It is known that in cases of regressions' random errors homoscedasticity, estimated coefficients developed using the method of minimum squares are ineffective. There are different methods to overcome the problem of random errors homoscedasticity in "the classic" regression, they are described in detain in econometric literature (see, for example, Johnston, DiNardo, 1997, chapter 6, Kennedy, 1999, chapter 8; Mátyás, Sevestre (ed. by), 1992, p. 67). One of the most used methods to get the best (effective and consistent) estimates in cases of presence of random error homoscedasticity (as well as correlation among objects) is the *Generalized Least Squares* method *(GLS*). Though its explicit use is complicated by lack of information in form of covariance matrix and, as a result, the need to estimate it, which in practice leads to use of *The Feasible (Estimated) Generalized Least Squares* method *(FGLS*). As a result, estimates received using the *Generalized Least Squares* method stop being linear estimates (due to the corresponding transformation of variables) or unbiased estimates. Nevertheless, in cases of consistent estimates of covariance matrix, estimates of coefficients developed using the *The Feasible (Estimated) Generalized Least Squares* method, have asymptotic properties, analogous to properties of those received using the *Generalized Least Squares* method (in more detail see in Kennedy, 1999, p. 118).

Another method to improve regression estimates in cases of heteroscedasticity used by many researches (see, for example, Barberis, Boycko, Shleifer, Tsukanova, 1996; Claessens, Djankov, 1997) is White's procedure (see White, 1980). This procedure allows getting consistent estimates of dispersion-covariance matrix of regression coefficients (*White Heteroscedasticity Consistent Standard Errors*) which will not be effective, though (estimates developed using the *Generalized Least Squares* method still remain the best). Thus, White's procedure allows overcoming the *Generalized Least Squares* method's susceptibility to violation of conditions of random error homoscedasticity. It is noteworthy that also in cases of *The Feasible (Estimated) Generalized Least Squares* method

[129] For more detail about advantages of panel data use see, for example in Baltagi, 1995.

White's procedure gives good results, if the sample size is big enough. As for the ways to correct random error heteroscedasticity of regressions for small or short samples one can suggest *The Feasible (Estimated) Generalized Least Squares* method using iterative procedure for estimation of weights and coefficients of regression.

Accordingly, in this research due to the specific features of the sample (the number of enterprises in the panel being quite large, while time domains being not numerous)[130] regressions were estimated according to the feasible estimated generalized least squares method (using iterative procedure for estimation of weights and coefficients of regression [131], which also allowed dealing with the problem of intermediate random error heteroscedasticity of regression (i.e. dispersions' differences by years), the presence of which could be assumed, as far as the sample included data for 1998 (which was the "central" year for the whole period of observations).

Another difficulty that arises at model development is the problem of correlated random errors and exogenous variables[132], which as a matter of fact means explanatory variables' endogeniety[133]. In our case one can assume dependence of the fact of privatisation in itself, as well as the time when it was performed, on the level of the enterprise's efficiency at the moment of privatisation, namely the fact that primarily the "best" enterprises (with respect to certain criteria) were privatised. Among the reasons one can name, for example, the fact that managers of the "best" enterprises were the interested parties in their quick privatisation, i.e. one can suppose that such enterprises in the process of privatisation were bought by insiders that possessed information about the current state of affairs at the enterprise as of the moment of privatisation and accordingly had better possibilities to assess its development outlooks in future. At the same time some researchers (see, for example, Claessens, Djankov, 1997; Djankov, et al, 1997) show that supposition about an earlier privatisation of the "best" enterprises is not always confirmed by analysis results of empirical evidence.

In cases of endogenous independent (explanatory) variables estimates received using the usual least square method will be inconsistent (see, for example,

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[130] For more detail see Dormont, 1999.

[131] Regressions were estimation using the "Econometric Views 3.1."

[132] It should be noted that the fixed effects model presupposed relations between chance terms and regressors. For more detail see Johnston, DiNardo,1997, p. 395-402; Arminger, Clogg, Sobel (ed. by), 1995, p. 390-391.

[133] In such a case fixed effects models will be consistent and effective, while chance effect models inconsistent. (For detail see Johnston, DiNardo,1997, p. 403-404.)

Baltagi, 1995, chapter 7), and to improve the regression quality (to get consistent estimates) one shall use instrumental variables methods. Most often to correct the possible endogenous independent variables the traditional two-sweep least squares method is used (see, for example Barberis, Boycko, Shleifer, Tsukanova, 1996), or Hackman two-step procedure (see, for example Claessens, Djankov, 1997). In both cases auxiliary regressions are estimated at the first step, the results of these estimations (adjusted values of explanatory variables in case of the two-sweep least squares method, or new variables (*the inverse Mills ratio*) in case of Hackman procedure[134]) are used at the second step when making estimates for the basic model. Depending on how strong the influence of the results received at the first step on final estimates is, one can judge, whether this was the case of endogenity in fact, or not. Results of many researches (see, for examaple, Barberis, Boycko, Shleifer, Tsukanova, 1996; Claessens, Djankov, 1997) show that taking a possible endogenity into account can lead to considerable changes in estimation results of final regressions.

In this research the primary attention was focused on examination of influence on the efficiency of enterprises' activities of factors, related to certain aspects of enterprise's corporate governance and distribution of stock ownership, but not the influence of privatisation. A possible endogenity associated with privatisation was certainly taken into account, but nevertheless in view of lack of the required statistical information making a correction of a possible endogenity was viewed as unfeasible.

[134] At the first stem of the two-step Hackman procedure one estimates the *probit*/*tobit* model with a dependent variable, which is the explanatory variable in the principal regression (which is estimated at the second step and is either truncated or censored, but it is supposed that it can depend on some factors (in our case these can be, for example, dependence of the privatisation choice on the efficiency of enterprise's activities as of the moment of privatisation). By the results of these estimations one can get a new variable (*The Inverse Mills Ratio*), which actually shows the value of the average truncated/censored normal distribution bias in comparison to the average normal distribution value. It is this variable that is added as regressor to the estimated model. (For more detail on estimation of *probit*/*tobit* models see, for example Tobin, 1958; Amemiya, 1973, 1974, also Greene, 1999, chapter 20.)

4.3. Sets of Methods to Calculate Total Factor Productivity Growth Rate

In the context of this research it is quite interesting to make a calculation of *The Rate of Growth of Total Factor Productivity* (TFPGr) of an enterprise. There exists a great number of researches dedicated to the total productivity of production factors at enterprises both in cases of continuity (see Jorgenson, 1996; Hulten, 1973; Star, Hall, 1976; Jorgenson, Griliches, 1967) and in cases of discontinuity (Hulten, 1973; Jorgenson, 1996). The classical target setting for a continuous case (see, for example Star, Hall, 1976, p. 257-258; Jorgenson, 1996, p. 57) is performed in this way.

Let production function $Y_t = F\left(X_{1,t}, X_{2,t}, \ldots, X_{n,t}, t\right)$, where $X_{i,t}$ $\left(i = \overline{1,n}\right)$ are production functions, be

- continuous, doubly differentiable;
- homogeneous of the first degree.

(All these conditions are satisfied, for example, by Cobb-Douglas production function.)

Then the logarithmic derivative of the production function in time will be equal to:

$$\frac{\dot{Y}_t}{Y_t} = \sum_{i=1}^{n} \frac{F_i \dot{X}_{i,t}}{F} + \frac{\dot{F}}{F}$$

where $\dot{Y}_t = \frac{\partial Y_t}{\partial t}$, $\dot{X}_{i,t} = \frac{\partial X_{i,t}}{\partial t}$, $F_i = \frac{\partial F}{\partial X_i}$, $\dot{F} = \frac{\partial F}{\partial t}$.

Assuming that $\beta_i = \frac{F_i X_{i,t}}{F}$, we get

$$\frac{\dot{F}}{F} = \frac{\dot{Y}_t}{Y_t} - \sum_{i=1}^{n} \frac{\beta_{i,t} \dot{X}_{i,t}}{X_{i,t}},$$

or (in designation of Jorgenson, 1996, p. 27-28 or 55-56)

$$TFPGr = \frac{\dot{P}}{P} = \frac{\dot{Y}}{Y} - \frac{\dot{X}}{X},$$

i.e. the total productivity growth rate of production factors is the difference of the output growth rate and the rate of growth of the weighed mean of factors invested into the production.

In a discontinuous case, which is more interesting for us, the latter equality can be rewritten as follows (for more detail see, for example Jorgenson, 1996, p. 150, 200; Hulten, 1973):

$$TFPGr = \left(\log Y_t - \log Y_{t-1}\right) - \left(\log X_t - \log X_{t-1}\right)$$

or

$$TFPGr = \Delta \log Y_t - \Delta \log X_t,$$

where Y_t is the output in period *t*, X_t [135] is the weigned mean of factors of production $X_{i,t}$ $\left(i = \overline{1, n}\right)$ in period *t*.

It should be noted that such a discontinuous approach to analysis of total productivity of production factors of an enterprise is not always possible due to lack of required data[136], especially in cases when research is done at macro level.

In the research of Claessens, Djankov (1997) the rate of growth of total productivity of enterprise's production factors is estimated according to the following pattern. Using sample observations of enterprises done in countries of Eastern Europe (panel data for 4 years for seven countries), panel regressions with random effects were estimated according to this formula:

$$\Delta \log Y_{i,t} = \hat{\alpha}_i + \beta_{Ls} \Delta \log L_{i,t} + \beta_{Ks} \Delta \log K_{i,t} + \beta_{Ms} \Delta \log M_{i,t} + \beta \cdot X + \hat{\varepsilon}_{i,t}$$ [137], (2)

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[135] The weighed mean of production factors in a discontinuous case is calculated according to the following formula $\sum_{i=1}^{n} \frac{1}{2}\left(v_{i,t} + v_{i,t-1}\right) \Delta \log X_{i,t}$, (1)

where $v_{i,t} = \frac{p_{i,t} X_{i,t}}{\sum_{j=1}^{n} p_{j,t} X_{j,t}}$, $\left(i = \overline{1, n}\right)$, $p_{j,t}$ is the price of factor *j* in period *t*.

[136] To estimate weighs information on prices on all production factors is required (for more detail see: Jorgenson, 1996; Hulten, 1973). It is evident that such information is not always available in a sampling observation.

[137] In this case under *X* is understood a certain set (column vector) of variables (including also dummy variables) that characterise the date of privatisation, some showings of financial activities, etc. (For more detail see: Claessens, Djankov, 1997, p. 12, 24), β is the row vector of corresponding coefficients.

where $Y_{i,t}$ is the income of company *i* as of *t*, $L_{i,t}$ is the number of man-hours worked out in company *i* by the *t* moment, $K_{i,t}$ is the quantity of electric power used up by company *i* by time *t*, $M_{i,t}$ volumes of costs of company *i* by time *t*, index *s* shows that coefficients change depending on which sector of the economy the enterprise belongs to.

Thus the total productivity growth rate of production factors can be viewed as a sum of an absolute term (in this case a random individual effect) and a random error:

$$TFPGr_{i,t} = \hat{\alpha}_i + \hat{\varepsilon}_{i,t} =$$
$$= \Delta \log Y_{i,t} - \beta_{Ls} \Delta \log L_{i,t} - \beta_{Ks} \Delta \log K_{i,t} - \beta_{Ms} \Delta \log M_{i,t} - \beta \cdot X.$$

But in this case there emerges a question of how much the method of estimation of the total factor productivity growth rate, used by Claessens, Djankov (1997) corresponds to the theoretical method. It is evident that if there are no additional variables in formula (2), coefficient estimates at logistic differences of production factors will be the estimates of weights at logistic differences of production factors in formula (1), which may be unknown. Inclusion of additional variables into a regression equation can be rather incorrect from the viewpoint of theoretical estimation of growth rate of total factor productivity[138], but can help to eliminate influence of some institutional features of enterprises (including the privatisational one and others) on received estimates. It is evident that institutional specific features can have a rather strong influence on efficiency of their activities (correspondingly, on estimates of growth rates of total factor productivity) especially in a transition period. Accordingly, one can assume that in case these additional institutional parameters are not taken into account, estimates of total factor productivity growth rates will turn out to be biased. That is why the above method of estimation of total factor productivity growth rates of enterprises in conditions of economies in transition is quite logic.

[138] It should be noted that the set of methods to estimate total factor productivity used, for example by Jorgenson, 1996; Jorgenson, Griliches, 1967, is applicable for estimation of growth rates of total factor productivity for well-developed economies, and in the general case there are no grounds to assume that an analogous set of methods can be applied for estimation of total factor productivity for economies in transition.

It follows that with respect to specification of our model, factor productivity can be estimated in this way:

$$TFRGr = \tilde{c}_t + \tilde{\varepsilon}_{i,t} =$$

$$= \Delta \log \frac{Y_{i,t}}{L_{i,t}} - \left(\alpha_1 \Delta \log \frac{K_{i,t}}{L_{i,t}} + \alpha_2 \Delta \log \frac{M_{i,t}}{K_{i,t}} + \alpha_3 \Delta R_{i,t} + \beta \cdot X \right) \quad ,(3)$$

where $\frac{Y_{i,t}}{L_{i,t}}$ is value added per employee of company *i* in year *t*, $K_{i,t}$ is the capital value of company *i* in year *t*, $M_{i,t}$ are costs of company *i* in year *t*, $R_{i,t}$ is the degree of use of equipment facilities of company *i* in year *t*, $L_{i,t}$ is the average number of those permanently employed by company *i* in year *t*, X is the column vector of additional variables, β is the row vector of corresponding coefficients.

Results of estimated rates of growth of the medium total factor productivity for different groups with respect to their privatisation (the first group consists of enterprises privatised in 1992 and earlier, the second group are enterprises privatised in 1993, and the last group are enterprises privatised after 1993) and for all regions of the sample are given in table 4.7[139].

TABLE 4.7

The Total Factor Productivity Growth Rates (TFPGr) For Different Privatised Groups (by all regions in the sample)

Year 1998	
The rate of growth of total factor productivity for the group of enterprises privatised in 1992 and earlier	**-0.267**
Number of observations	121
t-statistics (of the value of deviation of *TFPGr* for the group of companies, privatised after 1993)	0.718
The rate of growth of total factor productivity for the group of enterprises privatised in 1993	**-0.247**
Number of observations	69
t-statistics (of the value of deviation of *TFPGr* for the group of companies, privatised after 1993	0.434
The rate of growth of total factor productivity for the group of enterprises privatised after 1993	**-0.211**

[139] The results of analogous estimates by regions are given in appendix 4.

Table 4.7 con`s

Number of observations	40
Year 1999	
The rate of growth of total factor productivity for the group of enterprises privatised in 1992 and earllier	**0.022**
Number of observations	127
t-statistics (of the value of deviation of *TFPGr* for the group of companies, privatised after 1993	1.595
The rate of growth of total factor productivity for the group of enterprises privatised in 1993	**-0.034**
Number of observations	70
t-statistics (of the value of deviation of *TFPGr* for the group of companies, privatised after 1993	0.706
The rate of growth of total factor productivity for the group of enterprises privatised after 1993	**-0.095**
Number of observations	44

It follows from the table that there are no significant differences from analogous researchers done in countries of Eastern Europe (see, for example Claessens, Djankov, 1997) in values of rates of growth of total factor productivity for different privatised groups. Moreover, the change trend in growth rates of total factor productivity in 1998 when going over from enterprises that were privatised earliest to the group of the latest privatised enterprises is directly opposite to the estimated one: the earlier an enterprise was privatised the greater decline in total factor productivity was registered.

Neither in 1999 values of growth rates of total factor productivity for privatised groups were significantly different, though the trend of inter-group changes is reversed: as was expected, enterprises privatised in 1992, 1993 and earlier proved in 1999 to be more effective with respect to the growth rate of total factor productivity, than enterprises, which were privatised later.

4.4. Description of preliminary findings received

4.4.1. Privatisation

In view of the fact that all enterprises in the sample are privatised ones[140] (see table 4.6), and the majority of them were privatised in 1992-1993, it makes sense viewing the privatisation effect with respect to the date of privatisation.

[140] There are no available data for 21 enterprises of the sample, which in principal does not mean that these enterprises had not been privatised

That is why to measure the effect of an early privatisation there were used dummy variables for enterprises privatised in 1992 or earlier (1, if the enterprise was privatised in 1992 or earlier; otherwise 0), in 1993 or earlier (1, if the enterprise was privatised in 1993 or earlier; otherwise 0) and for enterprises privatised in 1993 (1, if the enterprise was privatised in 1993; otherwise 0). It is traditionally considered (see, for example Claessens, Djankov, 1997; Frydman, Gray, Hessel, Rapaczynski, 1999.; Leontyev Centre, 1996) that the earlier an enterprise is privatised, the more effective its activities will be later. Moreover, it would be quite interesting learning, whether companies privatised in 1992 or earlier differ form those that were privatised later.

An econometric analysis showed that the fact of an earlier privatisation does not necessarily influence the efficiency of enterprise's activities. In such cities as Ekaterinburg, Novosibirsk, Nizhni Novgorod (see appendix 5) as well as in the sample as a whole no relations between dummy variables that control the effect of privatisation and efficiency were detected. Moreover, even in cases when influence of the privatisation effect on efficiency of companie's activities was detected, it was not always that it had a positive character. For example, in Moscow oblast, St. Petersburg, Perm the effect of earlier privatisation was negative. It was only in Moscow and Krasnoyarsk that the fact of an earlier privatisation played a positive role in development of enterprises in these cities. Hence, one can say that the hypothesis about a higher efficiency of activities of companies that were privatised earlier, than others (probably connected with regional specific features of privatisation processes and institutional specific features of development of different regions' economies) has rather a local, than a common character.

4.4.2. Ownership

On the basis of results of studies done by a number of researches[141], there were developed the following hypotheses about a possible influence of distribution of capital stock on efficiency of enterprises' activities in the regions under study:

- The higher the share of insiders in the capital stock, the less efficient is the performance of the enterprise;
- Enterprises with a low share in the capital belonging to workers, and a high share in the capital belonging to managers have higher showings of efficiency;

[141] For a detailed review on the this topic see: Radygin, Arkhipov, 2000, Radygin, Arkhipov, 2001; Dolgopyatova, (ed., 2002).

- Enterprises with a higher share of the state (in particular of regional and municipal governments) in the capital stock are less efficient;
- More efficient enterprises have a higher share of outsiders (not counting the state) in the share stock;
- Enterprises with a small share of stocks belonging to Russian enterprises, and a large share of stock that belong to foreign enterprises are more efficient[142].

As in the case of privatisation effect, one cannot speak of a common character of the above hypotheses. To give some examples, in Moscow, Nizhni Novgorod, Novosibirsk , Samara, Perm, as well as in the whole of the sample there was not detected any influence on enterprises' activities efficiency on the part of insiders. In St. Petersburg, contrary to generally accepted hypotheses, there was revealed a positive dependence, and only in cases of enterprises in Moscow oblast, Ekaterinburg and Krasnoyarsk such a dependence, as it had been hypothesized, turned out to be negative: the larger the number of shares concentrated in the hands of insiders, the less effective is the performance of the enterprise.

As for influence of outsiders' share in the capital stock of companies on their activities, in all cases, except for Novosibirsk (where the expected positive dependence was detected), the corresponding variable turned out to be nonsignificant, i.e. one can speak about absence of such influence. It should be noted, that nevertheless, for some of the cities (namely, for St. Petersburg, Perm, Samara), as well for the sample as a whole a relation between the distribution of companies' capital stocks among other Russian enterprises and efficiency was present, this relation being positive in all cases contradictory to generally accepted hypotheses.

[142] The list of corresponding variables is given in appendix 2. A study of influence of workers' and managers' share in the capital stock on efficiency of companies' activities did not reveal any significant relation. Moreover, quite often inclusion into the regression of corresponding variables led to a considerable decrease of the number of observations used for regression estimates (see appendix 3), and, correspondingly, to big losses in degrees of freedom. That is why these factors were excluded from study under the present research.

4.4.3. Corporate governance[143]

By analogy with hypotheses in unit 4.4.2 and a number of generally accepted notions one can develop the following hypotheses about relation between the pattern of the Board of Directors at a given enterprise[144] and its efficiency:

- The bigger the share of outsiders in the Board of Directors at the enterprises, the more efficient is its performance;
- Enterprises with a higher share of government representatives in the Board of Directors turn out to be less efficient;
- Enterprises with a higher share of insiders in the Board of Directors can excel in a higher efficiency, which is related (there is a possibility of it) to the presence of stable "managerial" model of corporate governance built at these enterprises.

The collected data testify to the effect that in many cases (in Moscow, St. Petersburg, Krasnoyarsk, Samara and in the sample as a whole) none of parameters that characterise special features of enterprise governance exerts any influence on enterprises' efficiency. Influence of insiders at the Board of Directors on the efficiency of company's activities turn out to be positive for enterprises in Moscow oblast and negative for companies in Nizhni Novgorog. In a still smaller number of cases there was registered relation between the rest of features of Board of Directors' patterns and companies' efficiency: in Perm there was registered a positive influence of outsiders, in Novosibirsk and Ekaterinburg also a positive influence of representatives of other Russian industrial enterprises and foreign representatives correspondingly, and in Novosibirsk there was registered a negative dependence of companies' efficiency on the share of regional governments in Boards of Directors.

4.4.4. Regional specific features

As it follows from the above described results, on cannot speak of a homogeneity of data for different regions, as well as for the sample as a whole. Most interesting from our point of view are the results of estimates for Novosibirsk, Moscow oblast and Krasnoyarsk.[145].

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[143] At the present (preliminary) stage of the research analysis of relations between certain aspects of corporate governance and efficiency is of an illustrative-selective character.

[144] For the list of corresponding variables see appendix 2.

[145] Analogous estimates for the rest of the regions and for the database as a whole a given in appendix 5.

Novosibirsk

Novosibirsk differs from the rest of the cities in the sample by the fact that for its enterprises there exists a significant influence of such factors as the share of outsides in capital stocks of enterprises, the share of representatives of Russian enterprises in the Boards of Directors and the share of representatives of regional governments in the Board of Directors. This is actually the only city in the sample, where influence of these factors is at all registered. It should be noted that the character of influence on efficiency of enterprises' activities on the part of outsiders and regional governments completely agrees with the assumptions: there are observed both positive and negative influences, correspondingly. As for influence of the share of representatives of Russian enterprises in capital stocks on companies' activities, one can in principle suppose that its character can be both positive and negative. In this case the influence is positive.

TABLE 4.8

Dependence of the value of real value added per employee on parameters of production activity and different institutional characteristics of enterprises of Novosibirsk

Dependent variable: $\Delta \log \frac{Y_{i,t}}{L_{i,t}}$		
Total number of observations: 58		
Variable	Coefficient	*t*-statistics
α_{98}	-0.276	
α_{99}	0.074	
$\Delta \log \frac{K_{i,t}}{L_{i,t}}$	-0.435	-2.638
$\Delta \log \frac{M_{i,t}}{K_{i,t}}$	-0.218	-2.073
$\Delta R_{i,t}$	-0.004	-0.851
OUTSi	0.589	2.553
RUS_Gi	0.800	3.031
REG_Gi	-1.120	-3.157
Test statistics for the model		
Adjusted R^2		0.398
F-statistics		8.948
P-value(*F*-statistics)		0.000

Moscow oblast

The model that was developed for Moscow oblast is notable for the fact that on the one hand is shows a negative influence of the effect of an early privatisation on subsequent activities of enterprises, and on the other hand the same negative influence of a big share of insiders in enterprises' stock capitals. Hence, in this case one can speak of a negative role of privatisation performed in the interests of insiders. On the other hand, it's noteworthy that the presence of a large number of insiders at the Board of Director has a positive influence on the efficiency of enterprise's activities.

TABLE 4.9

Dependence of the value of real value added per employee on parameters of production activity and different institutional characteristics of enterprises of Moscow oblast

Dependent variable: $\Delta \log \frac{Y_{i,t}}{L_{i,t}}$		
Total number of observations: 64		
Variable	Coefficient	*t*-statistics
α_{98}	0.075808	
α_{99}	0.565746	
$\Delta \log \frac{K_{i,t}}{L_{i,t}}$	-0.568792	-2.177403
$\Delta \log \frac{M_{i,t}}{K_{i,t}}$	-0.104854	-1.712626
$\Delta R_{i,t}$	0.011254	2.205517
PRIV92i	-0.457243	-3.407565
INSi	-0.727469	-3.766921
INS_Gi	0.591516	2.333743
REG_Gi	-1.199514	-1.725832
Test statistics for the model		
Adjusted R^2		0.424385
F-statistics		9.074704
P-value(*F*-statistics)		0.000001

Krasnoyarsk

Calculations made for Krasnoyarsk show the presence of a positive effect of an early privatisation and a negative dependence of enterprises' activities efficiency on the large share of insiders in the stock capital. Influence of insiders' share in the Board of Directors, on the one hand, is insignificant, on the other hand exclusion of this variable from the regression rather seriously degrades its quality with respect to the value of the adjusted R^2.

TABLE 4.10

Dependence of the value of real value added per employee on parameters of production activity and different institutional characteristics of enterprises of Krasnoyarsk

Dependent variable: $\Delta \log \frac{Y_{i,t}}{L_{i,t}}$		
Total number of observations: 47		
Variable	Coefficient	*t*-statistics
α_{98}	-0.077740	
α_{99}	0.023870	
$\Delta \log \frac{K_{i,t}}{L_{i,t}}$	0.454482	2.546281
$\Delta \log \frac{M_{i,t}}{K_{i,t}}$	-0.075488	-0.502644
$\Delta R_{i,t}$	0.001117	0.180959
PRIV92$_i$	0.296075	2.218927
INS$_i$	-0.516250	-2.074759
OUTS_G$_i$	-0.201553	-1.106421
SEC13$_i$	0.538478	2.566798
Test statistics for the model		
Adjusted R^2		0.323704
F-statistics		5.002927
P-value(*F*-statistics)		0.000729

4.4.5. Final provisions

On the basis of the results described above one can make the following very general conclusions.

First, the hypothesis about a higher activities' efficiency of early privatised companies has expressed regional specific features and has rather a local, than a general character.

Second, traditional hypotheses about influence of property pattern on activities' efficiency of enterprises also have expressed regional specific features and were not completely confirmed as a result of the present research.

Third, the regional character of influence of different aspects of corporate governance on activities' efficiency of enterprises is particularly expressed and does not always coincide with the original theoretical suppositions.

It should be noted, that at the first stage not all variables that characterise distribution of specific features were used for models' identification. Taking into account the plentiful complexities of an econometric analysis of regional specific features (the problem of endogenity, the correct choice of dependent variables, etc.) a separate research is suggested.

Section 5
Corporate governance and accountability in Canada[146]

Introduction

- Canada has faced some of the same problems in corporate governance that Russia is facing today. Reforms have usually followed scandals of one sort or another, leading to the setting of new norms by governments. Thus the specific issue of the evolution and present state of corporate governance in Canada must be viewed in the context of the reform legislation that followed scandals or major political issues, as well as in the context of Canada's unique history and geography.
- Complicated as these issues may be, however, they are of fundamental importance to the performance of the national economy and to the social distribution of its fruits. Good governance means trustworthy and predictable actions by corporations, and means that investors may rely both on the formal public statements of corporations and, more importantly, on the integrity of their decision making processes as a whole. This reduces risk for investors and therefore the cost of capital for enterprises. Lower risk means a greater willingness on the part of owners of wealth, from the very wealthy to simple savers, to postpone consumption through investment in productive enterprises. It need hardly be said that such a model conduces not just to steady economic growth and greater per capita incomes, but also to a preferential reward to economic good behaviour.
- As in Russia, Canada's system of corporate governance involves both public and private corporations within a federal legal entity in which both the federation and the regions exercise at least quasi-independent power. The several forms of business entity each have distinct governance obligations, and minimum requirements for the

[146] Comments from James Baillie and Grant Reuber are gratefully acknowledged.

satisfaction of these obligations are laid out in law and regulation at federal and provincial level. There is no overwhelming logic to the locus of regulation save the accidents of history, but a lesson of Canadian history is that a somewhat illogical system can be made to work if there are incentives to do so and if underlying cultural norms are favourable.

- The purpose of this paper is to summarize some of the main elements of the Canadian story, using a partly historical approach, in the hope that the lessons Canadians have learned from sometimes painful experience may assist constructive reform in Russia. We begin with a discussion of the formal system and how it developed, stress the critical role played by information and disclosure, and survey present pressures for further reform. The spectacular difficulties of the US-based firms Enron and Andersen, for instance, are bringing about predictable calls for reform in Canada. We conclude with observations on how some particular problems are resolved within the Canadian federal system.

5.1.The formal system

5.1.1.Forms of corporate organization in Canada

- Canadian law recognizes a number of forms in which business enterprises may be organized. These are laid down in two Acts of the federal parliament and in parallel acts of the provincial legislatures. Federally, the *Canada Business Corporations Act* (CBCA) is the principal statute, but the *Canada Corporations Act* is often used for non-profit organizations, foundations and the like. All provinces have their own parallel acts, such as the *Ontario Business Corporations Act* and the *Quebec Companies Act.* In most cases it is a matter of convenience or local pride that dictates where a corporation decides to register; occasionally, some minor difference in statute may encourage one choice over another. Only the provinces, however, offer the alternative of the limited partnership structure, as in the *Limited Partnerships Act (Ontario).*
- The principal forms of company organization are proprietorships, partnerships (both traditional and limited), privately held companies, publicly held corporations, crown corporations and non-profit

enterprises. The corporate governance issues of concern to this paper really arise only in the context of fiduciary obligations – that is, where ownership and management are separated. We mention sole proprietorships, partnerships and joint ventures for completeness here, and concentrate thereafter on the corporation as such.

- ***Proprietorships*** are the oldest form of company organization and are really a subset of privately held corporations where all the ownership resides with a single proprietor. Many small businesses and farms are organized this way. Corporate governance is simple: the owner decides what to do, within the law. Records must be kept and information must be provided to the authorities for tax assessment, aggregate economic performance analysis, environmental performance, employment matters and the like, but it is provided in confidence.

Internal procedures and public disclosure relevant to the operation of public capital markets are irrelevant, although an owner wanting to gain access to credit will have to make substantial and continuing, but private, disclosure to the bank and to suppliers. Although this form of organization is as old as the country, and is still the most numerous in the universe of Canadian businesses, the fact that it does not require equity investment from other parties means that the public interest in regulating its governance is small. Creditors provide the necessary invigilation. Liability is absolute, limited only by insurance.

- ***Partnerships*** are like sole proprietorships in the sense that each partner bears "joint and several liability," meaning that each partner is fully liable, to the full extent of all his financial resources, for the actions of each of the others.[147] These obligations may be lightly assumed in good times but can be ruinous in bad: the Canadian "names" behind a number of Lloyd's syndicates, to cite a widely known recent case, have in many cases faced personal bankruptcy.[148] In proprietorships and partnerships, in other words, owners are liable for much more than the money originally invested. If things go wrong, they may lose everything they own. Historically, this form of corporate organization was a way of mobilizing capital from a small number of wealthy individuals, all of whom typically

[147] See *Partnerships Act (Ontario)*, R.S.O. 1990, c. P5.

[148] See Elizabeth Luessenhop and Martin Mayer, Risky business: an insider's account of the disaster at Lloyd's of London, New York: Scribner, 1995.

knew and trusted each other. The rise of modern financial intermediation has made this form of organization increasingly outmoded.

- Neither proprietorships nor partnerships are entities separate from the owners as individuals.
- ***Limited partnerships*** are a recent response to the potentially catastrophic problems of pure partnerships, and to opportunities for tax planning. [149] Increasingly, large professional services firms, such as the national units of the large accounting-consulting firms or large national law firms, have adopted this structure. In such firms, internal democracy can be more important than centralized management. Limited partners are sheltered from liability in the same manner as are shareholders in a corporation, but like shareholders, may or may not take an active role in management. Limited partnerships may be managed by general partners, who may themselves be corporations.
- ***Corporations*** differ from partnerships in the sense that they are legally distinct entities. They survive their owners. Their shareholders' liability is limited to the amount of their equity investment. There are several types of corporations:
- ***Privately held corporations*** are those whose shares do not trade on public exchanges and are therefore not subject to securities legislation. Often dominated by a single family, such corporations may be a means of passing wealth intergenerationally. They offer their owners the same advantages of limited liability as any other corporation.
- ***Publicly held corporations*** are the main focus of this report.[150] All large companies use this form, principally for four reasons: limited liability, a legal personality distinct from and which survives its in-

[149] In Ontario the governing legislation is the *Limited Partnerships Act (Ontario)*, R.S.O. 1990, c. L6.

[150] Canadian usage is sometimes confusing. The term "private company" is sometimes used to mean any enterprise in which there is no government ownership, and "public ownership," depending on context, can mean a situation where government owns or controls the enterprise, or alternatively, a situation where the general public ("private individuals," no less) acting through a stock exchange, owns and controls the company. Even the *Income Tax Act* adds to the confusion when it makes an important distinction between "CCPCs" (Canadian-controlled private companies) and all others. A CCPC is one whose Canadian private owners exercise effective control of the corporation.

dividual owners, the need for centralized management of a large enterprise, and the need to raise capital in public markets. It is the latter feature that gives rise to standardized forms of corporate governance, as opposed to the idiosyncratic forms that may characterize other styles of organization. It is perhaps worth stressing that the imposition of norms for corporate governance arises when fiduciary obligations are of the essence and when the financial actions of the entity may entail large externalities.

- In theory, the owners of common or voting shares elect directors, who have overall responsibility for the corporation, and the board of directors selects the executive officers of the corporation. Reality, discussed further below, is more complex.
- ***Crown corporation*** is the Canadian term for a company whose shareholder is the government (the "Crown") itself. In the past, these entities could have been created using the relevant statute, but more commonly they were created by a special act of parliament. Their powers may be constrained, and features of their operations that are relevant to public policy are often mentioned in the statute. So, for instance, the Act under which Air Canada operated before its privatization required that its head office be in Montreal. Since 1985, the *Financial Administration Act* has required the government to create new crown corporations only with the consent of parliament. Crown corporations of a commercial nature were traditionally assigned to the relevant minister for reporting and control purposes. Recently, in response to a patronage scandal involving one particular minister's use of crown corporations reporting to him, the federal government has decided that most crown corporations will report to parliament through the deputy prime minister, an individual noted for probity. It remains to be seen whether this is simply a response to a personnel problem or will be a lasting change.

The boards of directors of crown corporations are appointed by the government and usually hold their offices for a fixed term. Chief executives are likewise appointed by the government, sometimes with the advice of the board, and typically hold office "during pleasure," which means they can be dismissed at will. In point of fact, the power to dismiss is used sparingly, even when the government changes hands during an election and the incoming party sees many of these posts held by persons it suspects of sympathy with the outgoing government.

Chief executives tend to keep their political preferences private and are appointed on merit. Directorial appointments are less exacting but once in place directors are normally allowed at least to finish their terms before being replaced with (mostly) competent persons more sympathetic to the government of the day.

- ***Non-profit corporations and foundations***, for completeness, are entities with a social purpose that nevertheless operate by most of the rules of the marketplace. The major exception, for organizations that are officially recognized under the *Income Tax Act* as charities, is the privilege of granting receipts to donors that qualify the donors for tax relief. There are more than 200,000 charities and non-profits in Canada pursuing every kind of social, educational, charitable, religious and environmental purpose that thirty million people can imagine. Spending more than ten percent of the budget on public advocacy or lobbying for legislative change can, however, lead to withdrawal of registration. Occasionally the form is used by government to create arm's-length foundations to pursue public purposes.[151]

5.1.2.Historical roots

- The common root of all these forms of organization is British law and practice. Even the province of Québec, which uses the Napoleonic *Code civile* as the root of its commercial law, has adopted similar forms of corporate structure and governance.
- The first major company in Canada was the Hudson's Bay Company, incorporated in London as a joint-stock company in 1670 and entrusted with the governing and exploitation of the

[151] A number have been created in recent years, in part as a tool of fiscal management and in part to remove the suspicion that the expenditures contemplated might favour friends of the government. In such cases, like the Canada Foundation for Innovation or Genome Canada, the boards are composed of citizens of sterling reputation and relevant expertise ("the great and the good") and often have a self-perpetuating character. The Auditor General worries about loss of accountability. Canada, Auditor General, *Report of the Auditor General of Canada 2002*, chapter 1 ("Placing the Public's Money beyond Parliament's Reach"), Ottawa, 2002; Canada, Auditor General, *Report of the Auditor General 1999*, chapter 5 ("Collaborative arrangements") and chapter 23 ("Involving others in governing – accountability at risk"), Ottawa, 1999. See also the *2002 Report of the Auditor General*, Ottawa, April 16 2002.

fur resources of Rupert's Land (most of western and northern Canada, outside of the European settlements on the Atlantic littoral and in the St. Laurence valley). A competitor, the North West Company, was chartered a century later and folded into HBC in the 1820s.[152] Until the mid-nineteenth century the Hudson's Bay Company was the principal European presence in a territory that ran from Labrador to Vancouver Island to the Arctic Archipelago. Even today, descendant companies are still involved in factoring furs, supplying the north, and retailing goods to Canadians across the country. In colonial days its Governor and directors, meeting in London, operated in a manner that would be quite familiar to a modern board. The matters of government they undertook, and the relations they maintained with the native peoples even after the Proclamation of 1763,[153] were undertaken with a canny commercial eye but also a Scottish sense of honour.

- In 1867, the four colonies of Nova Scotia, New Brunswick, Lower Canada (Québec) and Upper Canada (Ontario) were united as a new Dominion of the British Empire through the *British North America (BNA) Act*, now called the *Constitution Act (1867).* Each of the founding colonies had a strong sense of its own distinctiveness and none wanted to be entirely governed from a new capital, still largely bush, on the Ottawa River. Complex negotiations led to a division of powers between provincial and federal governments that reflected this nineteenth-century political tug-of-war between those who wished to preserve provincial autonomy and those who wanted a modern state with sufficient central powers to stand up to the "manifest destiny" once again being felt, after a disastrous civil war,

[152] The rich and romantic story of the Hudson's Bay Company is told in Peter C. Newman's three-volume history, *Company of Adventurers* (1985), *Caesars of the Wilderness* (1987) and *Merchant Princes* (1991), Viking (Penguin), Toronto.

[153] The *Royal Proclamation of 1763* set the ground rules for relations between European settlers in British North America and the native peoples. In essence it commanded the colonial governments to treat with the natives and obtain land rights before allowing (agricultural) settlement. Since the Hudson's Bay Company wanted fur, not land, and had a commercial interest in a willing and energetic native labour force, conflicts were for the most part avoided.

in the Great Republic to the south. It is not too much of an exaggeration to say that the battle for states' rights was fought in both countries in the 1860s, with the "states" winning in Canada and the federal government winning in the United States.

- The consequence for commercial law was a division of powers that was neither logical nor easily changeable. Local institutions grew up around the functions allocated to one level or the other, with all their inbuilt capacity to resist change. The *BNA Act* itself was an act of a foreign parliament, a parliament never eager to become involved in colonial trivia – until 1982, when it became part of a patriated constitution with no practical amending formula at all.

Allocation of powers relating to corporate governance in the Constitution Act, 1867

Provinces:	Federal government:
Incorporation of companies with provincial objects	Regulation of trade and commerce
Property and civil rights in the province	Banking and incorporation of banks
Management of lands and resources	Bankruptcy and insolvency
Generally all matters of a merely local or private nature in the province	Patents and copyrigh
	Peace, order and good government
	Matters not exclusively assigned to the provinces

- This system would seem to create as much confusion as it resolves. The regulation of trade and commerce and the definition of property and civil rights, for example, are all but indistinguishable. In practice, however, the system works. The residual powers of the federal government with respect to matters not assigned to the provinces are wide, and have allowed a federal presence in such twentieth-century fields as environmental protection, a matter not wholly covered by provincial jurisdiction over resources. And there is the sometimes explicit, sometimes implied distinction between things that are of purely local moment and those which cross borders or are of compelling national interest. This allowed the federal govern-

ment, for example, to assert control of all matters nuclear in 1946, with the first *Atomic Energy Control Act,* or to create federal incorporation statutes. These, the *Canada Corporations Act* and the *Canada Business Corporations Act*,[154] are meant to apply to businesses that are not of a purely local character but whose activities cross provincial boundaries.

In practice, it is a matter of convenience to the organizers of a new business as to which level, federal or provincial, is chosen. Finally, there is a tradition[155] of judicial deference: one legislative body can act in disputed territory so long as it is vacant; if it is already filled or partly filled by an enactment from another level of government, the courts will "defer" to the statute that is closer to its constitutional roots, to the degree that there is a conflict. On all these matters there is now more than thirteen decades of case law built up to guide present-day designers of legislation and corporate governance systems.

5.1.3.Structure of publicly held corporations[156]

- Pursuant to statute, a corporation will operate within articles of incorporation or letters patent and general by-laws as well as any particular by-laws or resolutions that the shareholders may have adopted. Shareholders, as noted, elect directors, who in turn appoint managers. Directors and managers thus operate within rules established internally and externally.
- The general by-law usually contains rules for issuing shares, paying dividends, qualifying and indemnifying directors, electing directors, appointing and remunerating officers and employees, and for running meetings of directors and shareholders. Passing such a by-law is the first item of business when a company is organized. The rest of the initial agenda will deal

[154] Which should long ago have been amalgamated as a matter of legislative housekeeping.

[155] Activities that are persisted in long enough congeal into "constitutional conventions," and have all the force in common law that is so implied. The Supreme Court of Canada, for example, has used convention as a way of insisting that objective outsiders, and not politicians, should set judicial salaries.

[156] This section relies in part on Catherine Jenner, "Business corporations," chapter 15 in R.W. Pound, E.J. Arnett and M.E. Grottenthaler, eds., *Doing business in Canada*, Vol. 3, Stikeman & Elliott/Matthew Bender, New York, September 1997.

with securities and corporate records, appointing officers and an auditor, and banking arrangements.

- When a corporation first issues shares to the public, it falls under the jurisdiction of a provincial securities act, resulting in the application of a further series of requirements relating to corporate governance. The most important of these prescribe the 'full, true and plain disclosure' of all material information.
- The roles of managers and directors are in theory quite distinct. The board of directors has overall control and management of the affairs of the corporation; in many respects it is the corporation. The directors delegate day-to-day management of operations to officials whose hiring they initiate or ratify, and they hold those individuals accountable for results. In practice, there is some ambiguity. Usually a committee of the board nominates individuals for election to vacancies on the board. The committee structure and appointments may be heavily influenced by the chairman, who in turn may be the chief executive officer. Shareholder democracy can thus become somewhat attenuated.
- The duties, powers and liabilities of directors are sweeping. The duty of care requires that a director "exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances."[157] Liability may be avoided if a director relies in good faith on the financial statements of the corporation, or on the advice of a professional.[158]

Directors also have fiduciary duties: "Every director and officer of a corporation in exercising his powers and discharging his duties shallact honestly and in good faith with a view to the best interests of the corporation."[159] Directors must act in the best interests of the corporation, and have serious legal exposure if they are motivated by selfish considerations in their decision making. It is worth stressing that this fiduciary obligation is the bedrock of corporate governance; all the rest merely expands on or makes concrete this fundamental obligation.

The director must put the company's interest above his own; he must not, for example, act on confidential information regarding an upcoming transaction,

[157] *CBCA*, para. 122 (1)(b).
[158] The *OBCA* and *Quebec Companies Act* have similar features.
[159] *CBCA*, para 122 (1)(a).

takeover bid or reorganization to his own advantage. A director must act fairly in respect of all of the shareholders: the offence of oppression is the corresponding liability. This duty to the shareholders as well as the corporation comes into particular focus during a change of control situation, where a director's personal interests may diverge from those of the shareholders or the company. This general duty is one of the sources of the particular role of independent directors during takeovers – see the box, below, regarding Nova Bancorp and Strategic Value Corporation – as well as in more general matters of corporate governance.

A director must not profit from insider information,[160] and must disclose any contracts in which he has a material interest which may differ from the corporation's. He must not privately usurp an opportunity available to the corporation, at least before its rejection by the corporation. Directors must avoid placing themselves in a conflict of interest, disclose to the corporation any interests in an association or an enterprise which might give rise to a conflict, and declare any interest in any property, transaction or contract of the corporation.

Directors have duties to the employees and to the state, which normally come into play only during a bankruptcy or insolvency. Directors are jointly and severally responsible for up to six months' wages, for vacation pay, pension plan contributions, health insurance premiums, payroll taxes, and employment insurance premiums. In general, directors may be jointly and severally responsible, together with the corporation itself, for withholding taxes, sales taxes, and other taxes normally deducted at source.

Misrepresentations in filings by the corporation, including in prospectuses and circulars, or issuing shares for less than fair value, all expose a director to liability. In addition, certain actions by the corporation can expose the director to personal liability. Breaches of safety rules[161] and environmental protection laws[162] can attract penal as well as pecuniary penalties.

Nova Bancorp and Strategic Value Corporation:
Case of a Special Committee of a Board

Strategic Value Corporation, a publicly traded mutual fund management company, was bought by Nova Bancorp, a privately held corporation, in 1999. Strategic Value had a controlling shareholder who was also its chairman and

[160] These arise from the various securities acts: see, e.g., the *Securities Act (Ontario)*, R.S.O. 1990, c.S-5, secs. 122, 130, 131 and 134; *Securities Act (Quebec)*, R.S.Q., c.V-1.1, secs. 187 *et seq*.

[161] *Occupational Health and Safety Act (Ontario)*, R.S.O. 1990, c.O-1, sec. 32.

[162] For example, *Environmental Protection Act (Ontario)*, R.S.O. 190, c.E-19, sec. 194.

chief executive. In the circumstances of a "going-private transaction," regulations require that a Special Committee of the board of the target company composed of independent directors evaluate the transaction from a financial point of view, especially the point of view of the minority shareholders. The ratification vote in such circumstances requires a double majority – of all shareholders, and of minority shareholders considered alone. Complicating the matter was the fact that certain benefits were to be paid to the chairman that were not available to all shareholders. On the other hand, the price per share being offered was considerably higher than any recent market value, and Strategic Value was facing financial difficulties.

The Special Committee engaged an investment bank to evaluate the transaction and a law firm to advise on the complexities of the side benefits to the controlling shareholder. They concluded, in a report to the full board that was included in the proxy solicitation documents sent to all shareholders, that the benefits of the high price being offered outweighed any side benefits to the chairman, and recommended that shareholders should vote for the transaction. To the consternation of both parties to the transaction, the Special Committee decided that only full disclosure of all circumstances would serve the minority interests. In the event, the transaction was approved by all Strategic Value shareholders and by the minority shareholders as a class, with majorities in excess of 99 percent.

The obligations of many kinds of financial firms (though not all) and hence of their directors, are in certain areas more stringent. Banks and other deposit-taking institutions have a fiduciary obligation to their depositors that outranks other obligations. In the case of banks, depositors are protected by insurance. The insurer is the Canadian Deposit Insurance Corporation, a self-financing Crown corporation that establishes terms for extending insurance and charges a risk-related premium. One of its primary methods of ensuring good behaviour by its clients is the requirement that bank directors personally sign representations as to the adequacy of the bank's risk, credit and other policies. A similar but private corporation, the Canadian Life and Health Insurance Compensation Corporation (Compcorp), insures holders of insurance policies.

For most of these liabilities, a director can mount a defence of due diligence or reliance on financial statements or professional opinion. Directors can obtain special liability insurance to minimize their personal financial exposure. Insurers in turn will assess the quality of corporate governance – structures, records, reporting, decision making – in setting a premium. Some of the environmental stat-

utes impose criminal penalties, however, and for these no insurance may be purchased.

There is a large literature on directors' duties and liabilities.[163] The formal legal literature, read by itself, would make the reasonably prudent person presumed by the law think twice before accepting appointment. In point of fact, in ordinary circumstances, directors can focus on strategic questions and delegate execution to the officers they appoint without too much mental stress. It is a peculiarity of the legal approach to corporate governance that the personal liabilities faced by directors become threatening at precisely those moments – during a takeover, perhaps, or in the case of impending bankruptcy – when the corporation needs cool and experienced judgment at the top. In the extreme, the threat of joint and several liability may cause boards to resign just when they are needed most.[164]

In a more general sense, directors control and manage the corporation, taking a particularly strong interest in its strategy, organization, business policies, and relations with internal and external communities who have stakes in its continued prosperity. In this area too there is a vast literature.

5.1.4.Legal framework

The chief statutes bearing on corporate governance are the business corporation acts of the federal and provincial governments and, for publicly traded companies, the securities acts of the various provinces. In addition, as noted, there are a variety of other statutes that impose duties on corporate directors and thus have an impact on corporate governance. The most important of these are the laws relating to employment standards (provincial), environment (provincial and federal), and insolvency (federal). Statutes governing certain sectors, notably banking, insurance and telecommunications, impose further obligations. Several of these statutes give rise to regulatory bodies. In the case of banks and insurance companies, the federal government has an Office of the Supervisor of Financial Institutions (OSFI) whose principal concern is the soundness of the institutions, especially the management and control of risk. In contrast, the provincial governments, with their general mandate to look after the interests of consumers,

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[163] See, e.g., McCarthy Tétrault, *Directors' and Officers' Duties and Liabilities in Canada*, Butterworths, Toronto and Vancouver, 1997.

[164] The long slide of Canadian Airlines toward bankruptcy, eventually stopped only by a government-mediated merger with Air Canada, was punctuated by one such episode of director resignations.

regulate the conduct of financial institutions and their agents with respect to their day-to-day interaction with customers. The mandate of OSFI overlaps with that of CDIC, which, as insurer of deposits, has been at pains to improve risk management systems in the banks.[165]

Likewise, there is a federal Superintendent of Bankruptcy, a Director General of Corporations, as well as sectoral regulatory agencies like the Canadian Radio and Telecommunications Agency and the Canadian Transportation Agency. These offices do not directly impact on corporate governance except, perhaps, during crises or when a formal allegation of wrongdoing has been brought against a company.

Provincially, the most important statutes are the securities acts. Since Ontario is home to the most important stock exchange (and to 37 percent of the Canadian population) its securities act is the most important and has been used as a model, in whole or in large part, by all other provinces. [166] It regulates access to public equity markets, principally through the Ontario Securities Commission. It is both a policy-making and an enforcement body, having far-reaching investigative powers. In terms of its effect on the governance of publicly held companies, the OSC and its counterparts in the other provinces are the most important entities in Canada.

In addition to the OSC itself, there are a number of "self-regulating organizations" (SROs) under the *Ontario Securities Act* and its equivalent in other provinces that have an important bearing on corporate governance. The most important are the Toronto Stock Exchange (the biggest in the country) and associations of financial intermediaries, notably the Investment Dealers Association and to a lesser degree the Investment Funds Institute of Canada. These SROs impose standards of behaviour and disclosure on boards as a condition of continued access to capital markets, and so have great importance.

5.2.Pressures for reform

5.2.1.The changing market for corporate control

- The period after World War 1 saw a shift in power from proprietor-shareholders to professional managers. This was not a

[165] A recent and influential report recommended eliminating this overlap within the federal system: Canada, Task Force on the Future of the Canadian Financial Services Sector, *Change challenge opportunity: report of the task force*, September 1998, p. 221.
[166] V. Alboni, *The 1997 Annotated Ontario Securities Act*, Toronto: Carswell, 1996.

sudden revolution but a gradual move that started with the largest companies. In the period up to the War, great corporations were, in Canada as in the U.S., often associated with a controlling shareholder who was also a chief executive. Joseph Flavelle (munitions and other manufactures), Max Aitken (newspapers), the Massey family (agricultural machinery), Sir Donald Smith (railways) and others mirrored Henry Ford and J.P. Morgan in the U.S. During the interwar period, and strongly in the decades following the Second World War, managerialism became the norm for large corporations.

The U.S. political economist A.A. Berle was among the first to pay attention to this phenomenon, though Alfred P. Sloan, the architect of the modern General Motors, had already taken groundbreaking strides in the 1920s. As usual, the trend was more pronounced in the U.S. than in the smaller economy to the north, where the often smaller scale of corporate activity did not lead so strongly to professional managers. Indeed, many of the headline makers in Canadian business today, like Gerald Schwartz (Onex), Conrad Black (Hollinger), or Laurent Beaudoin (Bombardier) come from a visibly older tradition.

- Berle's thesis was that the shift to managerialism may have allowed the devolution of power within the corporation, substituting professional competence for idiosyncrasy and whim, but it did so at the cost of attenuating the close ties between the management of the corporation and the interest of the shareholders. Managerial salaries were not closely tied to corporate performance or bottom line profit. Managers were thought to operate corporations not so much for maximum performance but for maximum convenience to managers. Terms like "satisficing behaviour" – just enough to get by with, short of producing shareholder revolts – and "organizational slack," meaning the consumption of profit by employees, entered the literature. In the last decades of the century, again led by examples from south of the border, professional chief executives took more and more control of boards through effective control of nominations to the board and its committees. In the extreme, when CEO control extends to the compensation committee, opportunities for unjust enrichment may be hard to withstand. It is no surprise that it is companies whose CEOs have become immensely wealthy through the use of stock options – bluntly, a

dilution of the equity of the ordinary shareholders – which have so strenuously resisted reform of accounting rules to show such grants as expenses. Used in moderation, options can help align the interests of managers and shareholders. It is unlikely, however, that the marginal million dollars would visibly affect the diligence of a CEO already paid several times that amount.

- Managerial excess spawned a number of reactions, but an important one is a consequence of a further change in the market for corporate control. Institutional investors have risen from marginal players to the most important holders of equity in the last three decades. Today, the big blocks of common shares in major corporations tend to be owned by pension funds and mutual funds. Their managers have potentially enormous power, but only recently have some among them come to believe that it is part of their duty to exercise it.

Pension funds (and to a lesser extent, life insurance companies with similar long-dated obligations) have only recently become important players in the Canadian market for corporate control. Historically, they tended to be sleepy organizations dominated by highly risk-averse trustees. Investing in long-term government bonds was seen as the norm, with perhaps a few corporates added on days when trustees felt exceptionally daring. Debt, of course, did not threaten the perquisites of professional managers, at least in conditions short of default. The managers of pensions owned by civil servants at all levels of government were particularly careless of their obligations to pensioners, frequently simply investing the money deducted from pay cheques in low-yielding long-term obligations of the sponsoring government. However, the long-term return on equities became visibly better, in most years, than the returns on high-quality debt, especially when that debt was simply held and not traded as interest rates moved. Similarly, pension funds offering defined-benefit plans became increasingly conscious of the need for sustainably higher yields if their long-term obligations were to be met with the exceptionally high degree of assurance their market demanded.

Nortel: blinded by wealth

Canada's largest manufacturer of telephone equipment turned itself into an Internet giant during the heady late-90's phase of the dot.com bubble, competing with Lucent and Cisco for the market for routers and other hardware. Starting in 1997, a sleepy telephone company subsidiary became a free-standing stock market darling, with valuations growing even more rapidly than sales. John Roth was

made CEO of the Year and cashed in stock options worth more than $150 million. Roth was widely quoted as demanding more favourable tax treatment for options, claiming that Canada would lose in the international market for management talent if changes were not forthcoming. Then the bubble burst. In 2001 the company lost $27 billion and laid off 40,000 people. The stock trades for less than 5 percent of its peak value. Mr. Roth is comfortably retired.

Nortel's board acquiesced in what in a less polite age was called stock watering – dilution with a vengeance – and overpaid for a series of acquisitions at exceptionally inflated prices. As icing on the cake, the board raised Mr. Roth's base salary by 28 percent in the year the company set a new record for Canadian corporate losses.

Sources: Various CBC reports, and T. Edward Gardiner, "Sad case of Nortel reflects badly on its board," *Investor's Digest*, May 3 2002, p. 294.

Thus since about 1970 there have been several related trends in pension fund management:

- The primary fiduciary obligation of trustees to future pensioners has risen to become the most important objective in fund management;
- In turn, this has loosened the ties between corporations and governments, on the one hand, and the governance of pension funds;
- Trustees have become more interested in performance, which has come to mean a judicious balance between equity and debt;
- Trustees now devote considerable time and attention to the selection of fund managers, on the basis of their long-term performance on a risk-adjusted basis; and
- The steady accumulation of payroll deductions and employer contributions means that the major pension funds control many billions of dollars worth of corporate equities.

Eight of the ten largest pension funds belong to government employees, the exceptions being telephone and railway company employees. Together, the top ten had $245.4 billion in assets on January 1, 2000. In some respects, however, the most interesting was not the largest.

Canada's Top 100 Pension Funds at the Millenium

Assets under management:	$480.2 billion
Of which, equities:	127.3 billion

Source: *Benefits Canada*, April 2000, p.24.

The Canada Pension Plan Investment Board was created by Act of Parliament in 1997 to invest funds not needed by the Canada Pension Plan to pay current pensions. Since the Plan itself, which is administered directly by the federal government, invests only in debt obligations of the federal and provincial governments, the excess funds administered by the CPP Investment Board are invested solely in equities in order to balance the portfolio. The market value of the equity portfolio was $13.8 billion on December 31, 2001 and is expected to exceed $130 billion within ten years. The CPP Investment Board is mostly an index buyer, for now, with 95 percent of its cash so invested, but 5 percent is reserved for private equities. The longer-term intention is to move gradually away from pure index investing and into specific equities. The Board will thus have little to say about the governance of investee corporations in the short run (its small venture capital arm aside), but this can be expected to change in a relatively short period. In the meantime, the Board is conscious of its own obligations to be a leader in corporate governance.[167]

Other pension funds are already involved in the active oversight of their investee companies. The Ontario Municipal Employees Retirement System (OMERS), for example, has 60 percent of its $36.5 billion of assets in stock. It has strong and well-formed views about appropriate corporate governance, and has published them on its website.[168] It will vote against overly generous or improperly structured stock option plans, "golden parachutes" or "golden goodbyes," and leveraged buyout proposals where it appears management and the board have not adequately pursued shareholder interests – all of which are techniques used to favour incumbent management. They will also vote against unequal or subordinated voting share schemes, "greenmail," and excessive share issues. OMERS favours a strong majority of independent directors, and where the industry norm is to have the CEO also function as chairman, the election of a lead director from among the independents.

OMERS will not vote for any nominee to the audit, compensation, nominating or corporate governance committees who is not an independent member. They insist that voting at general meetings should be confidential so as to preclude improper pressures, and feel that directors should be elected one at a time rather than as a slate, in order that shareholders can exercise discretion about in-

[167] "The federal crown corporation won the Conference Board of Canada/Spencer Stuart 2002 National Award in Governance for the public sector." CPP Investment Board press release, January 9, 2002.

[168] OMERS, "Proxy voting guidelines,"
www.omers.com/investments/proxyvoting_guidelines, posted January 18, 2002.

dividual directors. They prefer directors to own shares rather than options. They are cautious about poison pills and other takeover protections that reward sitting management more than shareholders. OMERS also subscribes to the CERES (formerly Valdez) principles, created by the Coalition for Environmentally Responsible Economies in 1989 and published in Canada by the International Institute for Sustainable Development.[169] Altogether, their published guidelines and their behaviour as investors sets a high standard.

The Ontario Teachers Pension Plan Board (Teachers) follows similar practice. Its website publishes its investment policy as well as conflict of interest and code of conduct policies governing its employees, officers and directors. Its chief executive, Claude Lamoureux, has been a leader in calling for improved corporate governance. In a recent speech he noted that less than 40 percent of TSE-listed companies even bother to report their compliance with the Exchange's voluntary guidelines and cited Nortel and JDS Uniphase as examples of board laxity. He made eleven proposals regarding corporate governance and urged other institutional investors to join the Ontario Teachers in acting on them.[170] His proposals were as follows:

1. Fiduciaries (mutual funds, banks, insurance companies and pension funds) should report how they vote the shares they hold to those for whom they invest. (To this end, Teachers publishes on its website how it intends to vote on each item in upcoming general meetings.)
2. Corporations should report the results of shareholder votes within one day of the annual general meeting.
3. Governance committees should seek the active involvement of institutional investors in recruiting independent directors.
4. Directors should be required to invest their own money in the companies they govern.
5. Boards should meet regularly in the absence of management.
6. Accounting standards should be high rather than merely convenient. (Elsewhere in the speech Lamoureux bemoaned people's willingness to be dazzled by pro forma numbers while ignoring generally accepted accounting principles (GAAP).)
7. Press releases should be based on GAAP and be approved by audit committees.

[169] http://iisd1.iisd.ca/educate/learn/a5.htm
[170] C. Lamoureux, speech to the Canadian Club, Toronto, March 4, 2002.

8. Disclosure documents should be written in language accessible to laymen.
9. Auditors should not be allowed to earn other fees of any kind from the companies they audit.
10. Tax laws should make share ownership and options neutral.
11. Options should be charged on the statement of profit and loss; to this end, Teachers is asking other pension funds to join in writing to every TSE-listed company to ask that this be done voluntarily.

In case these should be seen as radical proposals, it is worth noting that Lamoureux is widely regarded as one of the most senior and respected leaders in the fund management industry; his fund, at $67.1 billion on January 1, 2000, is the biggest single pension fund in the country. Institutional investors had become restive earlier in the U.S. – CALPERS is a good example – in large measure because until recently, Canadian law actively discouraged soliciting others to behave in a concerted way to change corporate governance. No more.

Pension funds are increasingly looked to for leadership in areas besides investment performance. The Caisse de Dépôt et de Placement du Québec, created in 1965 by the Québec National Assembly, invests on behalf of public pension and insurance plans in Québec. With over $100 billion of assets under management, it is Canada's largest single equity investor. While it is mandated to make an adequate return for its pensioner customers, it is also required to invest with the long-term interests of Québec in mind. Funds like the Caisse are principal targets of the corporate social responsibility (CSR) movement, and of groups wishing to see more specific ethical, environmental and other criteria applied in investment decisions. To a degree they have been able to shelter behind legal limitations on what they may invest in, but this fig leaf is shrinking away. Even the Caisse, with its strongly nationalistic undertone, shares an agenda with other large institutional investors. Recently, for example, it joined others in publicly berating the directors of two large insurance companies, Clarica and Sun Life, for agreeing to an exceptionally large break fee as part of their planned merger.

Mutual fund companies in Canada now have $445.3 billion of assets under administration.[171] This is a more diverse industry with low costs of entry and a somewhat lesser degree of regulation than pension funds, banks, or other fiduciaries. The industry association is not a leader in calling for improved governance of investee companies, although it does strive to improve the operations of its

[171] Together with pension fund assets, this makes roughly one annual gross domestic product. Source: Investment Funds Institute of Canada, www.ific.ca/eng/home/index.asp.

members. IFIC aspires to become an SRO, but the Investment Dealers Association currently plays that role in Ontario and the Ontario Securities Commission has historically been dubious about mixing industry promotion and regulation in one private body. Individual mutual fund operating companies have not been as forthcoming on these issues as the pension funds, either. In some cases, industry leaders are themselves part of larger financial groups whose comfortable interlocking and self-perpetuating directorships might not stand the same scrutiny that they would be urging on others. Nonetheless, some mutual fund companies in the U.S., such as Fidelity, are taking a more visible interest in the subject, an indicator, perhaps, of things to come in Canada.

5.2.2. Cadbury and British precedents

In 1991 the British formed a committee to assess the financial aspects of corporate governance in the United Kingdom. The resulting paper, commonly referred to as the Cadbury Report after its principal author,[172] was a landmark in thinking on corporate governance, and its influence extended well beyond British borders. The report is considered something of a predecessor to Canadian efforts and spurred work in the United States and France as well.

At the time the Cadbury Report was written, it was widely believed that improvements in corporate governance were overdue. Though a generally sound system of corporate governance was in place in the UK, a sharp recession had led to the unexpected failure of same major companies, and company reports and accounts were being exposed to unusually close scrutiny.

The Committee saw two major issues: the perceived low level of confidence in the standards of financial reporting and accountability, and the ability of auditors to provide wholly unbiased assessments. The Committee determined that this was a result of loose accounting standards, the absence of a clear framework for ensuring that directors kept business control systems under constant review, and competitive pressures that made it difficult for auditors to stand up to demanding boards.

In response, the Committee made several recommendations and created a Code of Best Practice designed to clarify the responsibilities of boards of directors. The Code reflected existing best practice in Britain, and was based on the principles of openness, integrity and accountability. Though compliance with the Code was voluntary, the London Stock Exchange required, as one of its listing

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[172] Committee on the Financial Aspects of Corporate Governance, *The Financial Aspects of Corporate Governance*, (Cadbury Report), London: Gee and Co. Ltd., 1992.

obligations, that all listed companies registered in the UK state whether they comply with the Code, and give reasons for non-compliance.

Cadbury's examination fell into three categories: the constitution and responsibilities of the board, auditing practices, and the role and responsibilities of shareholders. In summary the key recommendations were as follows:

The board

- A properly constituted board is made up of executive directors and outside non-executive directors under a chairman.
- The board should include enough non-executive directors for their views to carry significant weight in the board's decisions.
- The board should meet regularly, maintain full control of the company, and monitor executive management.
- Matters on the board's agenda should at least include acquisition and disposal of assets, investments, capital projects, authority levels, treasury policies and risk management policies.
- Newly appointed directors should receive some form of training.
- There should be rules limiting the scope for uncertainty and manipulation in financial reporting.
- Listed companies should publish full financial statements annually and half-yearly reports in the interim. In between these periods shareholders should be informed of the company's progress and this information should be widely circulated.
- If the chairman is also the chief executive, there should be a strong independent element on the board.

Auditors

- Every listed company should form an audit committee and ensure that there is an objective and professional relationship with the auditors.
- The accountancy profession itself should take an active role in improving and enforcing better accounting standards by developing guidance for companies and auditors.

Shareholders

- Shareholders must insist on a high standard of corporate governance, require their company to comply with the Code, and make their views known to boards by communicating with them directly and attending general meetings.

- Institutional shareholders must use their considerable influence to contribute to good governance, and should take a positive interest in the composition of the board and understand the company's strategies.
- Boards must ensure that any significant information be made equally available to all shareholders.
- The shareholder must give consent before any price-sensitive information is given by the company. Shareholders should not deal in the company's shares until the information has been made public.

5.2.3 The Dey Report

In 1994, with the publication of what is commonly referred to as the Dey Report, Canada began it own modern attempt at assessing and improving the governance of publicly held corporations in Canada. The report, the first in a series, was created by a stock exchange committee rather than a public entity, and was in actuality called "Where Were the Directors?"[173] – a name reflecting public sentiment at the time.

In the early 1990s there was a growing feeling of dissatisfaction among Canadian investors and other interested parties with regard to the performance of boards of directors. Though most pubic companies were well governed, as in Britain the highly visible failure of several poorly managed public corporations, aggravated by a recession, demonstrated a need to make corporate governance more of a concern in Canada.

In response, the Toronto Stock Exchange (TSE) created a committee under Peter Dey, a former head of the Ontario Securities Commission, to find the root of the problem and to design guidelines for public companies based on existing best practices. The result was 14 recommendations focused on the board of directors and its relationship with shareholders and management. As with Cadbury, the recommendations did not have the force of regulation, but companies were required as a condition of listing on the TSE to state whether they complied, and if not, why not. The key recommendations were as follows:

- Boards of directors should be responsible for supervision and management, not the day-to-day running of the business, and this includes strategic planning, risk management, succession planning,

[173] Toronto Stock Exchange, Committee on Corporate Governance in Canada, "Where Were the Directors? Guidelines for Improved Corporate Governance in Canada," (the Dey Report), TSE, Toronto: December, 1994.

communications policy, and ensuring the integrity of the corporation's internal control and information systems.

- Each board should have a majority of 'unrelated directors,' that is, directors who are independent of management.
- Every board should assume responsibility for developing the corporation's approach to governance issues.
- To ensure the board can function independently of management, the board should adopt a chair who is not a member of management with responsibility to ensure the board discharges its responsibilities, or assign this responsibility to a committee of the board or to a director.

Five years after reporting on the Dey guidelines had been incorporated into the TSE listing requirements, the Toronto Stock Exchange and the Institute of Corporate Directors conducted a study of the results.[174] Principally a survey of chief executives and their views on corporate governance, the study revealed that in general the guidelines had become broadly accepted business practices. Most companies took the guidelines seriously and many of the larger companies were leaders in corporate governance. The study found, however, that compliance varied. The highest levels of compliance with the guidelines were in controlling board size, participation in strategic planning, and in having a majority of unrelated directors. The lowest levels were in measuring the performance of the board and in formalizing its roles, both of which tend to be seen as attacks on the collegiality and powers of boards.

Adherence to the guidelines varied with size and sector. Many smaller companies and mining companies found that the guidelines were not helpful or feasible. Some survey respondents felt that too much emphasis was placed on the formalization of corporate governance. Others wanted the recommendations to tackle more issues, like ethnic and gender diversity, and preparedness for the internationalization of markets.

Confederation Life: a failure in risk management

Confederation Life, an insurance company almost as old as the country, had assets of $19 billion and a triple-A credit rating, the best available, in 1993. On August 11 1994, it was seized by the regulators. The sudden

[174] Toronto Stock Exchange and Institute of Corporate Directors, Corporate Governance Report Committee, "Report on Corporate Governance, 1999: Five Years to the Dey," Toronto: Toronto Stock Exchange, June 1999.

collapse of this large, dull, conservative company astounded markets and for a time cast a pall on Canadian equities generally.

At heart the problem was that management failed to understand the risks inherent in new insurance products and in the real estate assets that supported them. And the board did not control management.

Source: Rod McQueen, *Who killed Confederation Life?* Toronto: McClelland & Stewart Inc., 1996

5.2.4 Institutional investors: the Kirby Report

Rounding out the update in governance regulation initiated by the Dey Commission, the Senate Standing Committee on Banking, Trade and Commerce of the federal parliament held hearings and released a report in 1998 recommending new measures to improve the governance practices of institutional investors.[175] The document, referred to as the Kirby Report after the Committee chairman, Sen. Michael J.L Kirby, recommended that boards of pension plans be knowledgeable and communicate with pension plan holders through an annual report and other means of communication, making sure to explain the risk management and governance practices of their fund manager. Kirby also recommended that every mutual fund be required to have a majority of independent directors and to adopt a corporate, rather than trust, structure.

The issue of proxy voting was also raised. Kirby's committee recommended that institutional investors should vote their shares in the best interests of their fiduciaries. Several pension funds were found to be exemplary in exercising their proxy voting rights, and had developed and published proxy voting guidelines. Not all institutional investors, however, assigned such importance to proxy voting. A 1997 survey of Pension Investment Association of Canada members revealed that " though a significant number of respondents were notified of important corporate issues, 71% of them did not provide specific instructions to external managers on proxy issues." [176] Mutual fund companies are even less active. Few have voting guidelines, and even fewer exercise their voting rights.

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[175] The Standing Committee on Banking, Trade and Commerce, Government of Canada, "The Governance Practices of Institutional Investors," (The Kirby Report), Ottawa: Government of Canada, November 1998, website:
http://www.parl.gc.ca/36/1/parlbus/commbus/senate/com-e/bank-e/rep-e/rep16nov98-e.htm.

[176] Pension Investment Association of Canada, "Submission to the Standing Committee on Banking, Trade and Commerce," November 1997, p. 7.

The Kirby Committee inclined to the view that confidential voting would be beneficial, and recommended that the federal government examine the issue in respect of companies incorporated under the *Canada Business Corporations Act*.

More recently, the Canadian Securities Administrators have published proposals for the governance of mutual funds and for the conduct of their employees.[177] They take a more nuanced view of mutual fund governance, noting that there are several forms of organization (principally corporations and trusts, though there are funds owned by their investors, as well as semi-closed or closed end funds) now existing, and that each poses particular questions regarding risk, conduct and governance.[178] In effect, the CSA argue that Kirby was too sweeping and that there is no reason to force all arrangements into the straitjacket of corporate organization. This view, while certainly convenient to the industry, is open for public consultation and comment until June 2002, and it will be many months before regulatory changes are final.

5.2.5. The Saucier Report

In 2000, a successor to the Dey Committee was created. The Joint Committee on Corporate Governance was formed in order to examine the effectiveness of the Dey recommendations, to re-evaluate corporate governance in light of a new political and economic landscape, and to update the TSE listing requirements on corporate governance. The Committee's report, named after its Chair, Guylaine Saucier,[179] paid particular attention to the impacts of globalization and modified the Dey recommendations accordingly.

The intervening six expansionary years had seen an unprecedented surge in global trade and investment. For Canadian businesses, the complexities of being small players in multi-jurisdictional markets for capital as well as sales placed new demands on corporate governance. Locally, a number of high-profile corpo-

[177] Canadian Securities Administrators, "Striking a new balance: a framework for regulating mutual funds and their managers. A concept proposal," Toronto, March 1 2002, website: www.ific.ca/eng/frames.asp?l1=Regulation_and_Committees. The paper contains a review of administrative law reform proposals in the area.

[178] The legal research underpinning the CSA position is in D.P. Stevens, "Trust law implications of proposed regulatory reform of mutual fund governance structures. A background report to Concept Proposal 81-402 of the Canadian Securities Administrators," Goodman and Carr LLP, Toronto, March 1 2002.

[179] Joint Committee on Corporate Governance, "Beyond Compliance: Building a Governance Culture," (The Saucier Report) Toronto: Chartered Accountants of Canada, Toronto Stock Exchange, and Canadian Venture Exchange, November 2001.

rate scandals had occurred since the implementation of the Dey recommendations, and a recent study had shown that 51 percent of 324 public companies surveyed did not report their practices against all of the TSE Guidelines.[180] The Committee concluded that rule changes did not appear to be followed by changes in underlying attitudes within the business community. There was a sense that form had changed, but not substance.

Bre-X: sleepy directors overlook fraud

Bre-X was a gold mining company whose claims of a monster mine in Indonesia were based on salted samples, the oldest trick in mining fraud. A vast market capitalization vanished, taking with it the dreams of many unsophisticated investors, as well as many who should have known better. The question of which officers were responsible may never be resolved – the CEO and a key geologist are dead and legal proceedings obscure the rest – but it is clear that the board never took the confirmatory steps that such unprecedented claims should justify. Instead, it fell to the chairman of Freeport McMoRan, an American firm that exercised the pre-investment due diligence that Bre-X directors should have, to blow the whistle.

Sources: Vivian Danielson and James Whyte, "Bre-X: gold today gone tomorrow" 1997.

Saucier's strategy was to focus more on behaviour – the competencies and functions of the board – and less on its structure. The Report stressed that boards and management must respect one another's roles, and described the roles of the board. It also proposed that Canadian auditing practices harmonize with the U.S. auditing practices established by the U.S. Blue Ribbon Committee.[181]

In its most controversial proposal, the Saucier Report recommended that Dey's encouragement to have a non-executive as board chair be upgraded from a voluntary guideline to a listing requirement. The Report conceded, however, that a chief executive can be chair as long as there is an independent board leader ("lead director") who is unrelated to management in the Cadbury sense and whose job, in consultation particularly with other outside board members, is to appraise the performance of the CEO. The recommendation has been controversial and has not yet been implemented.

[180] Patrick O'Callaghan and Associates in partnership with Korn/Ferry International, "Corporate Board Governance and Director Compensation in Canada: A Review of 2000," December 2000, p.8.

[181] The Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committee, "Report and recommendations," New York: The New York Stock Exchange and The National Association of Securities Dealers, 1999.

Fairvest Proxy Monitor Corporation[182] recently published a review of board practices at the companies that make up the Toronto Stock Exchange 300-stock index. The results suggest that, overall, governance has improved since 1996, but has weakened in some cases. The following list illustrates deterioration of governance practices according to the 2001 survey: [183]

- 22 percent of TSE 300 companies now have different classes of common shares with unequal voting rights, compared with 19 percent in 1996. This "violates the basic principle of 'one share, one vote' and distorts the relationship between ownership and control . . ."
- More companies are adopting the "poison pill" takeover defence, a move that can block a potential acquisition by making it more expensive. About 29 percent of TSE 300 companies had a poison pill in place in 2001, up from 24 percent in 1996.
- Only 8 percent of TSE 300 companies had confidential voting as of November 2001, down from 11 percent five years earlier.
- In 2001, 40 percent of companies had chief executives who were also board chairs, down from 45 percent in 1996. Still, there has been some movement among firms to separate the jobs. In 1996, about 45 percent of companies had the same person occupy the CEO and chairman's jobs, and this number dropped to 40 pe cent by 2001.
- Average board size fell from 10.6 members in 1996 to 9.7 in 2001. The largest board among TSE 300 firms was 24 members last year, well down from 34 members five years earlier.
- The average tenure for board members fell from 12.4 years in 1996 to 6.9 years in 2001.
- The average retainer paid to board members increased from $11,549 in 1996 to $14,387 in 2001. Per-meeting fees moved up from $821 to $950, on average.
- The average proportion of board members who are independent of the firm's management increased from 61 percent to 65 percent. However, the independence of nominating committees -- the board

[182] Website: www.fairvest.com

[183] Richard Blackwell, “Boardroom reform shows little progress, study says,” Globe and Mail, 5 January 2002, B3.

teams that find new directors -- was down substantially to 53 percent from 75 percent in 1996.

5.2.6 The Gadflies

There are a number of individuals who use the press and public occasions to improve corporate governance practices. In some cases they form organizations that fight for the rights of shareholders and stakeholders. Examples of such activists within Canada are Al Rosen, a forensic accountant concerned with current Canadian accounting principles, William M. Mackenzie, a shareholder rights advocate, Yves Michaud, the founder of an investor-rights association (and incidentally a Québec separatist), and J. Richard Findlay, a newspaper contributor who exposes substandard governance practices.

Al Rosen, a former advisor to the Auditor General of Canada, is a forensic accountant, frequently an expert witness, a university professor, and a journalist. Speaking to lawyers and business people across the country, Rosen argues that Generally Accepted Accounting Principles (GAAP) are a very poor way of reporting the finances of high-tech and other new-economy companies and tend to encourage misrepresentation in financial reporting. Rosen also criticizes the state of accounting education in North America, arguing that learning GAAP by rote does not require students to think critically.

Rosen has handled more than 300 accountancy negligence cases in court, including some prominent ones. In the early 1990s, he was hired by the state of Michigan to analyze the collapse of Confederation Life. Recently, in an attempt to reveal suspicious accounting before it ends up in court, Rosen has begun publishing a highly confidential and influential newsletter for mutual fund managers commenting on which public firms use dangerously aggressive accounting.

William M. Mackenzie is the President of Fairvest Proxy Monitor Corp.,[184] a Toronto firm that acts as a shareholder rights advocate and advises institutional investors on corporate governance. Fairvest's services include analyses of corporate proxy circulars, analysis of corporate governance issues facing shareholders, agency proxy voting services, voting results from shareholder meetings of Canadian corporations, and the publication of a bi-monthly newsletter. Fairvest's aim is to help institutional investors vote their proxies efficiently and intelligently. Where proxy proposals deviate significantly from the corporate governance standards set by the Pension Investment Association of Canada (PIAC), Fairvest provides comments with reference to the PIAC position on the issue. Fairvest's

[184] Website: http://www.fairvest.com/index.html

publications are discussed in the Canadian media and Mackenzie is often asked to comment on governance issues.

Yves Michaud is the founder of L'Association de protection des épargnants et investisseurs du Québec, a non-profit investor association founded in 1995 with over 1600 members, mostly from Quebec.[185] The association is affiliated with the International Corporate Governance Network and defends the interests of Québecois savings and investments by promoting the application of highest-standard corporate rules and regulations. The Association's principal objectives are to promote greater transparency of management in publicly held corporations, to create a forum for the discussion of the relationship between citizens and corporations, to promote better representation of shareholders to boards, and to promote the Association's views on the functioning of financial markets to governments. The Association has filed an application for a class action suit against Cinar, a movie company, and Nortel, the telecom giant, for having failed to fulfil their information obligations towards their shareholders, and in its early days won approval from the courts requiring corporations to include proposed shareholder motions in its notice of shareholder meetings.

J. Richard Findlay is the chairman of the Centre for Corporate and Public Governance, a Toronto-based think-tank on governance. He contributes regularly to newspapers across the country and is often quoted in newspaper and journal articles concerning governance issues. Findlay has commented on recent governance issues including the British Columbia Securities Commission's plan to reduce and simplify its rules on disclosure, employee layoffs as a result of the Canadian Imperial Bank of Canada's takeover of a large brokerage firm, and software maker Corel Corporation's intention to re-price management's options amidst low stock prices.

5.3.Emerging Issues

5.3.1. Crown corporations

Canada has long experience with reconciling the twin goals of performance and accountability in state-owned enterprises. Canadians have used various kinds of state enterprise to pursue national objectives in culture, economic development, research and higher education, social development, and regulation for health and safety, and even for defence procurement. Many federal crown corpo-

[185] Website: http://www.apeiq.com/index-logo.html

rations were privatized during the period 1984-93, but many remain, and the provinces and even the cities own a wide variety of other enterprises. Federally, there has been a move in recent years, dubbed "Modern Comptrollership," to improve the performance and accountability of agencies, departments and crowns. A special unit reporting to the Deputy Prime Minister oversees all crown corporations.

Crown corporations, like other corporations, are wont to sink into desuetude and sloth in the absence of competition. Since that is frequently a rationale for setting one up in the first place it is all too often a failure of these entities. The cure must be found in exceptional corporate governance regimes which invoke comparisons with like entities, perhaps on a function by function basis, through benchmarking, which maintain pressure on managements continuously to do better, and which erect serious measurement systems to see whether in fact performance is all it might be. This in turn implies that the boards of directors of crown corporations need to have all the skills of private boards and more besides.

Unhappily, politics is often at least as important as competence in board appointments. The Prime Minister's political office vets all appointees, ensures that none hold views inimical to the party in power, and that appropriate regional, ethnic and gender balances are maintained. Sometimes deputy ministers, who are supposed to be politically neutral, are appointed to ensure appropriate liaison with the policy directions of government, regardless of the inbuilt conflict of interest between a public servant who is expected to further the policy goals of the elected government and a director who is expected to devote all his skill and attention to the interests of the corporation. The appointments, salaries, and terms of employment of chief executives are usually set by the Prime Minister's office directly, so these normal methods by which boards exert influence over the behaviour of management are lacking. Under the circumstances it is a rare and happy occurrence when a board is truly effective.

The effectiveness of crown corporation boards could be increased in a number of ways, without, moreover, derogating from the equity and political filters applied at present. Lists of competent and experienced persons can be drawn up in advance from which the political authorities might make choices. (An analogous system works for judges, for instance.) Boards might be delegated more power with respect to the selection and compensation of senior management. In some cases, a "two-key" system is used, where a board and the political authorities agree in advance that both must independently be satisfied. In some cases – the well-managed municipal utility Epcor, for instance, which is owned by the

city of Edmonton – the city sets its overall policy in writing, appoints the board, and then relies on the board fully thereafter.

5.3.2 Information management

For many organizations today, information technology (IT) has become such an essential part of operations that a breakdown can be devastating. As such, boards must now incorporate IT issues into their strategic planning and risk management activities. To help organizations properly incorporate IT issues into their responsibilities, the Canadian Institute of Chartered Accountants released a report in 2002 outlining the specific measures boards need to take to ensure the integrity of their information systems.[186] According to the report, the key IT responsibilities of boards are:

- Having a strategic plan and an action plan for implementing and maintaining information systems, including top management in this process;
- Establishing a direct link between IT management and the highest executive levels of the organization;
- Determining the level of risk an IT system poses, and finding appropriate security measures to control that risk;
- Ensuring IT personnel are adaptable to change, trained in specific skills required by the company, and knowledgeable about good management and control procedures;
- Making sure the organization tracks current trends in technology and regularly upgrades hardware and software; and
- Developing policies that deal with privacy issues and intellectual property.

The report states that some of these responsibilities can be delegated, but makes clear that IT responsibilities must be monitored by the board and dealt with by upper management. The report suggests that boards appoint a vice president of IT, one who is not also responsible for Finance (as has often been the case in Canada), since financial issues often eclipse IT concerns.

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[186] Canadian Institute of Chartered Accountants, "20 Questions Directors Should Ask about IT," Toronto, CICA, January 2002, website: http://www.cica.ca/cica/cicawebsite.nsf/public/e_AARSpdf02/$file/e_20QIT.pdf.

5.3.3 Corporate social responsibility

In recent years, with increased globalization in a unipolar world economy and with the maturation of the environmental movement, there has been a broad push from the moderate left for a kind of corporate accountability that goes beyond the interest of shareholders and fiduciaries to a wider concept of society and environment. This takes many forms. In Canada, environmental groups attempt to influence corporate investment decisions through publicity campaigns, enhanced regulatory enforcement and the like, and more recently by trying to persuade companies to change their own internal governance systems in order to increase the attention paid to a wider audience of "stakeholders." A leader in this movement has been the International Institute for Sustainable Development (IISD), a federally-funded foundation in Winnipeg, which has adopted the view that economic and sustainably environmental performance by corporations go hand in hand, and that therefore the measures by which corporations govern themselves should be broader than financial profit and loss. IISD has supported the development of the ISO 14000 series of standards, noting however that these merely assist an organization in the attainment of its environmental goals.[187] It also wants those goals to be ambitious, in the sense that sustainability over the generations should be the starting point for corporate planning and decision-making. A concomitant is that seeding corporate boards with representatives of these broader interests would be a good thing. In this context, environmentalists sometimes make common cause with groups with specific social, or political concerns, such as gender equality, the plight of native peoples, or the need to enhance social equity by contributing to organizations assisting the poor or disadvantaged.

The movement is styled CSR, short for "corporate social responsibility." One group that focuses squarely on stakeholder rights is the Canadian Democracy and Corporate Accountability Commission, co-chaired by a retired chief executive and Ed Broadbent, the former head of the New Democratic Party, Canada's social democrats. Unlike IISD, who assert that profitability and good environmental behaviour go hand in hand, the Commission tends to see CSR as requiring some allocation of corporate resources that might otherwise appear as profit. The Commission's research involved interviewing a non-random sample of Canadians

[187] International Institute for Sustainable Development, "Global Green Standards: ISO 14000 and Sustainable Development," (The Green Report), Winnipeg, Manitoba: The International Institute for Sustainable Development, 1996.

from various sectors and regions, asking them how they feel about a corporation's responsibility towards stakeholders versus its right to make a profit.

The results were summarized in a recently released report.[188] The majority of those interviewed favoured more corporate accountability in Canada. Only 20 percent of those interviewed felt that corporations have a sole responsibility – profit.[189] In its report the Commission argues that the greatest method of improving CSR is through disclosure. Among other things, the Commission recommends that companies listed on Canadian stock exchanges be required to disclose their approach to corporate responsibility in their annual reports; that Canadian governments introduce laws protecting employees from being discharged, suspended, or otherwise punished for disclosing alleged criminal fraudulent acts committed by their employer; and that business schools develop mandatory classes on CSR.

5.3.4. Money laundering and September 11

As part of a growing international effort to combat money laundering, the Canadian government established the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) as an independent agency with a mandate to collect, analyze, assess and disclose information in order to assist in the detection, prevention and deterrence of money laundering. The Centre's mandate includes ensuring compliance with the record keeping and reporting requirements set out in the *Proceeds of Crime (Money Laundering) Act* and Regulations and enhancing awareness and understanding of matters related to money laundering. Since 2001 banks and other financial institutions must report suspicious financial transactions to FINTRAC. The requirement to report large cash transactions, electronic fund transfers and cross-border movements of cash is being implemented in stages during 2002. The Bank of Canada is also withdrawing large denomination printed money (notably the $1,000 bill) from circulation, to reduce the ability of criminal elements to move large sums of money through the Canadian financial system.

As a result of the terrorist attacks on New York on September 11, 2001, the mandate of FINTRAC was expanded under a revised law, the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*. Under the new legislation, in-

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[188] Canadian Democracy and Corporate Accountability Commission, "The New Balance Sheet: Corporate Profits and Responsibility in the 21st Century," Toronto, January 2002.
[189] Canadian Democracy and Corporate Accountability Commission, Executive Summary, available on website: http://www.corporate-accountability.ca/, p.2.

dividuals and business are now also required to report suspicions of terrorist activity financing and the organization is authorized to receive information from the public on suspicious financing activities that could be linked to terrorism.

5.3.5. Arbitrage

Two kinds of arbitrage give rise to questions regarding the functioning of markets and corporate governance in Canada. One is price: do prices of the same stocks on Canadian and US exchanges diverge, and if not, why? Arbitrage now works so seamlessly that the answer is resoundingly negative. The same brokers have seats on the main North American exchanges and engage in programmed trading. When an exchange rate adjusted gap appears, simultaneous buy and sell orders are entered automatically on the relevant exchanges, and prices quickly equilibrate. This represents merely an automation of a system that used to rely on brokers watching screens. Since markets respond so rapidly to price fluctuations, which is partly to say they respond to new information, fairness regarding access to information has lately become a concern. Corporate managements now give "guidance" on sales or earnings forecasts to their favoured analysts or investment bankers at their peril. Simultaneous electronic disclosure to all market participants is now the norm.

A more serious matter is sometimes called regulatory arbitrage. Companies have been known to "shop" for bourses or jurisdictions whose rules suit their circumstances. In the extreme this may lead to a kind or regulatory race to the bottom, led by exchanges or jurisdictions that want to increase their market share by offering a less stringent regulatory environment. For many years, until a reform in the late 1990s, the Vancouver Stock Exchange was known as a place amateurs should avoid – a playground for the wilder sort of penny mining stocks. This fear is, however, at least counterbalanced by a trend to seek the exchange or regulator with the highest standards of disclosure and probity. Where the rules are known to be stringent and the regulators fierce, investors may become more confident. With one source of risk reduced, the overall cost of capital for issuers may decline.

There are nonetheless occasions in Canada when jurisdictions may conflict. In particular, reference has been made to the split jurisdiction between federal and provincial governments in securities matters and to the deadweight cost of duplicative provincial regimes. In practice this has been addressed by coordination, harmonization and specialization among the several provincial and territorial regulators meeting in a formal body called the Canadian Securities Regulators. It is now generally possible to file a prospectus in one province and have its ac-

ceptance by the local regulator rubber-stamped by the others, although the necessity of providing this often voluminous documentation in two equally valid linguistic texts is still a matters of concern to issuers. There have been calls for a single national regulator from time to time – most frequently from issuers and from the Ontario Securities Commission – but some of the provinces, notably Québec and Alberta, object. The federal government, despite an arguable case for federal jurisdiction under the trade and commerce power of the BNA Act, has so far declined to act directly. Its grumblings[190] are usually enough to keep the interprovincial movement toward harmonization moving in the right direction.

Conclusions for Section 5

To recapitulate, the broad sweep of corporate management and finance in Canada has evolved over time from single proprietorships and partnerships to a system where ownership and management are increasingly separated. The substitution of hired managers for owners began in earnest a century ago. Since then the ultimate providers of equity capital have become increasingly distant from the day-to-day management of corporations. At first they were simply shareholders. Later they became investors in mutual funds, who became intermediates between small savers and corporate management, or beneficiaries of pension funds and insurance company investments. In the latter case a double layer of intermediaries lay between investors and management, as pension funds hired professional managers who in turn invested money on their behalf.

None of this enormous mobilization of capital would have been possible without the base of trust and fiduciary law, which emerged in nineteenth-century English jurisprudence and grew apace. Thus corporate directors have serious obligations to work in the best interests of the corporation and its shareholders and to exercise professional diligence in their interest. This is the heart of corporate governance in Canada. The critical modern difficulties arise when there are threats to this fiduciary relationship.

For corporations where the shareholders are private persons, the principal threat is concentration of power in the hands of a few insiders, for whom the temptations of self-enrichment may become overwhelming and around whose activities dense smokescreens of self-justification may be erected by clever and well-paid advisors. This situation arises in two broad cases. Most commonly the

[190] Cf. Elizabeth Church, "[Finance Minister] Martin calls for harmonization of provinces' securities rules," *Globe and Mail*, May 22 2002, p. B1.

layers of intermediates between owners and managers may so attenuate the bonds of accountability that corporate managements are able to appropriate an increasing slice of the economic value added by the corporation. The long-term secular rise in management compensation is evidence of this trend. Its most recent, and often spectacular, manifestation is the issuance of share options to the most senior managers which dilute the equity of ordinary shareholders and endow their holders with the sort of riches that, in an earlier age, were the prerogative of capitalists and not their hired help. In this light an important element of reform which may emerge from the current welter of suggestions is a proper accounting for the costs of such options, which are now favoured in large measure because they do not appear as costs in financial statements.[191]

The second broad case where concentration poses risks to good governance is when a publicly held corporation has a dominant, controlling, or even majority shareholder. This is more common in Canada than in other counties, notably the United States. In such circumstances the controlling shareholder often nominates all or most board members. The defence against oppression in this case lies even more strongly with fiduciary law and practice. The duty of independent directors to consider and act in the interest of minority shareholders comes to the fore, supported by special provisions in the law and corporate practice: see the example of the Nova Bancorp takeover of Strategic Value above. There are continuing tensions in this relationship, mitigated by the trend in reform recommendations to require boards to have majorities of independent directors, who in turn are to have decisive roles on compensation and audit committees.

Finally, there is the crown corporation – the company wholly owned by a government. While there is no formal bar to their privatization, there is often political reluctance to do so, and despite the hopes of free-market ideologues they will continue to be a part of the Canadian corporate landscape for many years to come.[192] Here the principal threat to good governance also comes from two quarters, but they are different ones. First, board appointees, and to a degree managers, are appointed for reasons that may include but go beyond their experience and fitness for the job. Directors of federal crown corporations must usually be friends of the government in power, and boards conventionally exhibit regional,

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[191] "Coming Clean on Stock Options," *The Economist*, April 27, 2002, 71-77.

[192] "Privatization in Canada and lessons for Russia," chapter 3 in A. Radygin, R. Entov, G. Malginov, Y. Gritson, V. Bondarev, O. Prerdeina, H. Swain, and T. Goodfellow, *Transformation of ownership relationship: comparative analysis of the Russian regions and the general problems of the emergence of the new system of ownership rights in Russia*, Institute for Economy in Transition, Moscow, 2001; also published in Russian.

ethnic, and gender equity in their composition. Here the defence is the institutionalization of a serious and professional appointment capacity in the single shareholder. The problem is that the attention paid to these matters tends to relate rather directly to the keenness of the governing political party and especially the first minister.

The second threat to the good governance of crown corporations is that many do not face the rigours of competition. This is, in fact, a principal justification for their existence as socialized entities. Where competition does not exist or is weak, society may properly defend itself against monopoly abuse in this way. But lack of competition breeds sloth, slack and *schlamperei*, and potentially available economic efficiencies disappear in comforts and compensation for the lucky staff. There does not appear to be a magic bullet for these circumstances, but useful avenues include the deliberate creation of surrogates for competition, such as performance benchmarking and compensation plans that relate to good outcomes. Wide public disclosure and a vigilant press can assist greatly.

These, then, are the principal threats to good corporate governance in Canada. There are others; indeed the enormous variety of corporate circumstances continually throws up all manner of new but more or less idiosyncratic temptations. Keeping these in mind may help Canadians sort their way through the clamourous demands of different advocates for improvements to corporate governance that have arisen in the wake of the recent spate of scandals, both in this country and the United States.

Conclusion

All suggestions for corporate governance development in Russia shall be based upon understanding of the existing social and economic processes. The model of corporate governance is to a very high degree being formed outside the framework of the law. At the same time in Russia at present there exist components of all traditional models: comparatively dispersed property (while the market being non-liquid and institutional investors weak), an explicit and stable trend towards more concentrated property and control (while adequate financing and effective monitoring are being absent), elements of interownership and formation of complicated corporate structures of different types (but in the absence of inclination to any certain type). Before one starts changing anything one should clearly realize who, from whom, what for and to which degree should be protected within the framework of a national model of corporate governance.

In the context of particular features' analysis of **legal control of the corporative sector in regions** the following conclusions can be drawn.

The highest emphasis in regions is placed on different aspects of governmental participation in economic companies, legal norms related to questions of protection of shareholders' rights and the bankruptcy proceedings are less developed, and problems of antimonopoly control are practically not attended to. The priority of questions of government participation in economic companies is confirmed not only by a great number of corresponding legal normative documents and the variety of their topics, but also by the fact that legislative authorities have played a rather active part in their making. Meanwhile, other groups of documents were prepared almost exclusively by executive authorities.

Corporate legislation is developed to a varied degree in different regions. Among the subjects of the Federation that focus their attention on these issues one should name, first of all, the Republic of Tatarstan, the Republic of Bashkortostan, the Altay Republic, Moscow, Moscow oblast, St. Petersburg. One can make a supposition that it is in these regions that authorities aim at establishing the highest possible control of enterprises and business activities.

On the other hand in the republics of Northern Caucasia as well as in a number of oblasts of Central Russia (including Belgorod, Oryol, Kursk, and other oblasts) corporative legislation is totally undeveloped, which can only testify to the effect that regional authorities leave these issues unattended.

Moreover, there is an evident relation between the degree of development of corporative legislations in a certain region and that of its municipalities. As examples of this one can name Bashkortostan and the city of Ufa, Rostov oblast and the city of Rostov-on-Don, Yakutiya and the city of Yakutsk, Buryatiya and its Ulan-Ude. The only exceptions here are Tatarstan and the Altay Republic. As for the first one, one can assume that authorities of this subject of the Federation strive for the highest possible control of all spheres of the corporative law, including those that are usually under the jurisdiction of municipal officials. As for Altay, it is as simple as that: the number of economic companies working on its territory is negligible and there is no need in a developed municipal legislation.

Making an analysis of regions' legislations we didn't find any direct contradictions to the federal corporative legislation. Nevertheless, the analysis gives the impression that authorities of subjects of the Federation easily evade its provisions when it's needed, just by reacting too slowly to new federal laws. Approximately the same situation is being observed with respect to legal normative documents related to protection of shareholders' and investor's rights. The Federal Law "On Protection of Rights and Legitimate Interests of Investors at the Equity Market" was passed in March of 1999, while the majority of regional legal normative documents related to this aspect of corporate legislation was adopted in 1998, which means that their adoption was a response to the presidential Decree "On Measures to Ensure Shareholders' Rights" signed as far back as in 1993. In a certain sense one can speak of inactivity in regional lawmaking.

In the same context one can view the policy currently pursued by the federal centre to unify regional legislations (as a matter of fact, to bring them to conformity with the Constitution of the Russian Federation and federal legislation). Regions' response to this aspect of the federal centre's policy undoubtedly varies, though the tendency to demonstrate their loyalty to the federal government is present. Let us have a look at just two examples.

On the one hand many regional officials were bound to give an adequate response to the requirement of the federal centre about unification of federal and local laws. On the other hand regional authorities (as well as a number of big private groups, which is often the same) were quite negative to the property expansion of the federal centre and its aspiration for establishing control of key financial flows.

It is quite possible that a more detailed analysis of documents relating to concrete enterprises and companies (including decisionы by arbitration tribunals) would uncover a considerable number of violations of federal legislation. This thought is indirectly supported by reports of authorities and arbitration tribunals

filed in regional legislative archives that registered a great number of violations of Russian laws and by-laws.

One can make a supposition that law-making activities of regional authorities directly depend on the activity of territorial departments of federal ministries on their respective territories. This is testified by the fact that among reviewed legal normative documents there were not found documents worked out by territorial departments of the Ministry for Antimonopoly Policy (in contrast to documents prepared, for example, by tax administrations or the Federal Securities Commission bodies), while it's namely these aspects of corporative law that are the least developed in regions.

Namely because of this federal authorities should place a higher emphasis on corporative legislation in regions (in addition to their requirements for unification), which, no doubt, needs a serious revision.

Within the framework of **the empirical study** there were made following conclusions.

First, in contrast to analogous researches done in countries of Eastern Europe there were not detected any significant differences in values of rates of growth of total factor productivity for different privatised groups. Moreover, the change trend in growth rates of total factor productivity in 1998 when going over from enterprises that were privatised earliest to the group of the latest privatised enterprises is directly opposite to the estimated one: the earlier an enterprise was privatised the greater decline in total factor productivity was registered.

Neither in 1999 values of growth rates of total factor productivity for privatised groups were significantly different, though the trend of inter-group changes is reversed: as was expected, enterprises privatised in 1992, 1993 and earlier proved in 1999 to be more effective with respect to the growth rate of total factor productivity, than enterprises, which were privatised later.

Second, the econometric analysis showed that the fact of an earlier privatisation in itself does not necessarily influence the efficiency of enterprise's activities. In such cities as Ekaterinburg, Novosibirsk, Nizhni Novgorod, as well as in the sample as a whole there were not detected a relation of dummy variables that control the effect of privatisation and efficiency. Moreover, even in cases when influence of the effect of privatisation on efficiency of enterprises' activities was detected, this influence not always had a positive character. For example, in Moscow oblast, St. Petersburg and Perm the effect of an earlier privatisation was negative.

It was only in Moscow and Krasnoyarsk that the fact of an earlier privatisation played a positive role in development of enterprises in there cities. Hence,

one can say that the hypothesis about a higher efficiency of activities of companies that were privatised earlier, than others (probably connected with regional specific features of privatisation processes and institutional specific features of development of different regions' economies) has rather a local, than a common character.

Third, there were registered visible regional differences when the analysis of the problem of a possible influence of share capital on efficiency of enterprise's activities was done .

As in the case of privatisation effect, one cannot speak of a common character of the above hypotheses. To give some examples, in Moscow, Nizhni Novgorod, Novosibirsk, Samara, Perm, as well as in the whole of the sample there was not detected any influence on enterprises' activities efficiency on the part of insiders. In St. Petersburg, contrary to generally accepted hypotheses, there was revealed a positive dependence, and only in cases of enterprises in Moscow oblast, Ekaterinburg and Krasnoyarsk such a dependence, as it had been hypothesized, turned out to be negative: the larger the number of shares concentrated in the hands of insiders, the less effective is the performance of the enterprise.

As for influence of outsiders' shares in the capital stock of companies on their activities, in all cases, except for Novosibirsk (where the expected positive dependence was detected), the corresponding variable turned out to be nonsignificant, i.e. one can speak about absence of such influence. Nevertheless, it should be noted, that for some of the cities (namely, for St. Petersburg, Perm, Samara), as well for the sample as a whole a relation between distribution of companies' capital stocks among other Russian enterprises and efficiency (real value added per employee) was registered, this relation being positive in all cases contradictory to generally accepted hypotheses. This fact is also notable because among outsiders the largest share holdings belonged exactly to other Russian enterprises.

Fourth, when testing the hypothesis about relation between the Board of Directors' pattern at an enterprises and its efficiency the collected data testified to the effect that in many cases (in Moscow, St. Petersburg, Krasnoyarsk, Samara and in the sample as a whole) none of parameters that characterise special features of enterprise governance exerted any influence on enterprise's efficiency. Influence of insiders at the Board of Directors on the efficiency of company's activities turned out to be positive for enterprises in Moscow oblast and negative for companies in Nizhni Novgorog. In a still smaller number of cases there was registered a relation between the rest of features of Board of Directors' patterns and companies' efficiency: in Perm there was registered a positive influence of outsiders, in Novosibirsk and Ekaterinburg also a positive influence of represent-

atives of other Russian industrial enterprises and foreign representatives correspondingly, and in Novosibirsk there was registered a negative dependence of companies' efficiency on the share of regional governments in the Board of Directors.

As it follows from the above described results, on cannot speak of a homogeneity of data for different regions, as well as for the sample as a whole. Most interesting from our point of view are the results of estimates for Novosibirsk, Moscow oblast and Krasnoyarsk.

Novosibirsk differs from the rest of the cities in the sample by the fact that for its enterprises there exists a significant influence of such factors as the share of outsides in capital stocks of enterprises, the share of representatives of Russian enterprise in the Board of Directors and the share of representatives of regional governments in the Board of Directors. This is actually the only city in the sample, where influence of these factors is at all registered. It should be noted that the character of influence on efficiency of enterprises' activities on the part of outsiders and regional governments completely agrees with the assumptions: there are observed both positive and negative influences, correspondingly. As for influence of the share of representatives of Russian enterprises in capital stocks on companies' activities, one can in principle suppose that its character can be both positive and negative. In this case the influence is positive.

The model that was developed for Moscow oblast is notable for the fact that on the one hand is shows a negative influence of the effect of an early privatisation on subsequent activities of enterprises, and on the other hand the same negative influence of a big share of insiders in enterprises' stock capitals. Hence, in this case one can speak of a negative role of privatisation performed in the interests of insiders. On the other hand, it's noteworthy that the presence of a large number of insiders at the Board of Director has a positive influence on the efficiency of enterprise's activities.

Calculations made for Krasnoyarsk show the presence of a positive effect of an early privatisation and a negative dependence of enterprises' activities efficiency on the large share of insiders in the stock capital. Influence of insiders' share in the Board of Directors, on the one hand, is insignificant, on the other hand exclusion of this variable from the regression rather seriously degrades its quality with respect to the value of the adjusted R^2.

On the whole with respect to **general recommendations in the sphere of corporate governance** one can formulate following suggestions:

Basic suggestions to improve corporate governance[193]

Problem	Current legislation	Measure to improve the situation
Guarantees for registration of investors' proprietary rights in companies' registers	The Law "On Equity Market", legal normative documents by the Federal Securities Commission of the Russian Federation	Work out standard terms and conditions for contracts with registers' holders Choose a register holder, terms and conditions of the contract shall be approved by the annual shareholders meeting Liability of register holders for frauds and register manipulations on the part of the register's owners (the owner or issuer)
"Dispersion" of shares by issuing new stocks	The Law "On Joint-Stock Companies" The Law "On Protection of Investors' Rights and Legitimate Interests" Standards by the Federal Securities Commission	Control the procedure of issue of convertible bonds Detailed elaboration of fractional shares, especially in cases of preemptive rights application
Violation of shareholders meetings procedures	The Law "On Joint-Stock Companies"	- legal settlement of unclear question (for example, posting ballots in the way that they are received after the meeting, shall be interpreted as a *material* infringement of rights that allows a subsequent (taking the case into court) exit from the joint-stock company receiving a compensation - regular checkups of general meetings convening and resolution release procedures (including the terms and procedures adopted in 2001)
Assignation of votes to company's managers in cases of ADR or GDR	Legal normative documents by the Federal Securities Commission	veto issue of ADRs and GDRs if they envisage assignation of votes to company's managers
Violations in companies'	The Law "On Joint-Stock	- to expand reorganisation types, making corresponding amendments to the Civil Code of the Russian Federa-

[193] Also used are materials of the Institute for Corporate Law and Control, recommendations of the OECD Round Table on questions of corporate governance in Russia (meetings in 1999-2001) and the White Book project on issues of corporate governance in Russia.

Problem	Current legislation	Measure to improve the situation
reorganisation and consolidation	Companies"	tion, the Law "On Joint-Stock Companies", and other. - in addition to the fulfilled requirement of preserving the property pattern when the company is reorganises, there is a need for a system of measures to protect creditors' rights - introduction of the requirement to invite an independent appraiser - improve information disclosure
Violation of the information disclosure requirement	The Law "On Joint-Stock Companies", the Law "On Equity market", the Law "On Protection of Rights and Legitimate Interests of investors", Standards by the Federal Securities Commission	- improve legislation on information disclosure - prohibit the practice of asymmetric information disclosure to some privileged parties and use of considerably important and confidential information in self-interest - introduce international accounting standards - establish criminal liability for nondisclosure of information
Nontransparent property and control patterns (exposing the property and control patterns is required to solve the problem of possible misuses related to deals with interested parties, including use of offshore and trust companies that are controlled by the management and	A considerable number of legal normative documents containing contradictory requirements (Some of these documents proceed from percentage of shares in registered capital, other deal with percentage of voices. Some legal documents also take in account the indirect control exerted through nominal owners. Finally, in	- a consistent and logical legislative basis to establish procedures and distribution of responsibility among all parties (shareholders, issuers, register holders, asset managers and the Federal Securities Commission); - establishing a legal norm prescribing that disclosure of information about changes in company's property to the stock exchange and the public as a whole is shareholders' responsibility, both domestic and foreign ones'; - legislative norms related to information disclosure shall unambiguously view cases of concerted action by parties and cases of participation of parties which are "de facto" or "de jure" are under interested parties' control. Sanctions for failure of information disclosure shall also be envisaged for such cases. - shareholders in open-type companies are obliged to inform the issuer, the stock market and mass media about their properties to the degree prescribed by the law. This responsibility to disclose one's own participation in property shall also be applied to property registered through nominal owners. Financial institutes that were granted the right to keep such counts of nominal owners and register holders shall also be accountable for

Problem	Current legislation	Measure to improve the situation
controlling shareholders.)	accordance with current regulations, there are no requirements prescribing to disclose even official agreements between shareholders).	violation of information disclosure requirements. - the Law shall also envisage adequate and understandable criminal and civil sanctions for failures to disclose information about considerable changes in property. These sanctions shall also apply to shareholders, issuers, register holders and organizations in charge of register keeping.
"Withdrawal" of assets	The Law "On Joint-Stock Companies", the Criminal Code of the Russian Federation (art. 165, 201, 204)	- reform of labour legislation (simplification of the procedure of dismissal from the office of director general) - improvement of financial accounts forms - more stringent and precise requirements to procedures in big deals and deals with interested parties - qualification of deals with affiliated persons, a wider notion of "affiliated persons" - working out of "a group of legally independent but economically connected persons" concept
Transfer price formation	The Law "On Joint-Stock Companies", the Criminal Code of the Russian Federation (art. 165, 201, 204)	- improvement of tax legislation and its enforcement - improvement of financial accounts forms
Deliberate (fictitious) bankruptcy with a subsequent buying up of assets	The Law "On Insolvency (bankruptcy), the Criminal Code of the Russian Federation	- introduce liability limits for arbitrage managers for actions (assets deals) in the interests of some of creditors - work out legislation on disqualification of managers, whose actions caused damages to organisations they are heads of or their creditors - take extra measures (criteria of starting up of bankruptcy procedure) to prevent unfair redistribution of property and legal proceedings against virtually solvent enterprises - more extensive use of the nonsuit practice by courts in cases when the bankruptcy procedure is used as a common means of acquittance (as abuse of rights in accordance with art. 10 of the Civil Code of the Russian Federation) - precise the role of governmental bodies (as creditors and representatives of state interests) and the procedure of their participation in bankruptcy processes

Problem	Current legis-lation	Measure to improve the situation
Unfounded suits against (blackmailing of) issuers (principal shareholders)	Court practice only	- introduce the procedure of alternative resolution of cases: administrative or arbitration hearings by a state regulative body, - develop the system of courts of arbitration within the framework of self-regulated organisations (SRO), - work out provisions aimed at protection of boards of directors (managers) of companies against abuse by small shareholders through (a) verification of validity of action, (b) use of the so called "safe harbours" (such means of legal assistance as the rule of "discretion case" or renunciation of ungrounded claims of information disclosure), (c) solving the problem of actions at law on the part of a shareholder – "owner of a single share" (introduction of quotas or elaboration of requirements to group suits.)
Enforcement (including the problem of insurance of shareholder's opportunity go to the law)	A complex of legal norms and procedural rules	- continuously create judicial precedents (for example, according to the Law "On Joint-Stock Companies" a shareholder is entitled to claim damages in favour or the company caused to it trough the management's fault. A description of such damages in legislation is in fact impossible, that is why concrete court decisions are important) - reform the judicial system as a whole - provide a complex of anticorruption measures - improve the commercial law, in particular legislation on companies, the law on securities and the bankruptcy law - teach judges the basic concepts of business intercourse, as far as the lack of a previous business experience leads to an excessively literal use of laws; - stydy the possibility of an intensified specialization of judges in the sphere of commercial law (establish specialized units in arbitration tribunals that will deal with corporate suits and actions for securities) - publish openly and distribute written court opinions and decisions with the aim to enhance the responsibility of the judicial system - develop the mechanism of private settlement of disputes and professional independent arbitration proceedings (the system of extrajudicial procedure of settlement of disputes: administrative hearings or independent arbitration proceedings).

Appendix 1
Questionnaire for industrial enterprises observations

NUMBER OF THE ENTERPRISE		THE QUESTIONNAIRE'S INPUT NUMBER	
THE COMPLETE NAME OF THE ENTERPRISE			
ENTERPRISE'S CODE (the OKPO-code)		THE BRANCH CODE (the OKONH-code)	
REGION	1 Moscow 2 Moscow oblast 3 St. Petersburg 4 Leningrad oblast 5 Nizhni Novgorod 6 Samara 7 Ekaterinburg	8 Perm 9 Novosibirsk 10 Krasnoyarsk 11 Volgograd 12 Chelyabinsk 13 Omsk 14_____	
THE COMPLETE POSTAL ADDRESS OF THE ENTERPRISE			
TELEPHONE NUMBER OF THE ENTERPRISE		FAX NUMBER OF THE ENTERPRISE	
FULL NAME OF THE RESPONDENT			
THE RESPONDENT'S OFFICE	1 Director general 2 Deputy director general 3 Director of economics 4 Finance director 5 Other (write in) _____		
DATE OF THE INTERVIEW (IN NUMBERS)		Day	Month
THE YEAR OF ENTERPRISE'S PRIVATISATION			
LEGAL OWNERSHIP FORM OF THE ENTERPRISE	1 Open-type joint-stock company 2 Closed joint-stock company 3 Limited society 4 Production cooperative 5 Other (write in) _____		
NAME OF THE INTERVIEWER		NUMBER OF THE INTERVIEWER	
The present interview was made by me in person, strictly according to the instructions. Before I handed in this questionnaire I checked that it was fully and correctly filled in. I pledge that I will not disclose the information received by me, nor give it to anybody else, than GfK			THE INTERVIEWER'S SIGNATURE

RESTRUCTURING

(15)	Which of the listed reforms were performed at Your enterprise in the past three years and when (state the year)? ASK ABOUT EACH OF THE REFORMS SEPARATELY. In case there were no reforms in the mentioned years, ask why.

	The year of the reform /SEVERAL ANSWERS ARE POSSIBLE /			Why the reform was not performed in the past three years? /ONE ANSWER ONLY/					
	1997	**1998**	**1999**	The reform was done prior to 1997	Would like to make the reform, but have not done it due to some reasons	The reform was not needed, neither is needed now	Undecided	Refuse to give an answer	With respect to us this question has no meaning
Production start of fundamentally new types of products or services*	1	2	3	4	5	6	7	8	9
Taking unprofitable types of products out of production	1	2	3	4	5	6	7	8	9
Social expenditures cuts	1	2	3	4	5	6	7	8	9
Reduction of the staff	1	2	3	4	5	6	7	8	9
Development of new sales markets	1	2	3	4	5	6	7	8	9
Increase in products' marketing expenses	1	2	3	4	5	6	7	8	9
Reorganisation of management	1	2	3	4	5	6	7	8	9
Application of new technologies to cut fuel and energy consumption	1	2	3	4	5	6	7	8	9
Application of new technologies to cut raw materials and labour expenses	1	2	3	4	5	6	7	8	9
Application of new technologies to increase products' quality	1	2	3	4	5	6	7	8	9

Liquidation (closedown) of nonprofitable workshops	1	2	3	4	5	6	7	8	9
Sale (lease) of excessive equipment	1	2	3	4	5	6	7	8	9
Sale (lease) of immovable property or land	1	2	3	4	5	6	7	8	9
Changing suppliers	1	2	3	4	5	6	7	8	9
Restructuring of accounts payable	1	2	3	4	5	6	7	8	9

* Fundamentally new products are meant here, not just changing models.

(16)	Which types of taxes and duties are the most significant ones for Your enterprise and need to be reduced in the first place? A MAXIMUM OF TWO ANSWERS

Payroll charges	1
Value added tax	2
Profit tax	3
Land and property tax	4
Other /WRITE IN /	
Undecided	5
Refuse to give an answer	6

(17)	Has Your enterprise ever encountered administrative or other non-market barriers that impeded the development of Your business?	
	Yes	1
	No	2
	Undecided	3
	Refuse to give an answer	4

IF "NO", SKIP THE FOLLOWING QUESTION

(18)	Which of these constitute the most serious problems for Your enterprise. A MAXIMUM OF TWO ANSWERS

Getting a permit or a license for new types of activities or construction is a problem	1
Constraints on the part of regional administrations in other regions to develop sales markets for Your products	2
An excessive and biased control on the part of controlling organisations (sanitary-and-epidemiologic institutions, fire, tax, ecological authorities, etc.)	3
Crime-related pressure	4
Other /WRITE IN /	
Undecided	5
Refuse to give an answer	6

SHOWINGS OF ENTERPRISE'S ACTIVITIES

(19)	As You see it, how much of the enterprise's equipment facilities (in %) were averagely used in the past three years? We mean, how large was the produce as compared to the highest possible, should equipment facilities be fully used?

	1997	**1998**	**1999**
The degree of equipment facilities' use	%	%	%
Undecided	1	1	1
Refuse to give an answer	2	2	2

(20)	At the present moment how large are the parts of the enterprise's equipment facilities that can be referred to the following age categories? **SHOW CARD 1**

Manufactured less, than 5 years ago	%
Manufactured 6 to 10 years ago	%
Manufactured 11 to 15 years ago	%
Manufactured more, than 15 years ago	%
PRODUCTION CAPACITIES, TOTAL	**100%**
Undecided	1
Refuse to give an answer	2

(21)	In view of technologies in use and production volumes, how can You assess the number of employees at Your enterprise compared to the optimal number **SHOW CARD 2**

Exceeds the optimal number by more, than 20%	1
Exceeds the optimal number by 11% -20%	2
Exceeds the optimal number by 5 -10%	3
Equals the optimal number	4
Is less, than the optimal number by 5 -10%	5
Is less, than the optimal number by more, than 10%	6
Undecided	7
Refuse to give an answer	8

(22)	If we take different geographical markets that Your enterprise is active at, what were the sales volumes' shares (percentage wise) at each of them in the past three years?

		1997		**1998**		**1999**	
	Sales, total	**100 %**		**100 %**		**100 %**	
a)	Russian domestic market	%		%		%	
b)	Including: the oblast/kray market		%		%		%

c)	Exports (total)	%		%		%	
	Including:						
d)	CIS countries		%		%		%
e)	other countries		%		%		%
	Undecided	1		1		1	
	Refuse to give an answer	2		2		2	

Note: a + c =100%; b <= a; d + e = c

BUSINESS COMPETITION

(23)	If one takes the principal types of Your products (services), how many domestic competitors does Your enterprise have at the oblast/kray level? At the whole of the Russian market /GIVE ONE ANSWER IN EACH LINE/						
		No competitors	1 enterprise	2-5 enterprises	More, than 5 enterprises	Undecided	Refuse to give an answer
	At the oblast/kray market	1	2	3	4	5	6
	At the market of Russia (including that of the oblast)	1	2	3	4	5	6

Note: as competitors any other manufactures of the same product are meant.

IF THE ANSWER IS "NO COMPETITORS",
SKIP THE NEXT QUESTION

(24)	Do any of the enterprises-competitors that you spoke of belong to foreign owners, are they joint ventures with foreign capital?	
	Yes	1
	No	2
	Undecided	3
	Refuse to give an answer	4

(25)	Do you feel any serious competition from imported goods?	
	Yes	1
	No	2
	This kind of products/services cannot be imported in principal	3
	Undecided	4
	Refuse to give an answer	5

(26)	Imagine that You have decided to advance the price for Your main product by 10% compared to the current price (after having taken in consideration the inflation and against the background of unchanged current competitors' prices). How will Your sales change as a result of this in natural numbers?	
	Will fall by more, than 10%	1
	Will fall by approximately 10%	2
	Will fall by less, than 10%	3
	Will remain unchanged	4
	Undecided	5
	Refuse to give an answer	6

FINANCE

(27)	Imagine a situation, when Your enterprise needs a short-term banking credit (with repayment in less, than 3 months) on a commercial basis. What will be the annual crediting rate You will have to pay?	%
	Undecided	1
	Refuse to give an answer	2

(28)	Imagine a situation, when Your enterprise needs a banking credit. What would be the maximum term that a bank would give Your enterprise a credit for?	
	< 1 month	1
	1-3 months	2
	4-6 months	3
	7-12 months	4
	1-2 years	5
	3-5 years	6
	> 5 years	7
	Getting a credit on commercial conditions is not possible	8
	Undecided	9
	Refuse to give an answer	10

(29)	Imagine a situation, when Your enterprise needs a banking credit on commercial conditions. How easy it would be for Your enterprise to obtain a short-term banking credit? **SHOW CARD 3**, /ONE ANSWER IN EACH COLUMN/

	A short-term banking credit on commercial conditions	A long-term banking credit on commercial conditions
Very easy	1	1
Quite easy	2	2

Rather difficult	3	3
Very difficult	4	4
Impossible	5	5
Undecided	6	6
Refuse to give an answer	7	7

(30)	Have Your enterprise received any financial support from the federal and/or regional/local budget in the past three years in any of the following forms? ASK ABOUT EACH OF THE FORMS SEPARATELY /OCCURENCE OF 1 AND 2 SIMULTANEOUSLY IS POSSIBLE /

		Received form the federal budget	Received form the region-al/local budget	Did not receive any support	Undecided	Refuse to give an answer
	A credit	1	2	3	4	5
	Tax allowances	1	2	3	4	5
	Tax immuni-ties	1	2	3	4	5
	Restructuring of tax debts	1	2	3	4	5
	Subsidies	1	2	3	4	5
	Other	1	2	3	4	5

(31)	Imagine a situation, when Your enterprise needs some kind of financial support (of the types listed in the previous question). How easy it would be for Your enterprise to get financial support from the federal budget? From the regional/local budget? **SHOW CARD 3 /**ONE ANSWER IN EACH COLUMN /

	From the federal budget	From the regional/local budget
Very easy	1	1
Quite easy	2	2
Rather difficult	3	3
Very difficult	4	4
Impossible	5	5
Undecided	6	6
Refuse to give an answer	7	7

QUESTIONS 32 AND 32 ARE PUT ONLY TO **OPEN-TYPE JOINT-STOCK COMPANIES** AND **CLOSED JOINT-STOCK COMPANIES** (CHECK BY THE ANSWER ON THE COVER)

(32)	Imagine a situation, when Your enterprise needs additional financing. How easy could You get the financing by issuing additional shares and selling them to Russian investors? **SHOW CARD 3**

	Very easy	1
	Quite easy	2
	Rather difficult	3
	Very difficult	4
	Impossible	5
	Undecided	6
	Refuse to give an answer	7

(33)	Imagine a situation, when Your enterprise needs additional financing. How easy could You get the financing by issuing additional shares and selling them to foreign investors? **SHOW CARD 3**

	Very easy	1
	Quite easy	2
	Rather difficult	3
	Very difficult	4
	Impossible	5
	Undecided	6
	Refuse to give an answer	7

(34)	Does Your enterprise have a minimal allowable profitability level or a maximum period for recoupment of capital investments when You make assessments of investments to the fixed capital?	
	Yes	1
	No	2
	Undecided	3
	Refuse to give an answer	4

CONTINUE, IF "YES". IN OTHER CASES GO OVER TO QUESTION 35.

If "Yes", what is		
	The minimal allowable profitability level	%
AND/OR	The maximum period for the recoupment	months
	Undecided	1
	Refuse to give an answer	2

(35)	Did Your enterprise make any big investments to the fixed capital after August of 1998?	
	Yes	1
	No	2
	Undecided	3
	Refuse to give an answer	4

(36)	What were the sources of investments to the fixed capital in 1997, 1998 and 1999? Please, give an assessment in % (total investments to the fixed capital – 100%) **SHOW CARD 4**

		1997	**1998**	**1999**
	TOTAL	**100%**	**100%**	**100%**
	The enterprise's internal funds	%	%	%
	Additional issue of shares and/or bonds sold at the open market	%	%	%
	Banking credits	%	%	%
	Means from the federal budget and off-budget funds	%	%	%
	Means from the oblast/kray budget	%	%	%
	Russian private investors	%	%	%
	Foreign private investors	%	%	%
	Other sources	%	%	%
	No investments to the fixed capital were made	3	3	3
	Undecided	1	1	1
	Refuse to give an answer	2	2	2

Note: in case the respondent cannot give an exact answer, please, ask him to give his approximate estimate.

(37)	Imagine the following situation for Your enterprise. The incoming cash flow for a given quarter is 10% lower, than planned. The temporal cash gap in three months equals to 10% of sales. (Please, point out that the money is coming, but will be overdue). But **the need for circulating capital and the production level remain the same**. In what way will You cover the deficit of financial means? Please, name 3 or 4 main sources. Please, estimate the share of each of them in %. **SHOW CARD 5**

			100%
	Sales of short-term financial investments	1	%
	Banking credit	2	%
	Suppliers' credit	3	%
	Delaying payments to suppliers/for utilities	4	%

	Issue of promissory notes	5	%
	Barter settlements	6	%
	Delaying payments to the budget (taxes) and off-budget funds	7	%
	Arrears of wages and salaries	8	%
	Subsidies from the government	9	%
	Other	10	%
	This can be done only by a reducing the production output of the enterprise	11	
	Undecided	12	1
	Refuse to give an answer	13	2

Note: in case the respondent says that it depends on the situation, ask him to imagine that the situation in question emerged today.

(38)	What was the share (%) of each of the below listed forms of settlement with suppliers in 1999? **SHOW CARD 6**	
	Cash and clearing	%
	Promissory notes	%
	Reciprocal settlements	%
	Barter	%
	Other	%
	TOTAL	**100%**
	Undecided	1
	Refuse to give an answer	2

(39)	What was the share (%) of each of the below listed forms of settlement with buyers in 1999? **SHOW CARD 6**	
	Cash and clearing	%
	Promissory notes	%
	Reciprocal settlements	%
	Barter	%
	Other	%
	TOTAL	**100%**
	Undecided	1
	Refuse to give an answer	2

PROPERTY

QUESTIONS 40 TO 43 ARE ONLY PUT TO OPEN-TYPE JOINT-STOCK COMPANIES AND CLOSED JOINT-STOCK COMPANIES (CHECK WITH THE ANSWER ON THE COVER)

(40)	What was an approximate distribution of shares of Your enterprise among different groups of shareholders (in %)? **SHOW CARD 7**

	As of the moment of privatisation	As of January 1, 2000
TOTAL	**100%**	**100%**
Workers/employees of the enterprise	%	%
Enterprise's managers	%	%
Former employees of the enterprise	%	%
Federal public authorities	%	%
Regional and local public authorities	%	%
Russian enterprises	%	%
Russian banks and commercial credit companies (including finance and industrial groups)	%	%
Foreign enterprises and banks	%	%
Other	%	%
Undecided	1	1
Refuse to give an answer	2	2

Note: in case the respondent cannot give an answer on workers and managers separately, ask him about all those employed by the enterprise (workers + managers)

(41)	Possessed any single shareholder more than 25% of common shares as of the moment of privatisation? As of January 1, 2000? /ONE ANSWER IN EACH LINE /

		Yes	No	Undecided	Refuse to give an answer
	As of the moment of privatisation	1	2	3	4
	As of January 1, 2000	1	2	3	4

(42)	Possessed any single shareholder more than 50% of common shares as of the moment of privatisation? As of January 1, 2000? /ONE ANSWER IN EACH LINE /

		Yes	No	Undecided	Refuse to give an answer
	As of the moment of privatisation	1	2	3	4
	As of January 1, 2000	1	2	3	4

IN CASE THE ANSWER IN ANY OF THE LINES OF QUESTION 42 IS "YES", SKIP THE CORRESPONDING LINE IN ANSWERING THE NEXT QUESTION

(43)	Possessed any two or three of shareholders more than 50% of common shares together as of the moment of privatisation? As of January 1, 2000? /ONE ANSWER IN EACH LINE /

		Yes	No	Unde-cided	Refuse to give an answer
	As of the moment of pri-vatisation	1	2	3	4
	As of January 1, 2000	1	2	3	4

OPERATION OF THE BUSINESS

(44)	Is Your company a part of any financial and industrial group or a member of any association? /SEVERAL ANSWERS ARE POSSIBLE/

No	1
A member of a regional association of manufactures	2
A member of a national association of manufactures	3
A part of a financial and industrial group	4
Other	5
Undecided	6
Refuse to give an answer	7

(45)	When was the chief executive of Your enterprise appointed/elected to his office?	In the year of
	Undecided	1
	Refuse to give an answer	2

(46)	When did the chief executive start working for the enterprise in any capacity?	In the year of
	Undecided	1
	Refuse to give an answer	2

(47)	Was the chief executive appointed/elected in-stead of a dismissed executive, or an executive that failed in his office?	
	Yes	1
	No	2
	Undecided	3
	Refuse to give an answer	4

(48)	Representatives of which of the below listed groups are at the Board of Directors of Your enterprise? What is their number? **SHOW CARD 8**		
			Number of member:
	Total		
	Including:		
	Representatives of employees	1	
	Representatives of the company's managers	2	
	Representatives of federal public authorities	3	
	Representatives of regional and/or local public authorities	4	
	Foreign representatives	5	
	Representatives of Russian banks	6	
	Representatives of Russian investment companies and funds	7	
	Representatives of other Russian industrial enterprises	8	
	Big Russian investors – private persons	9	
	Other	10	
	Undecided	11	1
	Refuse to give an answer	12	2

(49)	Does Your enterprise have a foreign investor?	
	Yes	1
	No	2
	Undecided	3
	Refuse to give an answer	4

(50)	Has any of the high executives at the enterprise (3-4 of them holding high offices) the following education?

		Yes	No	Undecided
	Higher education in economics received in Russian	1	2	3
	Higher education in economics received abroad	1	2	3
	Courses for managers attended in Russia in the past 5 years	1	2	3
	Courses for managers attended abroad in the past 5 years	1	2	3
	MBA degree received in Russian	1	2	3
	MBA degree received abroad	1	2	3

Note: MBA is Master of Business Administration

(51)	Has Your enterprise ever hired an external consulting company for employees training and project development? /SEVERAL ANSWERS ARE POSSIBLE/

		Yes, prior to 1997	Yes, in 1997-2000	Never	Unde-cided	Refuse to give an an-swer
	A foreign governmental or a nongovernmental organization	1	2	3	4	5
	A private foreign con-sulting company	1	2	3	4	5
	Private domestic con-sultants	1	2	3	4	5

Note: auditing is not included

ENCLOSURE TO THE QUESTIONNAIRE

COMPLETE NAME OF THE ENTERPRISE			THE NUMBER OF THE ENTERPRISE (taken from the executive's ques-tionnaire)
CODE OF THE ENTER-PRISE (THE OKPO-code)		THE BRANCH CODE (THE OKONH-code)	
PLEASE, WRITE, WHO ONE CAN TURN TO IN CASE THERE'S NEED TO SPECIFY SOME FIGURES (FULL NAME AND TELEPHONE NUMBER)			

Please, don't leave any table columns blank.

If any index equals to zero, please, put a "0" or a "-" in the corresponding cell.

INDICES OF ENTERPRISE'S ACTIVITIES

(52)	What was the average number of the permanent staff (employees on the payroll) at Your enterprise in each of the past three years? Note: can be calculated on the basis of statistics form nr. P-04, line 02

	1997	**1998**	**1999**
Average number of the perma-nent staff			

(53)	What was the average number of part-time workers (ones that combine jobs and term-contract workers) at Your enterprise in each of the past three years? Note: can be calculated on the basis of statistics form nr. P-04, lines 03+04

	1997	**1998**	**1999**
Part-time workers			

(54)	What were the average gross monthly wages and salaries of permanent employees at Your enterprise (employees on the payroll) in roubles (including additional payments and bonuses that are included into the wage fund, but prior to payments to social funds) in each of the past three years? Note: can be calculated on the basis of statistics form nr. P-04, line 02

Average monthly wages and salaries of employees	**1997**	**1998**	**1999**
	Roubles	Roubles	Roubles

(55)	What were the sales proceeds and cost prices of sold products and services in 1997, 1998 and 1999? What were profits and losses of Your enterprise (in thousands of roubles)? Note: the data can be taken from form nr. 2 “Report on profits and losses”

	Line code	**1997**	**1998**	**1999**
Products/services sales proceeds (excluding the VAT and excise-duties	010	thousand roubles	thousand roubles	thousand roubles
Cost prices of sold products/services	020	thousand roubles	thousand roubles	thousand roubles
Sales profits:	050			
In case of profit		thousand roubles	thousand roubles	thousand roubles
In case of losses		- thousand roubles	- thousand roubles	- thousand roubles
Interest payable	070	thousand roubles	thousand roubles	thousand roubles
Profits in the accounting period:	140			
In case of profit		thousand roubles	thousand roubles	thousand roubles
In case of losses		- thousand roubles	- thousand roubles	- thousand roubles
Taxation of profits	150	thousand roubles	thousand roubles	thousand roubles
Undecided		1	1	1
Refuse to give an answer		2	2	2

(56)	What was the structure of costs at Your enterprise in 1997, 1998 and 1999 (in thousand roubles) Note: the data can be taken, for example, from the Enclosure to the Balance schedule, form nr. 5, Part 6.

	Line codes	**1997**	**1998**	**1999**
Material costs	610	thousand roubles	thousand roubles	thousand roubles
Wage costs	620	thousand roubles	thousand roubles	thousand roubles
Assessments to social needs	630	thousand roubles	thousand roubles	thousand roubles
Depreciation of fixed assets	640	thousand roubles	thousand roubles	thousand roubles
Other costs	650	thousand roubles	thousand roubles	thousand roubles
Costs TOTAL	**660**	**thousand roubles**	**thousand roubles**	**thousand roubles**
Of these accredited to non-productive accounts	661	thousand roubles	thousand roubles	thousand roubles
Undecided		1	1	1
Refuse to give an answer		2	2	2

(57)	How much funds did Your enterprise spend on investments to the fixed capital each of the past three years? Investments into buildings and structures and investments into machinery and equipment are meant. Note: the data can be taken, for example, from statistics form nr. P-2, Part 2, lines 27 and 28.

	1997	**1998**	**1999**
Investments into buildings (except for residential constructions) and structures	thousand roubles	thousand roubles	thousand roubles
Investments into machinery, equipment, tools	thousand roubles	thousand roubles	thousand roubles
Undecided	1	1	1
Refuse to give an answer	2	2	2

(58)	What was the balance status of Your enterprise as of the end of the year (in thousand roubles)?

	Line code	1997	1998	1999
BALANCE	**399**	**thousand roubles**	**thousand roubles**	**thousand roubles**
I. Capital assets	**190**	**thousand roubles**	**thousand roubles**	**thousand roubles**
Including:				
Intangible assets	110	thousand roubles	thousand roubles	thousand roubles
Fixed assets	120	thousand roubles	thousand roubles	thousand roubles
II. Circulating assets	**290**	**thousand roubles**	**thousand roubles**	**thousand roubles**
Including:				
Stock	210	thousand roubles	thousand roubles	thousand roubles
Accounts receivable from buyers and customers with expected settlement within 12 months	241	thousand roubles	thousand roubles	thousand roubles
Money means	260	thousand roubles	thousand roubles	thousand roubles
III. Losses	**390**	**thousand roubles**	**thousand roubles**	**thousand roubles**
IV. Capital and working balances	**490**	**thousand roubles**	**thousand roubles**	**thousand roubles**
V. Long-term liabilities	**590**	**thousand roubles**	**thousand roubles**	**thousand roubles**
VI. Short-term liabilities	**690**	**thousand roubles**	**thousand roubles**	**thousand roubles**
Including:				
Arrears of wages	624	thousand roubles	thousand roubles	thousand roubles
Undecided		1	1	1
Refuse to give an answer		2	2	2

Note: 190+290+390=399, 490+590+690=399

(59)	What was the total volume of accounts receivable from buyers and customers by the end of the year? What was the volume of **overdue** accounts receivable from buyers and customers? Note: the data can be taken, for example, from statistics form nr. P-3, Part 1, line 05

	1997	**1998**	**1999**
Accounts receivable from buyers and customers	thousand roubles	thousand roubles	thousand roubles
Of these overdue	thousand roubles	thousand roubles	thousand roubles
Undecided	1	1	1
Refuse to give an answer	2	2	2

(60)	What were the amounts of the following accounts payable by the end of the year?
(61)	How much of these were overdue? Note: the data can be taken, for example, from statistics form nr. P-3, Part 1, lines 10, 13, 14, 16.

	Line number	Accounts payable, TOTAL			Of these overdue		
		As of December 31, 1997	**As of December 31, 1998**	**As of December 31, 1999**	**As of December 31, 1997**	**As of December 31, 1998**	**As of December 31, 1999**
Debts to budgets (federal and local)	10	thousand roubles	thousand roubles	thousand roubles	thousand roubles	thousand roubles	thousand roubles
Debts to off-budget funds	13	thousand roubles	thousand roubles	thousand roubles	thousand roubles	thousand roubles	thousand roubles
Debts to suppliers	14	thousand roubles	thousand roubles	thousand roubles	thousand roubles	thousand roubles	thousand roubles
Credit and loan debts	16	thousand roubles	thousand roubles	thousand roubles	thousand roubles	thousand roubles	thousand roubles
Undecided		1	1	1	1	1	1
Refuse to give an answer		2	2	2	2	2	2

Appendix 2
List of variables.

$\frac{Y_{i,t}}{L_{i,t}}$ – real value added per employee of company *i* in the year of *t*,

$K_{i,t}$ – capital value of company *i* in *t*,

$M_{i,t}$ – material costs of company *i* in *t*,

$R_{i,t}$ – the level of equipment facilities use by company *i* in *t*,

$L_{i,t}$ – average number of payroll employees in company *i* in *t*.

$priv92_i = \begin{cases} 1, \text{if the enterprise was privatised not later, than in 1992} \\ 0, \text{otherwise} \end{cases}$

$priv93_i = \begin{cases} 1, \text{if the enterprise was privatised not later, than in 1993,} \\ 0, \text{otherwise} \end{cases}$

$priv93\_92_i = \begin{cases} 1, \text{if the enterprise was privatised in 1993 } \textit{году}, \\ 0, \text{otherwise} \end{cases}$

Ins_i = the share of insiders in the share capital of the enteprise,,

$Work_i$ = the share of workers in the share capital of the enterprise,

$Manage_i$ = the share of managers in the share capital of the enterprise,

$Outs_i$ = the share of outsiders in the share capital of the enterprise.

Rus_i = the share of Russian enterprises in the share capital of the enterprise,

reg_i = the share of regional public authorities in the share capital of the enterprise,

Ins_g_i = the share of insiders in the Board of Directors,

$Outs\_g_i$ = the she of outsiders in the Board of Directors,

Rus_g_i = the share of representatives of Russian enterprises in the Board of Directors,

For_g_i = the share of representatives of foreign companies in the Board of Directors,,

$\mathrm{Re}g\_g_i$ = the share of representatives of regional public authorities in the Board of Directors..

$$\sec i = \begin{cases} 1, \text{if the enterprise belongs to sector i (i } = 13, \ldots, 18), \\ 0, \text{otherwise} \end{cases}$$

13 = chemical industry;
14 = mechanical engineering;
15 = timber industry;
16 = building materials industry;
17 = light industry;
18 = food industry.

$$Moscow = \begin{cases} 1, \text{if the enterprise is located in Moscow,} \\ 0, \text{otherwise,} \end{cases}$$

$$MosReg = \begin{cases} 1, \text{if the enterprise is located in Moscow oblast,} \\ 0, \text{otherwise,} \end{cases}$$

$$S\_Pb = \begin{cases} 1, \text{if the enterprise is located in St. Petersburg,} \\ 0, \text{otherwise,} \end{cases}$$

$$Ekat = \begin{cases} 1, \text{if the enterprise is located in Ekaterinburg,} \\ 0, \text{otherwise,} \end{cases}$$

$$Krasn = \begin{cases} 1, \text{if the enterprise is located in Krasnoyarsk,} \\ 0, \text{otherwise,} \end{cases}$$

$$N\_Nov = \begin{cases} 1, \text{if the enterprise is located in Nizhni Novgorod,} \\ 0, \text{otherwise,} \end{cases}$$

$$Novos = \begin{cases} 1, \text{if the enterprise is located in Novosibirsk,} \\ 0, \text{otherwise,} \end{cases}$$

$$Perm = \begin{cases} 1, \text{if the enterprise is located in Perm,} \\ 0, \text{otherwise.} \end{cases}$$

Appendix 3
Averaged Structures of Shareholders and Board of Directors Patterns

TABLE P3.1

Averaged Structure of Enterprises' Shareholders patterns (as of the moment of privatisation and as of January 1, 2000)

Region			Enterprise's workers/employees	Managers	Workers + managers	Former enterprise's employees	Workers + managers + + former employees	Federal public authorities	Regional and local public authorities	Russian enterprises	Russian banks and financial and industrial companies	Foreign enterprises and banks	Other
Moscow	As of the date of privatisation	Number of observations	26	25	30	30	30	31	31	31	31	31	31
		Average value	0.56	0.16	0.70	0.05	0.75	0.06	0.04	0.11	0.04	0.00	0.01
	As of January 1, 2000	Number of observations	25	24	29	29	30	30	30	30	30	30	30
		Average value	0.39	0.24	0.62	0.09	0.70	0.05	0.05	0.11	0.06	0.01	0.03
Moscow oblast	As of the date of privatisation	Number of observations	28	28	33	33	37	37	37	37	37	37	37
		Average value	0.48	0.15	0.66	0.06	0.74	0.09	0.09	0.05	0.00	0.01	0.02

Region			Enterprise's workers/employees	Managers	Workers + managers	Former enterprise's employees	Workers + managers + + former employees	Federal public authorities	Regional and local public authorities	Russian enterprises	Russian banks and financial and industrial companies	Foreign enterprises and banks	Other
	As of January 1, 2000	Number of observations	30	30	34	34	37	37	37	37	37	37	37
		Average value	0.35	0.14	0.48	0.14	0.64	0.06	0.02	0.10	0.02	0.08	0.08
St. Petersburg	As of the date of privatisation	Number of observations	23	23	34	34	36	37	37	37	37	37	37
		Average value	0.54	0.10	0.69	0.05	0.73	0.07	0.04	0.07	0.02	0.01	0.06
	As of January 1, 2000	Number of observations	23	24	33	33	38	38	38	38	38	38	38
		Average value	0.27	0.12	0.50	0.10	0.57	0.03	0.01	0.21	0.04	0.04	0.09
Nizhni Novgorod	As of the date of privatisation	Number of observations	16	16	44	44	46	46	46	46	46	46	46
		Average value	0.58	0.12	0.72	0.04	0.75	0.06	0.04	0.08	0.02	0.00	0.06
	As of January 1, 2000	Number of observations	19	19	47	47	50	49	49	49	49	49	49
		Average value	0.48	0.20	0.69	0.08	0.76	0.01	0.00	0.15	0.03	0.00	0.04

Region			Enterprise's workers/employees	Managers	Workers + managers	Former enterprise's employees	Workers + managers + + former employees	Federal public authorities	Regional and local public authorities	Russian enterprises	Russian banks and financial and industrial companies	Foreign enterprises and banks	Other
Samara	As of the date of privatisation	Number of observations	12	12	26	26	27	27	27	27	27	27	27
		Average value	0.50	0.21	0.76	0.02	0.77	0.06	0.04	0.05	0.02	0.00	0.06
	As of January 1, 2000	Number of observations	16	16	27	27	28	28	28	28	28	28	28
		Average value	0.26	0.17	0.50	0.12	0.64	0.01	0.02	0.18	0.04	0.03	0.08
Ekaterinburg	As of the date of privatisation	Number of observations	17	17	38	38	41	41	41	41	41	41	41
		Average value	0.55	0.08	0.63	0.02	0.63	0.11	0.06	0.10	0.05	0.00	0.05
	As of January 1, 2000	Number of observations	22	22	41	41	45	45	45	45	45	45	45
		Average value	0.33	0.09	0.42	0.04	0.46	0.04	0.03	0.22	0.09	0.04	0.13
Perm	As of the date of privatisation	Number of observations	19	19	27	27	30	30	30	30	30	30	30
		Average value	0.48	0.08	0.61	0.02	0.64	0.08	0.02	0.11	0.01	0.00	0.14

Region			Enterprise's workers/employees	Managers	Workers + managers	Former enterprise's employees	Workers + managers + + former employees	Federal public authorities	Regional and local public authorities	Russian enterprises	Russian banks and financial and industrial companies	Foreign enterprises and banks	Other
	As of January 1, 2000	Number of observations	18	18	26	27	32	33	33	33	33	33	33
		Average value	0.33	0.15	0.49	0.07	0.51	0.03	0.05	0.17	0.02	0.00	0.21
Novosibirsk	As of the date of privatisation	Number of observations	22	22	32	32	34	34	34	34	34	34	34
		Average value	0.53	0.18	0.68	0.04	0.73	0.06	0.03	0.10	0.02	0.00	0.05
	As of January 1, 2000	Number of observations	25	25	37	37	38	38	38	38	38	38	38
		Average value	0.30	0.33	0.57	0.13	0.71	0.03	0.02	0.13	0.04	0.03	0.05
Krasnoyarsk	As of the date of privatisation	Number of observations	26	26	32	32	32	32	32	32	32	32	32
		Average value	0.59	0.07	0.67	0.03	0.70	0.07	0.10	0.03	0.02	0.00	0.08
	As of January 1, 2000	Number of observations	23	23	30	30	30	31	30	30	30	30	30
		Average value	0.49	0.10	0.61	0.04	0.65	0.03	0.06	0.06	0.07	0.02	0.13

Region			Enterprise's workers/employees	Managers	Workers + managers	Former enterprise's employees	Workers + managers + + former employees	Federal public authorities	Regional and local public authorities	Russian enterprises	Russian banks and financial and industrial companies	Foreign enterprises and banks	Other
All Regions	As of the date of privatisation	Number of observations	189	188	296	296	313	315	315	315	315	315	315
		Average value	0.53	0.13	0.68	0.04	0.71	0.07	0.05	0.08	0.02	0.00	0.06
	As of January 1, 2000	Number of observations	201	201	304	305	328	329	328	328	328	328	328
		Average value	0.36	0.17	0.55	0.09	0.63	0.03	0.03	0.15	0.04	0.03	0.09

ТАБЛИЦА П3.2

Averaged Structure of Board of Directors Patterns at Enterprises (as of the date of observation)

Region		Employees' representatives	Representatives of the company's managers	Representatives of federal public authorities	Representatives of regional and/or local public authorities	Foreign representatives	Representatives of Russian banks	Representatives of Russian investments companies and funds	Representatives of other Russian industrial enterprises	Big Russian shareholders – private persons	Other
Moscow	Number of observations	34	34	34	34	34	34	34	34	34	34
	Average value	0.18	0.52	0.02	0.04	0.01	0.00	0.01	0.11	0.02	0.10

Region		Employees' representatives	Representatives of the company's managers	Representatives of federal public authorities	Representatives of regional and/or local public authorities	Foreign representatives	Representatives of Russian banks	Representatives of Russian investments companies and funds	Representatives of other Russian industrial enterprises	Big Russian shareholders – private persons	Other
Moscow oblast	Number of observations	39	39	39	39	39	39	39	39	39	39
	Average value	0.26	0.45	0.05	0.03	0.03	0.00	0.01	0.08	0.04	0.03
St. Petersburg	Number of observations	42	42	42	42	42	42	42	42	42	42
	Average value	0.22	0.35	0.02	0.01	0.01	0.02	0.07	0.11	0.06	2
Nizhni Novgorod	Number of observations	57	57	57	57	56	56	56	57	56	56
	Average value	0.26	0.52	0.01	0.02	0.01	0.01	0.02	0.08	0.02	0.05
Samara	Number of observations	31	31	31	31	31	31	31	31	31	31
	Average value	0.43	0.32	0.01	0.02	0.02	0.02	0.04	0.08	0.02	0.05
Ekaterinburg	Number of observations	46	46	46	46	46	46	46	46	46	46
	Average value	0.25	0.35	0.02	0.03	0.01	0.00	0.05	0.18	0.03	0.09
Perm	Number of observations	32	32	32	32	32	32	32	32	32	32
	Average value	0.27	0.37	0.02	0.07	0.00	0.00	0.01	0.17	0.02	0.04

Region		Employees' representatives	Representatives of the company's managers	Representatives of federal public authorities	Representatives of regional and/or local public authorities	Foreign representatives	Representatives of Russian banks	Representatives of Russian investments companies and funds	Representatives of other Russian industrial enterprises	Big Russian shareholders – private persons	Other
Novosibirsk	Number of observations	40	40	40	40	40	40	40	40	40	40
	Average value	0.25	0.40	0.02	0.03	0.00	0.01	0.06	0.13	0.03	0.07
Krasnoyarsk	Number of observations	34	34	34	34	34	34	34	34	34	34
	Average value	0.42	0.23	0.02	0.06	0.01	0.00	0.05	0.07	0.03	0.10
All Regions	Number of observations	355	355	355	355	354	354	354	355	354	354
	Average value	0.28	0.40	0.02	0.03	0.01	0.01	0.04	0.11	0.03	0.07

Appendix 4
Total Factor Productivity Growth Rates (TFPGr) by Different Privatisation Groups and Regions

	Moscow	Moscow oblast	St. Petersburg	Ekaterinburg	Krasnoyarsk	Nizhni Novgorod	Novosibirsk	Perm	Samara
1998									
Rate of growth of total factor productivity of the group of companies privatised in 1992 or earlier	0.07	0.11	0.11	-0.12	-0.11	0.03	-0.51	-0.46	-0.63
Number of observations	14.00	20.00	13.00	18.00	8.00	17.00	14.00	11.00	12.00
t-statistics (of the value of deviation from *TFPGr* for the group of companies privatised after 1993)	0.35	0.13	1.14	0.56	1.37	0.36	2.88	0.02	0.49
Rate of growth of total factor productivity of the group of companies privatised in 1993	0.14	-0.09	-0.23	-0.06	-0.21	-0.01	-0.11	-0.97	-0.25
Number of observations	7.00	4.00	6.00	12.00	8.00	16.00	7.00	5.00	6.00
t-statistics (of the value of deviation from *TFPGr* for the group of companies privatised after 1993)	0.63	0.64	0.12	0.45	1.99	0.54	0.67	1.12	3.56
Rate of growth of total factor productivity of the group of companies privatised after 1993	0.00	0.08	-0.18	-0.03	0.11	0.10	0.04	-0.45	-0.75
Number of observations	6.00	7.00	4.00	3.00	7.00	3.00	7.00	1.00	5.00
1999									
Rate of growth of total factor productivity of the group of companies privatised in 1992 or earlier	0.48	0.52	0.26	0.12	0.08	0.30	0.15	0.00	-0.04

	Moscow	Moscow oblast	St. Petersburg	Ekaterinburg	Krasnoyarsk	Nizhni Novgorod	Novosibirsk	Perm	Samara
Number of observations	15.00	22.00	16.00	20.00	9.00	19.00	15.00	10.00	11.00
t-statistics (of the value of deviation from *TFPGr* for the group of companies privatised after 1993)	0.30	0.50	0.50	0.10	1.47	1.89	1.75	0.06	0.48
Rate of growth of total factor productivity of the group of companies privatised in 1993	0.51	0.69	0.36	0.23	0.16	0.16	0.06	0.20	-0.17
Number of observations	8.00	4.00	6.00	12.00	8.00	16.00	6.00	7.00	7.00
t-statistics (of the value of deviation from *TFPGr* for the group of companies privatised after 1993)	0.48	0.21	0.24	0.48	1.80	1.58	0.77	0.69	0.15
Rate of growth of total factor productivity of the group of companies privatised after 1993	0.41	0.63	0.32	0.09	-0.21	-0.26	-0.05	-0.01	-0.14
Number of observations	6.00	7.00	3.00	3.00	7.00	4.00	9.00	3.00	5.00

Appendix 5
Dependence of the amount of the real value added per employee on parameters of production performance and different institutional characteristics of enterprises by regions and the database as a whole

The database as a whole

Dependent variable: $\Delta \log \frac{Y_{i,t}}{L_{i,t}}$		
Total number of observations: 520		
Variable	Coefficient	*t*-statistics
α_{98}	-0.262205	
α_{99}	-0.021150	
$\Delta \log \frac{K_{i,t}}{L_{i,t}}$	-0.063006	-1.428446
$\Delta \log \frac{M_{i,t}}{K_{i,t}}$	-0.062845	-2.246221
$\Delta R_{i,t}$	0.006279	3.366967
RUS_i	0.261968	2.710830
$SEC18_i$	-0.193961	-3.169250
$MOSCOW_i$	0.197304	3.306938
$MOSREG_i$	0.159406	2.648196
S_PB_i	0.310362	4.759300
Test statistics for the model		
Adjusted R^2		0.163431
F-statistics		15.77012
P-value(*F*-statistics)		0.000000

Moscow

Dependent variable: $\Delta \log \frac{Y_{i,t}}{L_{i,t}}$		
Total number of observations: 56		
Variable	Coefficient	*t*-statistics
α_{98}	0.073594	
α_{99}	0.472057	
$\Delta \log \frac{K_{i,t}}{L_{i,t}}$	0.379089	1.390548
$\Delta \log \frac{M_{i,t}}{K_{i,t}}$	-0.134847	-2.107800
$\Delta R_{i,t}$	0.000184	0.019495
PRIV92$_i$	0.397702	2.877445
INS_G$_i$	-0.365811	-1.276468
SEC15$_i$	-0.913001	-2.193138
SEC18$_i$	-0.684017	-2.957716
Test statistics for the model		
Adjusted R^2		0.352166
F-statistics		6.316381
P-value(*F*-statistics)		0.000064

Moscow oblast

Dependent variable: $\Delta \log \frac{Y_{i,t}}{L_{i,t}}$		
Total number of observations: 64		
Variable	Coefficient	*t*-statistics
α_{98}	0.075808	
α_{99}	0.565746	
$\Delta \log \frac{K_{i,t}}{L_{i,t}}$	-0.568792	-2.177403
$\Delta \log \frac{M_{i,t}}{K_{i,t}}$	-0.104854	-1.712626
$\Delta R_{i,t}$	0.011254	2.205517
PRIV92$_i$	-0.457243	-3.407565
INS$_i$	-0.727469	-3.766921
INS_G$_i$	0.591516	2.333743
REG_G$_i$	-1.199514	-1.725832
Test statistics for the model		
Adjusted R^2		0.424385
F-statistics		9.074704
P-value(*F*-statistics)		0.000001

St. Petersburg

Dependent variable: $\Delta \log \frac{Y_{i,t}}{L_{i,t}}$		
Total number of observations: 47		
Variable	Coefficient	*t*-statistics
α_{98}	-0.030708	
α_{99}	0.288111	
$\Delta \log \frac{K_{i,t}}{L_{i,t}}$	-0.277625	-2.393283
$\Delta \log \frac{M_{i,t}}{K_{i,t}}$	-0.265707	-2.825641
$\Delta R_{i,t}$	0.013356	3.477058
PRIV93$_i$	-0.470529	-2.677712
INS$_i$	0.603021	3.466235
RUS$_i$	1.187878	3.220939
SEC14$_i$	0.239867	2.422563
Test statistics for the model		
Adjusted R^2		0.568080
F-statistics		11.41688
P-value(*F*-statistics)		0.000000

Ekaterinburg

Dependent variable: $\Delta \log \frac{Y_{i,t}}{L_{i,t}}$		
Total number of observations: 66		
Variable	Coefficient	*t*-statistics
α_{98}	-0.095215	
α_{99}	0.160458	
$\Delta \log \frac{K_{i,t}}{L_{i,t}}$	-0.017310	-0.243750
$\Delta \log \frac{M_{i,t}}{K_{i,t}}$	-0.039749	-1.113273
$\Delta R_{i,t}$	0.006309	0.969333
INS_i	-0.266297	-1.644333
FOR_G_i	1.123934	2.371905
$SEC15_i$	-0.348580	-3.106010
$SEC18_i$	-0.481088	-3.242358
Test statistics for the model		
Adjusted R^2	0.393284	
F-statistics	8.355696	
P-value(*F*-statistics)	0.000002	

Krasnoyarsk

Dependent variable: $\Delta \log \frac{Y_{i,t}}{L_{i,t}}$		
Total number of observations: 47		
Variable	Coefficient	*t*-statistics
α_{98}	-0.077740	
α_{99}	0.023870	
$\Delta \log \frac{K_{i,t}}{L_{i,t}}$	0.454482	2.546281
$\Delta \log \frac{M_{i,t}}{K_{i,t}}$	-0.075488	-0.502644
$\Delta R_{i,t}$	0.001117	0.180959
PRIV92$_i$	0.296075	2.218927
INS$_i$	-0.516250	-2.074759
OUTS_G$_i$	-0.201553	-1.106421
SEC13$_i$	0.538478	2.566798
Test statistics for the model		
Adjusted R^2		0.323704
F-statistics		5.002927
P-value(*F*-statistics)		0.000729

Nizhni Novgorod

Dependent variable: $\Delta \log \frac{Y_{i,t}}{L_{i,t}}$		
Total number of observations: 79		
Variable	Coefficient	*t*-statistics
α_{98}	0.032290	
α_{99}	0.203065	
$\Delta \log \frac{K_{i,t}}{L_{i,t}}$	-0.168148	-1.638411
$\Delta \log \frac{M_{i,t}}{K_{i,t}}$	-0.147745	-2.439510
$\Delta R_{i,t}$	0.008738	1.250463
INS_i	0.392092	2.323512
INS_G_i	-0.487260	-2.560031
$SEC15_i$	-0.240742	-1.633917
Test statistics for the model		
Adjusted R^2	0.195566	
F-statistics	5.192529	
P-value(*F*-statistics)	0.000406	

Novosibirsk

Dependent variable: $\Delta \log \frac{Y_{i,t}}{L_{i,t}}$		
Total number of observations: 58		
Variable	Coefficient	*t*-statistics
α_{98}	-0.276	
α_{99}	0.074	
$\Delta \log \frac{K_{i,t}}{L_{i,t}}$	-0.435	-2.638
$\Delta \log \frac{M_{i,t}}{K_{i,t}}$	-0.218	-2.073
$\Delta R_{i,t}$	-0.004	-0.851
$OUTS_i$	0.589	2.553
RUS_G_i	0.800	3.031
REG_G_i	-1.120	-3.157
Test statistics for the model		
Adjusted R^2		0.398
F-statistics		8.948
P-value(*F*-statistics)		0.000

Perm

Dependent variable: $\Delta \log \frac{Y_{i,t}}{L_{i,t}}$		
Total number of observations: 36		
Variable	Coefficient	*t*-statistics
α_{98}	-0.605834	
α_{99}	0.069798	
$\Delta \log \frac{K_{i,t}}{L_{i,t}}$	-0.364486	-1.516500
$\Delta \log \frac{M_{i,t}}{K_{i,t}}$	-0.631047	-2.738137
$\Delta R_{i,t}$	0.005062	0.453302
$PRIV92_i$	-0.543623	-2.509341
INS_i	0.395997	1.233364
RUS_i	0.863781	1.937464
$OUTS\_G_i$	1.140840	3.185413
Test statistics for the model		
Adjusted R^2		0.386092
F-statistics		5.001966
P-value(*F*-statistics)		0.001461

Samara

Dependent variable: $\Delta \log \frac{Y_{i,t}}{L_{i,t}}$		
Total number of observations: 46		
Variable	Coefficient	*t*-statistics
α_{98}	-0.558669	
α_{99}	-0.103014	
$\Delta \log \frac{K_{i,t}}{L_{i,t}}$	-0.159648	-0.680912
$\Delta \log \frac{M_{i,t}}{K_{i,t}}$	-0.079288	-0.549810
$\Delta R_{i,t}$	0.007579	1.047796
$PRIV92_i$	0.333296	2.566990
RUS_i	0.718799	2.316928
Test statistics for the model		
Adjusted R^2		0.250938
F-statistics		5.268781
P-value(*F*-statistics)		0.001720

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