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External Relationship of Russian Corporations

Svetlana Avdasheva,
Viktoria Golikova,
Fumikazu Sugiura
and
Andrei Yakovlev

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Svetlana Avdasheva

STATE UNIVERSITY-HIGHER SCHOOL OF ECONOMICS, MOSCOW

Victoria Golikova

STATE UNIVERSITY-HIGHER SCHOOL OF ECONOMICS, MOSCOW

Fumikazu Sugiura

HITOTSUBASHI UNIVERSITY, TOKYO

Andrei Yakovlev

STATE UNIVERSITY-HIGHER SCHOOL OF ECONOMICS, MOSCOW

The Institute of Economic Research

Hitotsubashi University

Tokyo, Japan

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The Institute of Economic Research, Hitotsubashi University
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Abstracts

Chapter 1

Holding Company Groups And Model Of Corporate Governance In Russia

Svetlana B. Avdasheva

The paper explores the Russian holding company groups (business-groups), which have grown into an important factor in the development of Russian markets. We discuss the scale of expansion and internal structure of these groups, incentives to create them, the patterns of corporate governance and decision-making.

New empirical data make a contribution to the discussion about the type of companies that appear as a result of corporate integration. Have Russian holding company groups emerged as an outcome of contracts concluded by private initiative, or their creation was initiated by the state, directly or indirectly? Is there any evidence of positive influence of holding company groups on competitiveness at enterprise level? Is there higher demand for instruments of corporate governance in the firms belonging to holding company groups? How much is managerial decision making centralized in these groups? Is there any reliance on internal financial markets, and if yes, are there any signs that internal financing is replacing external financing?

Among other, the survey results could highlight several important features of national corporate governance model, and first of all, the influence of corporate governance model on the firm's boundaries. Inefficiency of ownership separated from management means should restrict the growth of firms in Russian institutional environment. In spite of the common view on "oligarchs" as omnipotent actors in Russian economy, the established holding company groups could be unstable if the special additional tools to discipline management are absent.

The survey shows that Russian holding company groups are heterogeneous. Special corporate governance mechanisms are used in the great part of group member firms more actively than in independent enterprises. External ownership is developing in the business-groups, and consequences of concentration of ownership and control in the hands of directorate are gradually subdued. Enterprises in the groups maintain certain independence; the system of decision-making is related to corporate governance. At the same time, subsidiaries in the holding company groups with separated ownership and management and developed internal corporate governance are firms in the industries where ultimate owner has powerful tools to influence the decision-making at the level of companies even without ownership rights.

The trends in development of corporate governance in the groups are contradictory. On the one hand, separation of ownership and control itself calls for higher demand for instruments of corporate governance. On the other hand, while the role of internal financing increases, the incentives to attract new owners, and consequently, to develop the system corporate governance, decrease.

JEL classification numbers: D23, G34, P31, P34

Key words: stock holding company group, corporate governance, firm's boundaries.

Chapter 2

Membership of Russian Companies in Enterprise Associations

Victoria V. Golikova

The main goal of the paper is to explain main incentives of Russian companies to participate in business associations on the national and regional levels and in the professional (industrial) associations as well. The paper is based on the analysis of data collected in the framework of Japan – Russia joint research Project “Corporate Governance and Integration Processes in the Russian Economy” by Higher School of Economics and Hitotsubashi University (2004-2006).

The goal of the paper is to examine which type of firms are more likely to be the members of enterprise associations and what they can benefit from participation in them. To what extent the membership in the associations could be explained in terms of growing demand for law? Do relations with stakeholders, especially with state authorities, or former job experience of

the general manager in state institutions still play an important role in the decision to become a member of association? The empirical analysis provides evidence about significant difference in the decision of the enterprise to participate in business associations and a set of benefits gained among the firms differentiated by size of business, industry, organizational form, ownership and control, managerial characteristics, presence on the stock exchange, relations with stakeholders.

JEL classification numbers: D71, P31, P39

Key words: enterprise associations, institutions, state authorities

Chapter 3

Relationship Between Russian Corporations And Financial Institutions: The New Role Of Sberbank

Fumikazu SUGIURA

The article clarifies the recent development of relations of the JSCs with the financial institutions. It is obvious that under the conditions of high uncertainties in the 1990's Russian corporations have been very hesitant to get credit from the financial institutions for various reasons. However, a new tendency seems to appear recently with the support of strong economic conjuncture and a different institutional setting. In order to understand this positive trend more precisely, making use of interview survey conducted in 2005 we found that one-third of the surveyed firms had not received any finance from external sources. They are relatively small, insider-dominated firms, with a tendency towards being closed joint-stock companies (ZAO). At the same time we have also seen that they are very active in investments with their own financial resources, which shows the potentiality of SME finance in Russia. We also analyzed firms with Sberbank credit, which also represented almost one-third of the surveyed enterprises. The result is more ambiguous, since Sberbank seems to have a wide range of portfolio. Those companies are open-type incorporations (OAO) and have a high share of government ownership. They are also active in introducing equipment, and export their products. Further development of

the financial sector will be indispensable for Russia's long-term development.

JEL classification numbers: E44, G21, P43

Key words: Russia, corporate finance, banking sector

Chapter 4

The Russian Corporation And Regional Authorities: Models Of Interrelations And Their Evolution

Andrei Yakovlev

In this chapter, we deliberate the possible impacts of corporate governance and performance on managerial turnover using a unique dataset of Russian corporations. This study is different from most previous works in that we deal with not only CEO dismissals, but also with managerial turnover in a company as a whole. We find that nonpayment of dividends is correlated significantly with managerial turnover. We also find that the presence of dominant shareholders and foreign investors is another important factor in causing managerial dismissal in Russian corporations, but these two kinds of company owners reveal different effects in terms of turnover magnitude.

JEL classification numbers: D21, G34, G35, P31, P34.

Keywords: ownership structure, corporate performance, managerial turnover, Russia.

Biographies

AVDASHEVA, Svetlana is a head of laboratory of market analysis of the Institute of Industrial and Market Studies and professor of institutional economics department of Higher School of Economics in Moscow, Russian Federation. The fields of interest are evolution of the market structure and corporate integration, antitrust economics and deregulation of network industries in Russia. Publications in international and Russian economic journals cover the issues of recent trends in corporate governance and market strategies of Russian companies, as well as impact of public policy and changes in legislation on economic environment.

GOLIKOVA, Victoria is a senior researcher at the Institute for Industrial and Markets Studies of Higher School of Economics in Moscow, the Russian Federation. She has advanced experience in the implementation of projects funded by different international lending agencies, Ministry for Economic Development and Trade, focusing on private sector development, enterprise restructuring and competitiveness. top-managers of the enterprises, state authorities , etc). The main topics of professional interest are enterprise' behavior in the transition economies, entrepreneurship, informal sector. Main publications in 2005–2007 are: “Russian industry on the crossroad: what prevents the firms to become competitive,” – Moscow: SU–HSE, 2007, 101 pages (with co–authors)/in Russian; “Management teams and decision making – in the book Integration processes, corporate governance and management in the Russian companies.” – Moscow: Moscow Public Science Foundation, 2006, p. 134–156. (in Russian); “Open air markets and “shuttle trade”: yeasterday, today, tomorrow (evidence from emprirical surveys in 2001–2005)” (with co–authors) – Moscow: SU–HSE WP4/2006/05/, 28 p.; “Competitiveness of Small Enterprises: Evidence from Empirical Survey in Two Russian regions (with Galina Ermilova)” – in New Generation of Russian Economic Studies. Edited by Kazuhiro Kumo and Fumikazu Sugiura. – HIER Discussion Paper Series (B), 2006, pp. 39–65 (in English); “New large companies (“business–groups”) in the

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SUGIURA, Fumikazu is a lecturer of the Institute of Economic Research at Hitotsubashi University, Tokyo, Japan (E-mail/ fsugiura@ier.hit-u.ac.jp). He studies corporate finance issues and financial sector development in the former Soviet blocs, especially in the Russian federation. He has written a lot of articles in Japanese on the non-monetary transaction and non-payment issues in the Russian Federation. His recent works are: “Non-payment of Wages in Russia,” *Slavic Studies*, Vol.50, Hokkaido University, March 2003, pp. 177–202, “The Problem of Non-payment and Banking Sector Development in Russia,” *Bulletin of the Japan Association for Comparative Economic Studies*, Vol. 42, No.2, June 2005, pp. 27–41.

YAKOVLEV, Andrei is vice-rector of State University – Higher School of Economics and director of Institute for Industrial and Market Studies (Myasnitskaya, 20, Moscow, 101990, Russia. E-mail: ayakovlev@hse.ru). He is one of leading Russian expert in analysis of enterprises behavior, corporate governance, industrial policy, business–government relations. His recent works are: ‘On Reasons of Barter, Arrears and Tax Evasion in the Russian Economy,’ *Voprosy Ekonomiki*, 4, 1999 (in Russian); ‘Asymmetric Information and the Russian Individual Savings Market,’ (With Svetlana Avdasheva) *Post-Communist Economies*, 12, 2, 2000; ‘Barter in the Russian Economy: Classifications and Implications (Evidence from Case Study Analysis),’ *Post-Communist Economies*, 12, 3, 2000; ‘Why is Non-risk Tax Evasion Possible in Russia?,’ *Voprosy Ekonomiki*, 11, 2000 (in Russian); ‘“Black cash” Tax Evasion in Russia: Its Forms, ‘Incentives and Consequences at Firm Level,’ *Europe-Asia Studies*, 53, 1, 2001; ‘Demand for Law in the Sphere of Corporate Governance: Evolution of Economic Actors’ Strategies,’ *Voprosy Ekonomiki*, 4, 2003 (in Russian); ‘Interaction of Interest Groups and Their Impact on Economic Reform in Contemporary Russia, *Mir Rossii*, 4, 2003 (in Russian); ‘Informal tax competition on a regional level: the Russian scenario’. // *East-West Journal of Economics and Business*. Vol.V, 2002, No. 1, pp.109–121; ‘On the Use of New Industrialized Countries Experience in Russia for Institutional Development and Stimulation of Innovation-Based Economic Growth.’ (with Ksenia Gonchar)// *Voprosy Ekonomiki*. 2004. No.10 (in Russian); ‘The Evolution of

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Chapter 1

Holding Company Groups And Model Of Corporate Governance In Russia*

Svetlana B. Avdasheva

1.1. Introduction

Contemporary studies pay much attention to Russian holding company groups (HCGs) as a form of concentration of capital and assets and at the same time, a way to restructure companies. The largest HCGs are controlling almost a half of the Russian industry (Guriev, Rachinsky, 2005) and the great majority of companies listed on stock exchanges (Boone, Rodionov, 2002). Having passed in the 1990s the phase of acquisition of undervalued assets or bringing them

* This chapter is a part of joint research project of the State University-Higher School of Economics (Russia) and the Hitotsubashi University (Japan) on corporate governance and integration processes in the Russian economy. Financial support of Moscow Public Scientific Foundation, sponsored by the United States Agency for International Development (USAID) and Higher School of Economics Scientific Foundation (personal research grant 06-01-0063) should be mentioned. The point of view presented in the paper may not agree with points of view of the above named organizations. The author expresses her gratitude to V.Golikova, T.Dolgopyatova, I.Iwasaki, I.Ivashkovskaya, R. Kapelushnikov, V.Kleiner, B.Kuznetsov, I.Rodionov, Y.Simachev, F.Sugiura, A.Yakovlev and to other participants of the discussion on this paper at the International Conference “Economic Modernization and the State” held by SU-HSE in April 2006 and at the panel “Exploring Russian Corporation” of the European Association of Comparative Economic Studies (EACES) 9th bi-annual conference “Development Strategies – A Comparative View” in September 2006.

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under control with non-property instruments, in recent years HCGs are making substantial efforts to restructure their member companies (Radygin, 2004). “Oligarchs’ are not only the largest shareholders but also the more efficient owners in comparison with the owners of their enterprises (Guriev, Rachinsky, 2005).

However, the literature presents different, sometimes directly opposite views on the issues related to Russian HCGs:

- To what extent did HCGs emerge as an outcome of strategies employed by new private owners, and to what extent are they the legacy of resource allocation under socialism? It is not improbable that dominance of holding company structure is not so much due to the wave mergers after privatization as to the wide presence of this form of industrial organization in the Soviet period.

- How strong influence, direct or indirect, was made by the state on creation of Russian HCGs? Even if the state never prescribed formation of individual groups, it cannot be ruled out that incentives of private owners for business consolidation were aimed at getting stronger bargaining power in their relations with authorities.

- Do HCGs really implement market-oriented restructuring on the consolidated level, or are the results of modernization implemented by group companies attributed to them? This question is related with the common causality problem: we know that HCGs exhibit better performance than stand-alone companies. At the same time we do not know whether the better performance is explained by the fact of more efficient restructuring in the groups or by the fact that ultimate owners of groups succeeded to put under their control the better privatized enterprises.

- What patterns of corporate governance are used in HCGs? Are such typical of Russian companies’ features as high concentration of ownership and inseparability of ownership and management also typical of HCGs? How competitive can be the model of concentrated external ownership in

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comparison with models of “private enterprise” or “co-operative of managers” (Dolgopyatova, 2001), where ownership and performing functions of management is the main tool to establish and secure property rights?

- How much is decision making centralized in Russian HCGs? Does centralization suppress independent decisions made by group companies, reviving the Soviet planning system on a different scale?

- Does internal financial market exist in Russian HCGs? If it does, what role is played by internal financing – is it complementing or crowding-out the other external sources of funds?

At least partly the doubts on the development of HCGs are connected with the general question of the determinants’ of firm’s boundaries in the Russian economy. The national model of corporate governance influences on the balance of cost and benefits of firm’s growth. For the HCGs the higher are the costs necessary to establish and secure property rights in the economy, the lower are the optimal number of companies in the groups. The same factors those caused inefficiency of ownership and control separation (weak institutional environment, weak property rights, weak contractual enforcement) should restrict the firms’ growth. From this point of view the violent development of the business groups seems unexplainable. Looking for reasons for fast growth of large companies organized as HCGs, the role of the state should be examined on the first place among other potential explanation. If the state supports business-groups it is possible to them to grow even suffering from the weakness of property rights and external and internal mechanisms of corporate governance.

Finding answers to the questions mentioned above, we will be able to make important conclusions about the role of corporate governance in Russian corporations. The greater is the part of HCGs initiated by private owners, the more important it is to analyze the system of corporate governance. If we could find evidence suggesting that restructuring is going more actively and

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performance is better, we could make a conclusion whether companies with relatively complicated internal structure (organized as HCGs) can be successful in the Russian transitional economy. Analysis of corporate governance in HCGs could provide an answer whether development of such groups involves separation of ownership from management. Respective conclusions can be made both on the base of data describing relationship between ownership and management and on the base of data related to mechanism of decision making in the groups.

The paper presents empirical evidence that was obtained during a sample survey conducted in 2005 under the Japan-Russia Joint Research Project on Corporate Governance and Integrations Processes in the Russian Economy of Higher School of Economics and Hitotsubashi University (2004 - 2007). A detailed account of the tools used in the survey and of the sample, including their comprehensive statistical description can be found in (Dolgopiatova, Iwasaki, 2006).

Section 2 gives a brief review of literature on Russian HCGs. Section 3 gives a description of the groups including time and incentives for their creation, modernization and efficiency of the use of resources in the groups. Section 4 discusses the system of corporate governance in the groups, including concentration of ownership, relationship between ownership and management, the scale of centralized decision making, and the use of internal financial market. Section 5 concludes.

1.2. Russian Holding Company Groups And Corporate Governance: What We Know From The Literature

Both problems of interest to us, competitiveness of HCGs and development of corporate governance in the groups, are being discussed in economic literature, although to a variable extent. However, conclusions are made mostly in qualitative terms, and quantitative estimates of influence of holding company structure on competitive power are few in number.

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An estimate of influence of holding company structure on total factor productivity (TFP) was made in the framework of the World Bank project (Ruehl, 2004; Guriev, Rachinsky, 2005). The results were found to be mixed: on the one hand, enterprises under oligarchic control failed to demonstrate the best efficiency in static; on the other hand, they did demonstrate it in dynamics. However, we cannot help mentioning that a change in the calculated indicator of efficiency within one period – from 2001 till 2002 – is also unlikely to be regarded a sufficiently reliable evidence. Therefore, the question whether “oligarchs” are more effective owners or not remains open.

There is also no distinct answer to the question of influence of HCGs on intensity of modernization. Reasoning from data of two surveys, T. Frye (Frye, 2004, 2005) demonstrated that affiliation with groups, along with other factors under consideration, improves the chances of investment projects to be implemented¹. Comparing firms that belong and don't belong to the groups, T. Dolgopiatova (Dolgopiatova, 2005) discovered that the former, all other factors being equal, had invested twice as much. But again the problem of causality remains.

Results of an enterprise survey conducted by the SU-HSE in 2003 (Yasin (ed.), 2004) revealed that group member firms demonstrated higher activity in the majority of lines of modernization. On the other hand, a more elaborate analysis of factors explaining this activity (Avdasheva, 2005) leads to a conclusion that significance of belonging to business groups as itself, unrelated to affiliation to a certain industry and size of the enterprise is much lower, and in some cases has an indefinite sign.

Assessment of corporate governance in HCGs tends to seriously change over time. In the 1990s, the majority of authors regarded business groups as amorphous formations where decision making was not linked to structure of

1. To be accurate, we have to mention that the questionnaire used by T. Frye gives a very broad definition of affiliation to business groups (belonging to holding company groups, to financial and industrial groups, to trade associations).

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ownership. However, the situation has been changing in recent years: after consolidation of ownership and corporate restructuring, the majority of Russian HCGs more and more resemble corporations with a unified system of governance (Radygin, 2004).

At the same time, a discussion is still going on about to what extent are the instruments of corporate governance being used in the groups and how much are ownership and management separated. Some authors cite the data telling that centralization of decision-making is extremely high in companies where ownership and management are non-separated (TTPP, 2004), while other point to division of responsibilities between parent company and subsidiaries in a HCG, while operational autonomy of the latter is high.

1.3. Russian Holding Company Groups: General Characteristic

1.3.1. Scale, structure and time of creation of holding company groups

Our estimations of the share of HCGs in employment are a little higher than the data cited by other authors (partly because the data reported earlier were surpassed by the expansion of groups, partly because our sample consists of the large- and medium-scale enterprises, partly because of industrial structure of our sample, including high share of telecommunication companies united by Svyazinvest holding). Representation of integrated structures is different by industry (Fig. 1). Communications, fuel and electric power, iron and steel and non-ferrous metals are the leaders, while light industry and building materials are the outsiders. Comparing shares of HCGs in the number of companies and in employment we can see that the larger companies are involved in group membership.

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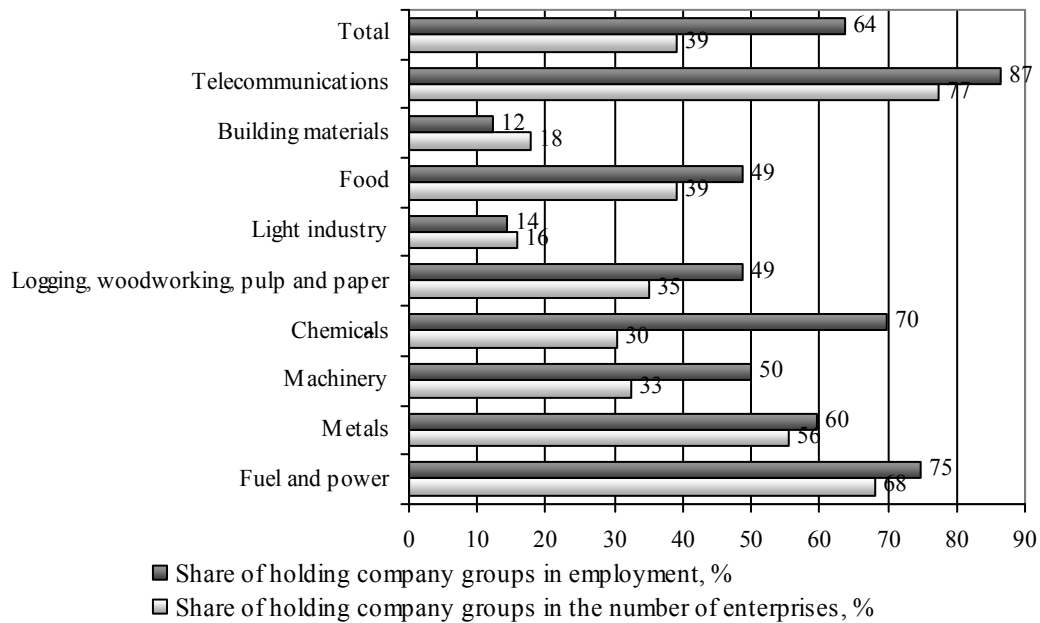


Figure 1: Share of HCGs in number of companies and in employment, %

Scales of HCGs vary a great deal, while differences by industry certainly can be observed. Most enterprises in metals and chemicals (and naturally, in electric power and communications) belong to groups with more than 10,000 employees each. Enterprises in other industries, as a rule, are members of groups with employment of 3,000 to 10,000. However, there are respondents in absolutely all industries that have reported belonging to very small groups – with employment less than 1,000. The typical HCG (apart from those that include enterprises in electric power and communications) consists of 5 to 10 enterprises.

The majority of Russian HCGs are still “mysterious islands” à la Jules Verne, for they include in addition to a main industrial nucleus, a number of legally independent enterprises servicing their core business. Commercial facilities in the structure of groups were mentioned by 38.4% of respondents; banks, by 9.3%; insurance companies, by 7.4%; investment companies, by 16.7%; auditors and consultants, by 13.9%, and R&D facilities, by 22%. Lack of such enterprises in HCGs was mentioned only by 35% of the respondents.

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The activity of joining HCGs went up high since 1999 and reached its peak in 2002. By now, for the enterprises of our sample this period of intense mergers and acquisitions is over. Our data make possible to distinguish three periods when Russian HCGs were created: before 1992 inclusive (previous to the start of mass privatization); from 1993 to 1998 (during mass privatization that went along with transformational recession), and the period since 1999 (under economic growth). Affiliation of the largest companies in fuel and electric power to HCGs fell on the first period. Enterprises in other industries joined the groups during the second and most actively, the third period. For instance, the number of companies that joined HCGs in six years since 1999 was four times as high as in the second period in food industry, and twice as high in machinery.

At the same time, there is no evidence that the point in time to join a HCG depends on the size of a company (excluding fuel and power). At first sight the larger companies should be expected to be first to join the groups, but survey data give no grounds for such a conclusion.

The survey demonstrated once more that Russian HCGs are heterogeneous, including their origin: although the majority of companies joined them when privatization was over, the largest groups were created from companies with government participation and outside the process of redistribution of property among private owners.

1.3.2. Joining holding company groups: incentives and assessments

The incentives to join HCGs can be judged by two indicators: who initiated affiliation to the group and what benefits the enterprise obtained from operating as a member of the group. Among those who initiated the entry of a company into a group, the key role belonged to owners of the parent company (as mentioned by more than 40% of the respondents). However, in a third of all cases the initiative came from private owners of other companies as well. This gives the impression that in the Russian industry, “friendly takeovers” clearly

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prevail over the “hostile” ones. The role of public administrative bodies as initiators of corporate integration was relatively modest, and it was practically nil in the contracts concluded after 1999 (initiative of administrative bodies was mentioned by only 7 respondents out of 190). Companies in electric power industry and telecommunications, naturally, are the exclusion to this rule.

Benefits of enterprises from belonging to HCGs are related mainly to better adjustment to market environment, better position in markets of goods and access to capital investment, contrary to the gains that arise from special relations with various levels of public administration (Fig. 2). More than a half of the respondents said that they benefited from better marketing of their products. Almost the same part mentioned gains related to capital investment and introduction of new technologies. Ranking third in importance is protection from hostile takeovers, and the fourth is improvement in bargaining position in relations with authorities (mentioned by approximately every fifth enterprise). Assessments of benefits obtained by companies demonstrate certain industry-wise qualities: better marketing was most often mentioned by food companies, and protection from hostile takeovers was reported by companies in fuel and electric power and building materials. Companies in the two latter industries also found essential their gains in bargaining position in relations both with federal and regional authorities. Finally, gains from access to the international market were, more often than others, mentioned by enterprises in logging, woodworking and pulp and paper and in chemicals.

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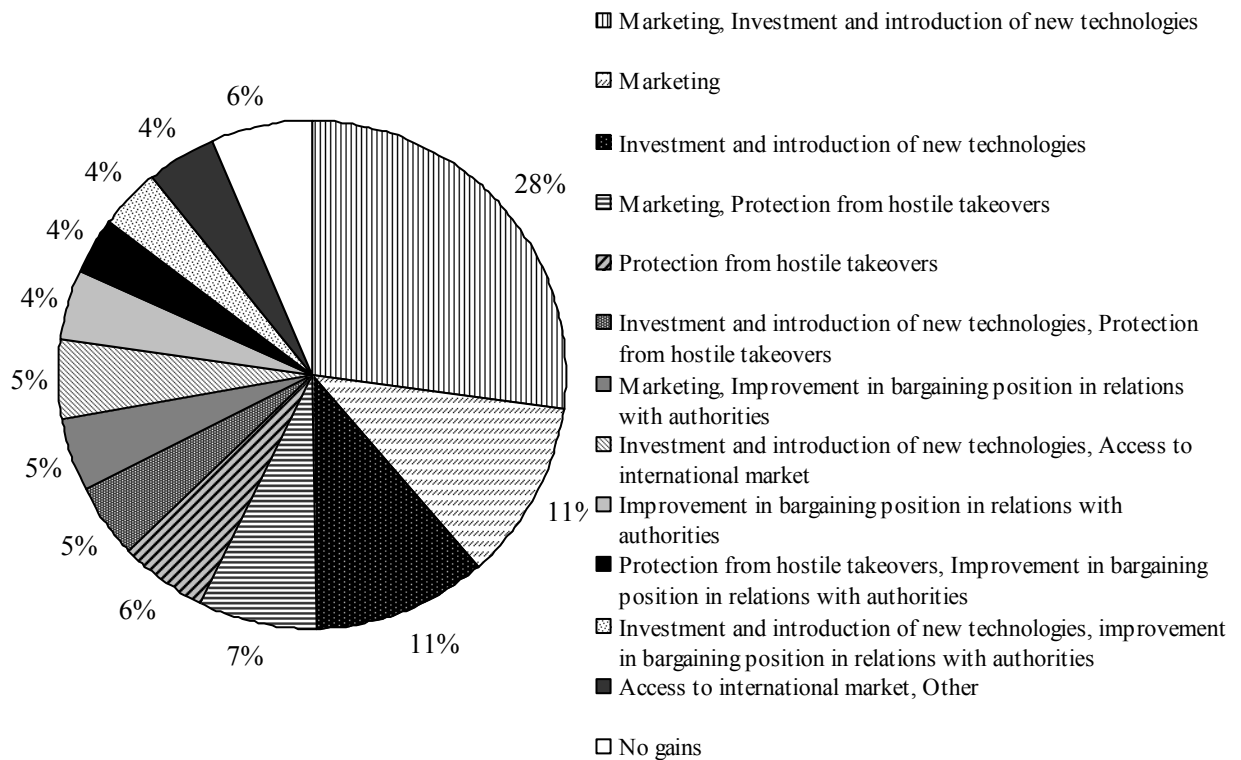


Figure 2: Gains from Joining Holding Company Groups, % of the respondents that gave answer (clockwise)

To what extent is this positive subjective assessment of HCGs by managers justified by objective indicators? As in most previous studies, results of survey of modernization in group member companies are mixed. On the one hand, group member companies are more active in all fields of modernization, excluding exports, marketing and advertising. However, even this lag may be attributed to concentration of marketing and advertising on the level of parent companies, contrary to independent enterprises. On the other hand, looking at individual industries we see quite a different picture (Table 1). There are no indicators that can demonstrate advantages of group companies over independent enterprises across all industries. In some industries (food, machinery, chemicals and petrochemicals) group enterprises are much more active, in other they are less active (light industry, building materials).

Apart from enterprise activities for modernization, the survey included assessment of changes in labor productivity. The respondents were asked about changes in output and employment in 2001-2004. An indicator was

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constructed on the base of their answers to demonstrate increase in labor productivity during this period. We found that among those group member companies that are eligible for the conclusion that their labor productivity has changed, 60% have actually improved it, against 50% of independent enterprises. It is remarkable that among the group enterprises that successfully improved their efficiency, almost 60% relied on cutting down their jobs. In the group of independent enterprises that have improved labor productivity, decrease in jobs was found only at 1/3 of the respondents. The above data show that positive assessment of influence of the groups on enterprise performance given by managers is generally justifiable.

Table 1. Innovation Activity in Independent and Group Member Companies in 2000-2004 by industries

Industries Indicators	Fuel and power	Food	Machinery	Metals	Chemicals	Logging, woodwork and paper	Light industry	Building materials	Telecommunications
Substantial investment		+	**	+		+			
New capacities		+							**
New products									***
New technologies		***			+				***
Marketing and advertising		-	-						
Growing expenditures on marketing and advertising		***	**						
R&D	***								
Growing expenditures on R&D				+					
Exports							+		-
Growing exports		**	+		**				
ISO product certification	+	+	**	+	**				

Note: + Advantage of group companies, - disadvantage of group companies, only significant differences are indicated;

Growth in exports, R&D expenditures and marketing is indicated only for the enterprises that were actually engaged in these activities

*** Differences significant on the 1%-level; ** on the 5%-level; * on the 10%-level

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To sum up, the majority of HCGs were initiated by private owners of parent companies and/or independent enterprises in an effort to improve their competitive power. Most managers of enterprises believe that they have benefited from joining the groups, and the gains are related to competitive advantages in contrast to relation with authorities. The data show that in 2001-2004, group member companies more frequently demonstrated stronger competitive power.

1.4. Corporate Governance In Russian Holding Company Groups

1.4.1. Ownership and patterns of corporate governance

Analyzing the structure of owners and corporate governance in Russian HCGs, we can expect that the groups made greater advance than typical independent companies in the developments that take place in the Russian corporate sector today. Privatization, high level of concentration and rise of corporate governance tools marked with specific national features went somewhat further in the groups than in independent JSC. Corporate integration is the main way of reorganization in the Russian economy, and for this reason, final owners of holding group member companies should display more active attitude in this course of restructuring as well.

Survey data confirm our expectations. The overwhelming majority of enterprises, excluding those in fuel, electric power and communications, are controlled by private owners (Table 2). High proportion of state ownership in fuel, electric power and communications raises the overall rate of public control over the sample to 45% (measured by employment). Foreign owners have much lower control than Russian owners (chemicals is an exception in this respect, because foreigners are owners of a single large enterprise). Groups without steady control have a negligible share in the sample.

In terms of patterns of control, group member joint stock companies, particularly subsidiaries, are distinctly different from independent companies

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(Table 3). Among group member companies, a large part is under unilateral control. This control is largely based on shareholding: 2/3 of independent enterprises mentioned that they had a shareholder or a group of shareholders with a controlling stake, but almost 4/5 of group member companies already had such owners. A less frequent presence of an owner of a blocking package together with a controlling stake is an additional indicator of higher concentration of control in subsidiaries. On the contrary, parent companies of HCGs more often have an owner of a controlling stake along with a different person holding a blocking package.

Explanation of the pattern of corporate control in companies belonging to HCGs is a nontrivial task. It is well known that Russian JSC demonstrate high concentration of ownership and indivisibility of ownership and management as a reaction against weakness of property rights' protection. In turn, direct control of owners over a company's activity brings the demand for instruments of corporate governance down. In this context, corporate actions are preserved as an element of imitation (Yakovlev, 2004) in order either to make a demonstrational effect or to attract such external investors whose importance as a source of funds is low, which also implies aiming at a demonstrational rather than a financial result.

In the framework of this model of corporate governance, emergence and development of business groups looks inexplicable. To efficiently manage enterprises in a group, controlling stake of shares of all group companies and all power of decision making should be completely concentrated in the hands of one person. Otherwise, holding companies group will be defeated in terms of competitiveness by independent companies with unified ownership and management – but such cases are never met in the real world. A very interesting question is to what extent Russian HCGs demonstrate the first variant of development of ownership and control (a model of “private enterprise” or “co-operative of managers” in the entire group), and to what extent they are still using traditional instruments of corporate governance.

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Group member companies, especially subsidiaries, demonstrate lower scale of amalgamation of ownership and management. Half as less frequently again large owners participate in day-to-day supervision of subsidiaries as managers, and half as less frequently again a CEO is a shareholder in a joint-stock company. Both indications of indivisibility of management and control (large owners take part in management, a CEO is a shareholder) are present in a half of independent enterprises and only in one out of four subsidiaries of HCGs.

Concentrated external ownership is going together with stronger reliance of internal instruments of corporate governance (Table 4). The average share of managers on the boards of directors in holding member companies is 40% lower. The share of external owners on the boards is much higher in subsidiaries. Finally, the presence of independent directors is found twice as frequently on the boards of group member companies. The respondents representing group member JSC more frequently report that the boards are playing important role in decision making in their companies.

Use of instruments of corporate control that are important when ownership is separated from management presumes strong reliance both on the market of control and the market of managers. At enterprise level, this reliance must be reflected in terms of higher frequency of change of owners, top managers (including CEOs) and membership of the boards of directors (Table 5). In the period of 2001-2004 when integration went on most strongly, every third enterprise belonging to a HCG changed its owner. In the sub-group of enterprises where an owner of a controlling stake is present, indicators of renewal of the main owner are even higher. This means that redistribution and concentration of equity stakes are interrelated. The more frequent change of executive and supervisory bodies in a joint stock company (the CEO and the board of directors) is also related to change of the owner.

Although HCGs more often use external ownership and separation of ownership from management, the groups themselves are very heterogeneous.

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At least a third of the enterprises display features of a “private enterprise” or a “co-operative of managers” (concentrated ownership unified with the management) (Dolgopyatova, 2001)². This sub-group which is prevailing in metals, light and food industries, also includes smaller units with a half as large numbers of companies in the groups. In the group firms where ownership is not separated from management, a half of boards of directors consist managers and only a fifth are large external owners. Independent directors take part only in one board out of five. In the companies of this sub-group, CEOs were much less frequently changed in 2001-2004, and boards of directors were seldom renewed (Table 6).

Looking at the industries where subsidiaries with separated ownership and control are prevalent, we can receive an idea what is the tool that support property rights in the HCGs with separated ownership and management. For power and telecommunication companies the state as a dominant owner can establish and keep managerial discipline relying mainly on regulatory power than on the ownership rights. On the other hand, it is simply impossible to follow the national model of corporate governance for the state as dominant owner. The companies in chemical and petrochemical industry most probable belong to the subordinated holdings with the “*Gazprom*” as an owner. Here the property rights are highly supported by the position of “*Gazprom*” as the only supplier of the enterprises under analysis. It is necessary to stress that in the industries where ultimate owner of HCG doesn’t have an additional tools to discipline subsidiaries’ management the participation of owners in the management is typical.

2. It is necessary to stress that it is impossible to draw conclusions on the distribution of HCGs with separated ownership and control in the Russian industries using these data only. It is evident that from 173 respondents representing HCGs with separated ownership and management many belong to the same HCG. For electric power industry this is the holding “RAO UES” and subordinated sub-holdings, for telecommunication companies this is “Svyazinvest” company.

Table 2: Controlling Entities of HCGs, by industry

Industry	Private Russian owners		Private foreign owners		State		Control not yet established		Total number of respondents
	Number of respondents	Share in employment, %	Number of respondents	Share in employment, %	Number of respondents	Share in employment, %	Number of respondents	Share in employment, %	
Fuel and power	19	44,47	-	-	23	55,53	-	-	42
Metals	17	88,25	1	9,90	1	1,86	-	-	19
Machinery and metalworking	68	89,31	4	3,19	6	6,81	1	0,69	79
Chemicals and petrochemicals	7	57,23	1	35,22	1	7,55	-	-	9
Logging, woodworking, pulp and paper	17	70,67	2	5,89	-	-	2	23,44	21
Light industry	6	91,02	2	8,98	-	-	-	-	8
Food	53	88,13	3	6,30	4	3,87	1	1,71	61
Building materials	13	95,67	-	-	1	4,33			14
Communications	18	13,54	5	0,98	28	85,48			51
Total	218	50,68	18	3,95	64	44,54	4	0,83	304

Note: Industrial affiliation was determined according to industrial affiliation of respondents' enterprises; employment was defined in the same way

Table 3: Ownership and Management in Independent and HCG Member Enterprises

Indicators of concentration, separation and inseparability of ownership	Independent(1)	HCG members (2)	<i>In HCGs</i>		Differences significant on the 5%-level
			Parent (3)	Subsidiaries (4)	
A controlling owner or a controlling group of owners is present	85,2 (461)	90,7 (311)	90,7 (43)	90,7 (268)	Between (1) and (2)
An owner (consolidated group of owners) of a controlling stake (50%+1 share) is present	66,3 (460)	78,1 (297)	66,7 (42)	80,0 (255)	Between (1) and (4)
Apart from the owner of a controlling stake, an owner of a blocking package is present	32,7 (294)	27,2 (224)	50,0 (28)	24,0 (196)	Between (1), (3) and (4)
Large shareholders act as enterprise managers	56,2 (473)	35,0 (309)	53,5 (43)	32,0 (266)	Between (1), (3) and (4)
CEO (chairman of the board of directors) holds the enterprise shares, % of respondents	70,2 (477)	50,7 (304)	68,3 (41)	47,9 (263)	Between (1), (3) and (4)

Note: Only the share of respondents having positively answered the question was counted; the number of respondents is given in brackets, % of respondents

Table 4: Use of Instruments of Corporate Governance in Joint Stock Companies Belonging and Not Belonging to HCGs

Indicators of use of instruments of corporate governance	Independent(1)	HCG members (2)	<i>In HCGs</i>		Differences significant on the 5%-level
			Parent (3)	Subsidiaries (4)	
Share of managers on the boards of directors, % (in brackets, standard deviation)	53,72 (33,88) (467)	31,95 (30,21) (283)	34,12 (31,91) (39)	30,00 (29,54) (244)	Between (1) and (2)
Share of not working at the enterprise large shareholders on the boards of directors, % (in brackets, standard deviation)	23,61 (30,11) (467)	44,40 (30,86) (283)	28,14 (29,75) (39)	47,00** (33,81) (244)	Between (1) and (4)
Share of boards having independent directors, %	13,7 (467)	26,5 (283)	25,6 (39)	26,6 (244)	Between (1) and (2)
Shareholders meeting has strong influence on decision making, %	45,8 (478)	55,8 (310)	45,0 (40)	57,4 (270)	Between (1) and (2)
Board of directors has strong influence on decision making, %	63,1 (471)	71,4 (301)	77,5 (40)	70,5 (261)	Between (1) and (2)

Note: Only the share of respondents having positively answered the question was counted; the number of respondents is given in brackets, % of respondents

Table 5: Changes in Corporate Governance in Joint Stock Companies Belonging and Not Belonging to HCGs

Indicators of use of instruments of corporate governance	Independent(1)	HCG members (2)	<i>In HCGs</i>		Differences significant on the 5%-level
			Parent (3)	Subsidiaries (4)	
Main owner was changed in 2001-2004, % of respondents	26,0 (484)	35,1 (316)	39,5 (43)	34,4 (273)	Between (1) and (2)
Main owner changed was in 2001-2004, in enterprises having an owner or a group of owners holding a controlling block by the time of survey, % of respondents	29,5 (302)	37,0 (230)	39,3 (28)	36,6 (202)	Between (1) and (2)
In 2001-2004, CEO was changed an least once, % of respondents	31,9 (498)	49,2 (323)	27,3 (44)	52,7 (279)	Between (1), (3) and (4)
In 2001-2004, board of directors was changed substantially or completely, % of respondents	24,6 (475)	45,2 (303)	25,6 (39)	48,1 (264)	Between (1) and (4)

Note: Only the share of respondents having positively answered the question was counted; the number of respondents is given in brackets, % of respondents

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Table 6: Subsidiaries in HCGs with and without Separation of Ownership from Management

<i>Large owners</i>	Do not take part in management	Take part in management
<i>Indicators of enterprises and HCGs:</i>		
Average employment (1,000); in brackets, standard deviation	4,0 (9,8)** (173)	1,8 (4,63)** (81)
Share in total employment of the sample, %	83,0 (173)	17,0 (81)
Industry (in which shares of groups in employment are much higher than in total sample)	Power, Telecommunications, Chemicals	Metals, light, industry, food, building materials
Average number of enterprises per group; in brackets, standard deviation	33,28 (66,35)** (159)	15,25 (43,00)** (76)
<i>Indicators of corporate governance</i>		
Average share of managers in boards of directors (%); in brackets, standard deviation	20,67 (22,73)*** (156)	49,89 (31,65)*** (79)
Average share of large outside shareholders directors (%); in brackets, standard deviation	57,62 (30,98)*** (156)	26,50 (28,88)*** (79)
Presence of independent directors on boards (% of respondents having mentioned their presence)	29,5** (156)	17,6** (74)
<i>Indicators of change of corporate control</i>		
Main owner was changed in 2001-2004, % of respondents	32,4 (173)	39,7 (81)
CEO was changed at least once in 2001-2004, % of respondents	60,1*** (173)	38,3*** (81)
Board of directors was renewed substantially or completely in 2001-2004, % of respondents	57,9*** (164)	26,6*** (79)

Note: Only the share of respondents having positively answered the question was counted; the number of respondents is given in brackets;

χ^2 criterion was used for comparison of frequencies, and F-statistics, for comparison of averages

*** Differences significant on the 1%-level ; ** on the 5%-level

To sum up: ownership structure of group companies does not substantially differ from that of independent enterprises. However, this is not completely true for the patterns of corporate control. JSC affiliated to the groups again are very heterogeneous. The smaller companies and groups exhibit the pattern of non-separated ownership and management, and their demand for instruments of corporate governance is low. The separation of

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ownership and management and high demand for external and internal instruments of corporate governance is typical for the substantial part of subsidiaries, but especially for state-owned ones in the regulating industries or for those included in the subordinated holding of the only supplier.

1.4.2. Centralization of decision-making and the role of stakeholders in corporate governance

During the last decade, abundance of organizational forms in the Russian industry was giving birth to a variety of opinions about mechanisms of decision making in Russian HCGs. Some authors believe that both strategic and operative decisions in the groups are extremely centralized (TTTP, 2004), but other think that strategic and operative decisions are divided between parent companies and subsidiaries in more advanced way (Radygin, 2004). Finally, there is an evidence that authority is divided between parent companies and subsidiaries in a rather irregular way: a parent company controls financial decisions (both strategic and operational ones in a traditional concept of this division), and subsidiaries control production decisions (Avdasheva, 2005).

The results obtained from our survey (Fig. 3) are mixed. Modes of strategic and operative decision making are apparently different. However, the degree of centralization of the decisions doesn't look very high. Strategic decisions are centralized only in 40% of the groups, and operative, only in 5%. The place where strategic decisions are taken is statistically dependent on whether large owners take part in management: if they do, most decisions are coordinated within the groups. This pattern, as we have mentioned above, is typical of smaller enterprises where cost of centralization of decisions is lower.

The degree of centralization of strategic decisions is positively related to the scale of a HCG: the larger is the membership, the higher is the role of the parent company (owners of the group) in decision making. For instance, in the category of HCGs with membership of less than four companies (50

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respondents), strategic decisions are made on the group level in 26.5% of all cases, but in the category of groups consisting of more than 30 members (35 respondents), group level decisions are made in 60% of all cases.

Explorers of Russian enterprises are used to mention high importance of network forms of cooperation, which in some cases are inherited from the Soviet period. Influence of network-type formations on behavior and position of enterprises was evaluated either positively (Moers, 2000), or very negatively (Gaddy, Ickes, 1998). In the framework of our survey, using a special set of questions we evaluate the scale of cooperation between enterprise owners, on the one hand, and different groups of stakeholders, on the other.

Although group member companies more often coordinate their strategic decisions with different types of stakeholders, the scale of this coordination is quite modest. A large part of the respondents – 69% of independent enterprises and respectively, 57% of group member companies have reported that they coordinate their strategic decisions with neither outside stakeholder. The difference between group member companies and independent enterprises is due to larger scale of business activities of the former. In the group member companies employing more than 10,000, stakeholders have much stronger influence on decision making. In turn, member companies of smaller groups show little difference from independent enterprises (Table 5).

However, even concerning the largest HCGs we must treat the conclusion that decisions are actively coordinated with great caution. Almost a half of the well represented in our sample group member companies, which belong to the largest structures (employing more than 10,000), are in electric power and telecommunications. They are operating as natural monopolies and therefore, are in a special position which obliges them to coordinate important decisions with federal and regional authorities.

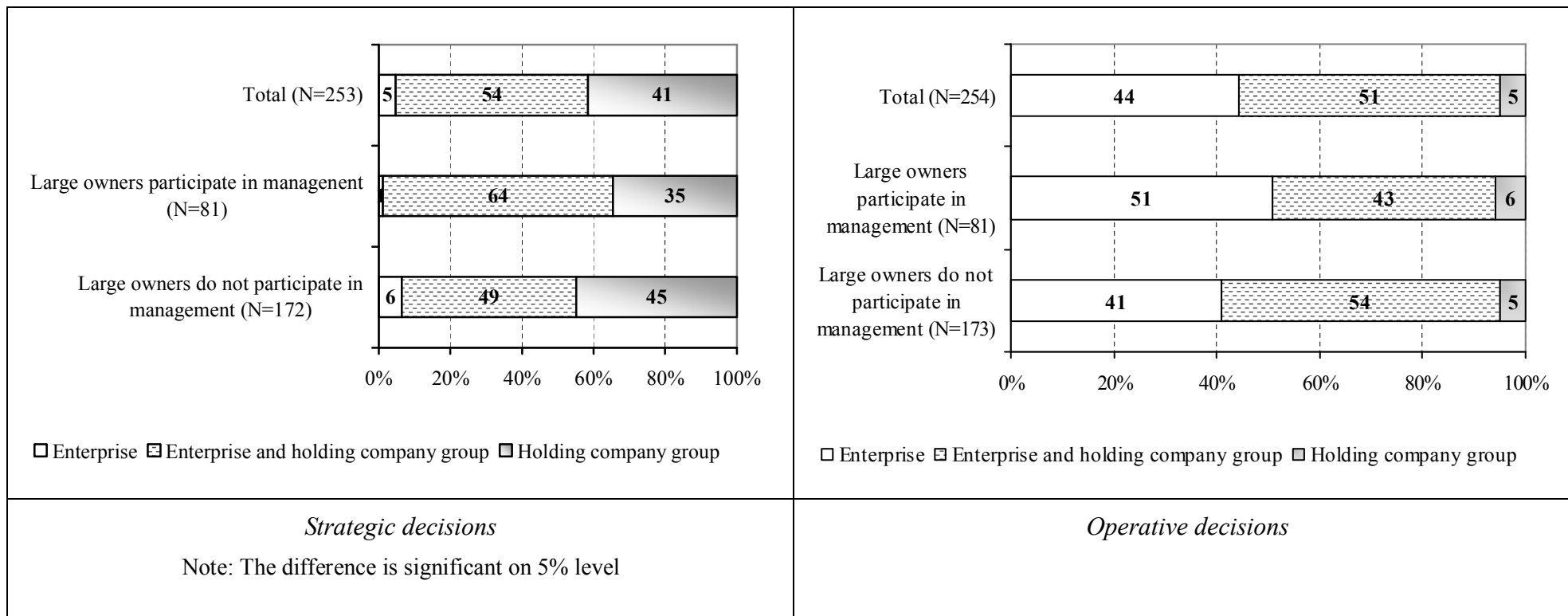


Figure. 3: Centralization of strategic and operative decisions in subsidiaries of HCGs

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Table 7. Percentage of companies coordinating strategic decisions with outside stakeholders (%)

	Holding group member companies with employment of			Автономные предприятия
	Less than 2,999	From 3,000 to 9,999	More than 10,000	
Federal authorities	12	16	35	10
Regional authorities	29	23	51	23
Labor collective	24	28	56	27
Banks (not group members)	15	16	25	12
Suppliers and customers (not group members)	18	17	27	13
Members of HCG	30	24	39	-
Number of respondents	97-100	79-82	110-114	469-472

The survey doesn't confirm the view of HCGs as corporations where managerial decisions are extremely centralized. On the other hand, there is no proof of a hypothesis that influential groups that are neither managers nor owners are active participants of corporate governance.

1.4.3. Internal financial market

Evidence about an internal financial market in Russian HCGs is controversial. Earlier studies (Perotti, Gelfer, 2001) confirmed the hypothesis about its existence, but the later didn't (Shumilov, Volchkova, 2005). In order to get a description of the scale and role of the internal financial market in the groups, the respondents were asked about proportions of different sources of funds for investing in their enterprises in 2001-2004. The share of own funds in the investment is relatively low and ranging from 50% to 60%. In comparison with independent enterprises, group member companies have a slightly smaller share of their own funds in financing capital investment.

In the group companies, the second and third places among financial sources for investing are shared by bank borrowings and group funds (15-20%). Funds of partners not affiliated to the groups and proceedings from floatation of securities (equities and bonds) are relatively much smaller – up to 5% on the average. Budgetary funds from federal and regional governments are insignificant (about 3%).

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This data do not perfectly comply with the aggregated statistics on investment financing by large- and medium-scale companies. According to the Rosstat data³, in 2005 the share of own funds in investments in fixed assets was 48%, the share of parent organization (including parent companies in HCGs) was 11%, the share of bank's credits was about 7% that is more or less close to the survey's results. At the same time the share of budgetary funds is remarkably higher according to Rosstat data – about 18%, divided between federal and regional budgets in proportion one to two.

About a third of the respondents have reported that they do not use any group funds for financing their investment. The highest share of such enterprises is in electric power (about 60%) and in building materials (50%), and the lowest is in chemicals and petrochemicals (22%) and in the light industry (17%).

Since financing of enterprises from group funds is not a negligible component, we have to find out whether internal financing is complementing or crowding-out other sources of funds. If the share of financing from group funds were in negative dependence on the shares of bank borrowings or proceedings from floatation of securities, we could conclude that external sources of funds were being replaced with internal sources. However, we didn't find a statistically significant correlation between the shares of group funds and other sources of financing capital investment. At the same time, we have obtained data telling that internal financial market is evolving better in those groups that made no dividend payments on ordinary shares in 2001-2003 (Fig. 4). This evidence could be interpreted in such a way that for JSC which receive financial resources from parent companies it is less important to attract external investments. Correspondingly, the demand for corporate governance is lower. Less frequent dividend payment is just a sign of that.

3. Social and economic performance of Russia (Socialno-ekonomicheskoye polozheniye Rossii), January 2006. Section 4.3, Table 4.

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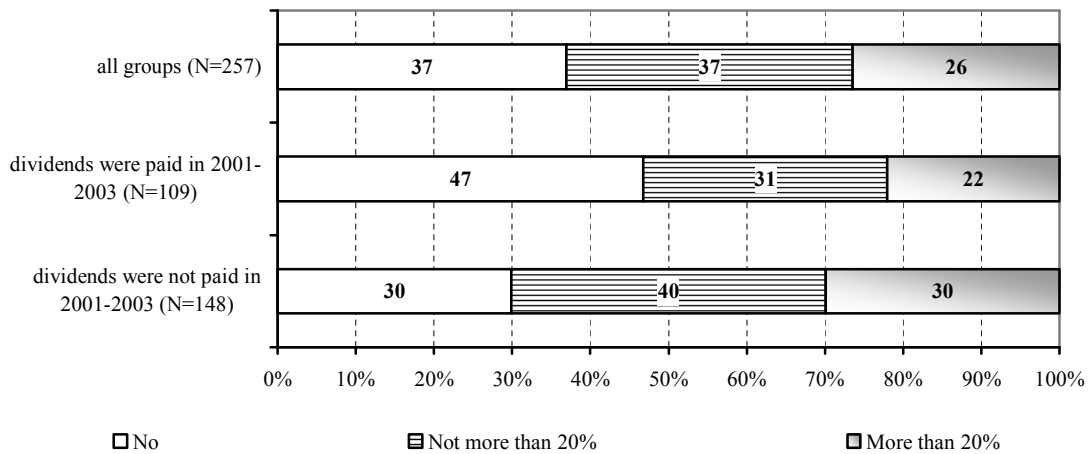


Figure 4: Share of HCG funds as a source to finance investments in 2004 (the difference is significant on 5% level).

1.5. Conclusions

The data obtained from the survey enable us to clarify the assessment of Russian HCGs. The overwhelming majority of enterprises joined the groups after mass privatization was over, during an economic upswing since 1999. However, the largest HCGs including companies with state ownership were created by the initiative of the state, some even before the start of privatization.

The majority of deals that arranged affiliation of companies to the groups were “friendly”, in contrast to “hostile” mergers. Gains from joining the groups, although quite diverse by industry, are mainly related to improvement of competitiveness in the marketplace. Reasons to increase bargaining power in relations with public authorities better are insignificant, especially in the deals that were concluded after 1999. High personal assessments of the role of holding company in the restructuring of enterprises are supported by the data on performance: the share of companies having improved their labor productivity in 2001-2004 was higher among the group members.

Ownership is as highly concentrated in Russian HCGs as it is in independent companies, but it is more frequently separated from management. More than a half of JSC in the groups are using the model of external

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ownership and generate high demand for corporate governance. It is necessary to mention however that the main part of these JSC belongs to the HCG in regulated industries with the state as a dominating owner or to the holding subordinated to the only supplier as an ultimate owner.

We got no evidence either of high concentration of decision making on the level of parent companies of the groups or of active participation of outside stakeholders in corporate governance. Most probably, managers of group member companies maintain considerable autonomy, while strategic decisions are concentrated in the upper layer.

The data on the use of group funds for financing capital investment confirm the hypothesis about the existence of internal financial market in Russian companies. Yet it remains unclear whether borrowed funds are crowding out the internal group financing, but judging from a negative correlation between the use of group funds and dividend payments, the internal financial market is replacing at least financing from issuance of shares.

Generally speaking, the results of our survey confirm the interpretation of Russian business groups as a way to create new corporations. Specific features of ownership, management and demand for corporate instruments allow us to make a conclusion that development of HCGs will remain an important factor in the evolution of the national model of corporate governance.

The results obtained seem important to contribute to the discussion of national corporate governance model and determinants of firms' boundaries in the Russian economy. In spite of the prevailing type of the governance with the ownership not separated from management, there is an evidence of demand on both external and internal instruments of corporate governance. At the same time corporate governance itself plays a subordinated role in many companies with external ownership or at least the corporate governance is supported by the additional tools, sometimes by the regulatory power of the state, sometimes by the monopoly power of the only supplier. Management by the owners (or

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ownership by the managers) spread not only among stand-alone companies but also among holding company groups. It seems that in spite of the common view on omnipotent oligarchs the national model of corporate governance should be the factor restricting the firms' growth. However, many of these conclusions are preliminary and definitely require further analysis.

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Chapter 2

Membership of Russian Companies in Enterprise Associations

Victoria V. Golikova

2.1. Introduction

Non-government business organizations (further, NGBOs) do not belong to the new institutions, which emerged in the transition from centrally planned to a market economy. A number of nationwide unions and associations that are in existence at present were “born” in the Soviet past, such as the Russian Chamber of Commerce and Industry, one of the largest federations with a network of regional chambers in every region of Russia, which unifies 20,000 enterprises and organizations. Before the start of market-oriented reforms, the prevailing type of enterprise unions in Russia were organized by industrial sector, and they never were and never could be equal partners in their dialogue with the authorities. Their role in the economy and lines of their operations were determined by the policies of government agencies.

With transition from a centrally planned to a market economy and development of legal regulations for the new system of relations between economic agents a great number of new unions and organizations came into being, and the old ones underwent a certain transformation. Newly organized unions expressed the interests of large, medium-size and small business entities, and also professional guilds, unions and associations. Along with them, new organizations by industrial sector appeared on the scene, often competing with each other for “representation of interests” of whole target groups. Some

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NGBOs (such as “the New Russian Union of Industrialists and Employers”) at first unified the interests of a narrow segment of industrialists (in the above case, owners of big and super-big businesses), but later on chose to present themselves as national unions and now are expanding their membership by way of inclusion of medium-size and small enterprises.

Evolution of the NGBOs as institutions of civil society in the period of transformation was not entirely smooth. Empirical surveys show that usurpation of power, dependence on authorities, favoritism towards those in “close connection” and discrimination against ordinary participants were quite usual at the initial stage of operation of newborn unions and associations of enterprises and entrepreneurs (Golikova et al, 2003). For this reason, most of these institutions had no such asset as good name in the initial period of economic reforms.

The majority of existing enterprise associations was set up after 1998 financial crisis¹. According to the manual “Enterprise associations in Russia” at the beginning of 2000s there were more than 1000 registered associations. (Rossiyskie ob’edineniya, 2001). To what extent did this most dramatic period of transition in the Russian economy, the era of redistribution of property rights, help to nurture civilized forms of enterprise associations and unions? How is this institution of civil society evolving in terms of quantity and quality? This paper is focused on estimation of demand for this institution from enterprises, on evaluation of the factors that generate this demand and on assessing how well the NGBOs as an institution which expresses collective interests of business community is fulfilling its potential. The paper is based on the results of empirical surveys conducted in 2002-2005 with the author’s participation, of which the central one is the survey of top managers of 822 large and medium-sizes joint stock industrial and communications companies

¹ A survey of 200 business associations implemented by W. Pyle and the Levada Analytical Center proves that the solid majority of associations were initiated in the past decade, with 2000 being the year most frequently cited. A small minority reports entering associations during the Soviet era. (W. Pyle, 2006a)

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carried out in 2005 in 64 regions of Russia by the Analytical Center of Yuri Levada (Levada Center) ² under the Joint Research Project that was conducted in 2005 by the Institute for Industrial and Market Studies, State University-Higher School of Economics (SU-HSE) and the Institute of Economic Research, Hitotsubashi University. For a comparative analysis, we also invoked:

The results of a survey of 304 open joint stock companies in industry, transportation, construction and communications carried out 2004 by the Autonomous Non-profit Organization “Projects for the Future: Scientific and Educational Technologies” in three regions of Russia (Golikova et al, 2003);

The results of a survey of 147 enterprises of different organizational and legal forms carried out by the same organization in 2005 in five regions of Russia (Tikhomirov, ed., 2005);

In-depth non-formalized interviews with heads of a number of enterprise associations collected in the project “Insiders, Outsiders and Good Corporate Governance in Russia and Bulgaria” (TTPP, 2004).

2.2. The Level of Consolidation of Interests of Russian Joint Stock Companies: Membership in Enterprise Associations and Its Determinants

The results of a number of studies conducted in 2002-2004 found out that demand for law was forming in the business community and that preference was taking shape for legal civilized ways of doing business (Development of Demand for Law, 2003, TTPP, 2004). One of indicators of this demand is membership of entrepreneurs in a number of non-government organizations – guilds, unions, associations (further, NGBOs) which are

² The paper was prepared within the framework of the project ‘Business Integration in the Corporate Sector: Incentives, Patterns and Economic Effects’, which was carried out in 2005-2006 with a research grant from the Moscow Public Scientific Foundation, sponsored by the United State Agency for International Development (USAID). The point of view presented in the paper may not agree with points of view of the above named organizations.

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provided for in Article 121 of the Civil Code of the RF for the purposes of coordination of their entrepreneurial activity and also representation and defense of common property interests.

The results of the 2005 empirical survey show that slightly more than a half of medium-size and large Russian enterprises (54, 7%)³ are members of one or another non-government organization of entrepreneurs. Comparing the data of the 2002 and 2005 surveys in commensurable ranges of industries, numbers of enterprises and their organizational and legal forms we find that membership follows a positive trend, proving that this institution of civil society is rather growing in popularity with representatives of medium-size and large enterprises (by 4.2 percentage points in three years). As for the level of consolidation of business community in the sphere of Russian small enterprises, at present it is at least two or three times lower. For example, the 2005 survey (Tikhomirov, ed., 2005) has revealed that only 19.3% of enterprises and organizations with less than 100 employees are members of various NGBOs.⁴

Examination of medium-size and large members of trade associations in a whole (Fig. 1) allows us to point out that their majority (3/4) prefer to be a member of only one out of three types of associations, choosing a nation-wide or industry-wise one a little more frequently than a regional one. A quarter of NGBO members are in different associations at the same time. One out of ten NGBO members on the average chooses the strategy of simultaneous membership in all three types of associations.

³ In the survey of 1300 industrial enterprises implemented by W. Pyle in 2004, 58% of respondents of the firms with over five hundred employees belong to at least one association. (W.Pyle, 2006a). In our survey implemented a year later in 2005 the membership rate for this group is a little bit higher – 62,7%, though the results are not strictly comparable because our sample includes only JSC.

⁴ The survey implemented by W. Pyle in Russia in 2004 provides an evidence of practically the same rate (21%) among firms with under one hundred workers (Pyle, 2006a).

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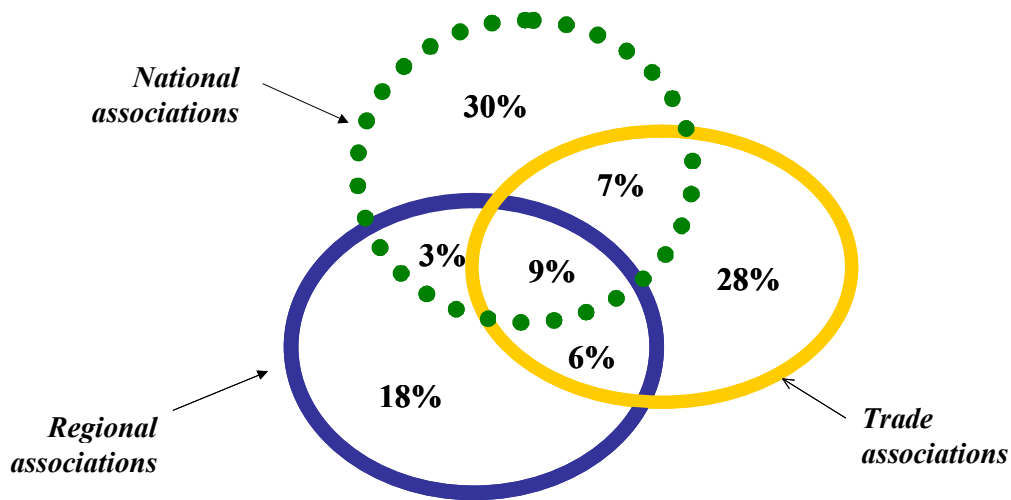


Fig. 1 Strategies of Membership in Associations (% of number of members)

Source: Survey of 822 joint-stock companies conducted in 2005 by the SU-HSE (Russia) and Hitotsubashi University (Japan).

Membership in the associations correlates with industrial affiliation of the enterprises, their size by number of employees, their organizational and legal form and geographical location. At the same time, this membership does not depend on history of their foundation and belonging to business groups: the privatized ones and those established after 1991, members and non-members of business groups are represented equally.

The most distinct differences are disparities by industry and by size. For instance, variations by shares of association members in the whole sample between the leading industry (machinery) and the outsider (chemicals and petrochemicals) are 24.5 percentage points (differences are significant at the 0.003-level). However, they are due exclusively to typical enterprise sizes in each concrete industry.

The larger the Russian joint stock companies are, the more often they consolidate their interests in the NGBOs (Fig. 2). Dependence of membership in a NGBO on size is typical of all kinds of associations, whether they are national, regional or trade ones. As well as in the 2002 survey, the overwhelming majority (70.2%) of large enterprises with more than 1,000 employees are members of one or another association; in the medium-size

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category (under 500 employees) their share is much lower – about a half (differences are significant at the 0.000-level). Meanwhile, statistically significant correlations between numbers of employees and shares of enterprise members in the NGBOs can be noticed only in the sub-sample of open joint stock companies, and they are absent between closed joint stock companies.

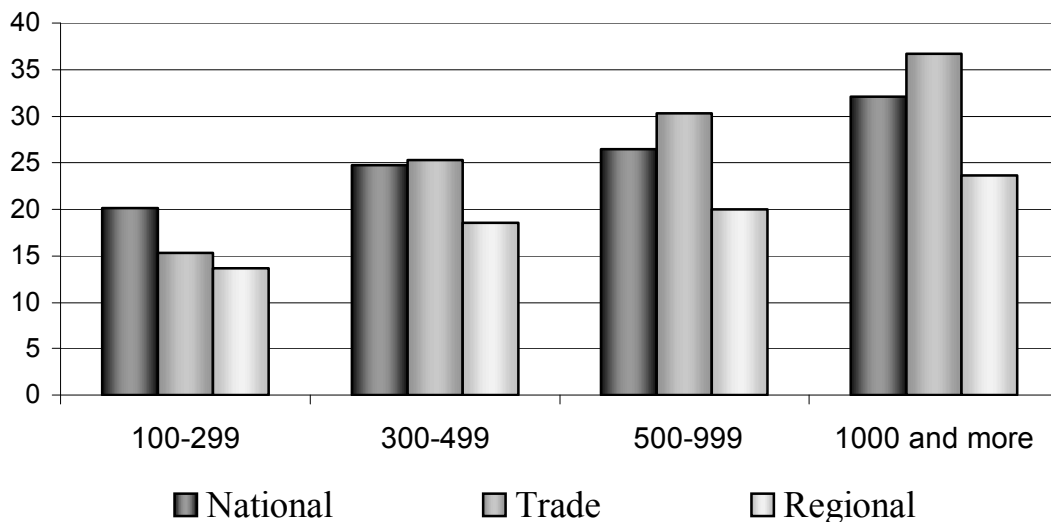


Fig.2 Joint Stock Companies Membership in Associations by Enterprise Size*, %

* - by number of employees

Source: Survey of 822 joint-stock companies conducted in 2005 by the SU-HSE (Russia) and Hitotsubashi University (Japan).

In the 2002 survey of joint-stock companies, substantial differences by region were found in shares of NGBO members. For instance, regional respondents were members of NGBOs by a factor of 1.5 less frequently than in Moscow (Golikova, 2003). The results of the 2005 survey show that geographical differences in NGBO membership are still significant among joint stock companies, and even as they are insignificant for participation in national and regional associations, they are important for membership in trade associations. The level of joint stock company membership in any type of NGBO is above the sample average in the European part of Russia – in the Central, North-Western and Ural Federal Districts. It is lower in the

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Privolzhsky (Volga) and Southern Federal Districts, and in the Asian part of Russia (the Siberian and Far Eastern Federal Districts). High levels of joint stock company membership in NGBOs are also typical of the North-West and Urals (mentioned by 38% of the respondents) where it is twice as high as in the Southern and Privolzhsky (Volga) Districts.

Differences related to organizational and legal forms of enterprise are less distinctive. Membership in NGBOs is 9.5 percentage points higher among open joint stock companies than among closed joint stock companies (differences are significant at the 0.010-level). The survey has revealed that joint stock companies with fairly high level of concentration of ownership (having a single owner with a no lower than a blocking package of shares) are more eager to take part in NGBOs than joint stock companies with no larger shareholders (Table 1). In the former group, the share of members in NGBOs is 13.8 percentage points higher. The level of business integration is insignificant for membership in NGBOs.

Table 1 Dependence of Level of Ownership Concentration on Membership in NGBOs % of surveyed enterprises)

Presence of an owner of no lower than a blocking package of shares % in column	Membership in NGBOs			Balance of assessments*	N
		No	Total		
Yes	57,2	42,8	100	+14,4	650
No	43,4	56,6	100	-13,2	99
In total sample	55,4	44,6	100	+10,8	749
Statistical importance of differences is 0.010					

* Balance of assessments is calculated as the difference between the share of respondents having mentioned their membership in NGBOs ('plus') and the share of respondents that are not members in NGBOs ('minus').

Source: Survey of 822 joint-stock companies conducted in 2005 by the SU-HSE (Russia) and Hitotsubashi University (Japan).

Membership in the NGBOs is more attractive to those CEOs who are large shareholders (Fig. 3). Almost 2/3 (62.1%) of them are NGBO members, while among the enterprises headed by hired managers this share is less than a half (47.9%) (Differences are significant at the 0.002-level).

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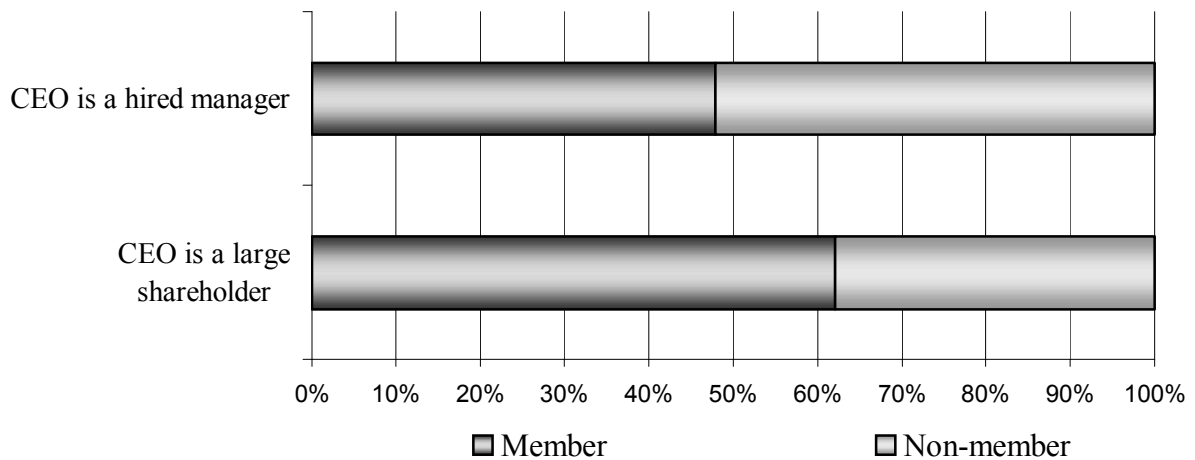


Fig.3 Status of CEOs in Joint Stock Companies and Membership in Associations *

*Status of the CEO was determined on the base of two indicators (whether the CEO is a shareholder in the company or whether large shareholders are managers)

Source: Survey of 822 joint-stock companies conducted in 2005 by the SU-HSE (Russia) and Hitotsubashi University (Japan).

The result of this survey show that the age of the CEO positively correlates with NGBO membership. This is quite expectable because a number of unions, especially trade associations were “born” in the Soviet past and being their member is homage to a tradition for the cohort of top managers belonging to the older age group.

Along with age, experience of top managers in government agencies also positively correlates with NGBO membership (Table 2). Almost 2/3 of joint stock companies having managers with this experience are NGBO members, but only a half are members in cases when such experience is lacking. Regarding types of unions, experience in government agencies is significant for membership in regional associations.

Table 2 Experience of Top Managers in Government Agencies and Membership in Associations (% of surveyed enterprises)

Presence of experience % in column	Membership in NGBOs			N
	Yes	No	Total	
Yes	63,6	36,4	100	206
No	51,9	48,1	100	536
In total sample	55,1	44,9	100	742
Statistical importance of differences is 0.004				

Source: Survey of 822 joint-stock companies conducted in 2005 by the SU-HSE (Russia) and Hitotsubashi University (Japan).

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What types of firms are interested in NGBO membership? Our original hypothesis was that under increasing pressure of globalization, steadily growing financially stable Russian companies should strive for becoming active members in NGBOs to be able to defend collective interests in the domestic market and overseas. Rising competition with foreign and international companies will push them for taking this option. The results of our survey show that as far the force of competition is in question this hypothesis is proved to be only partly true. Levels of competition with Russian producers, foreign companies in Russia and enterprises in the CIS countries do not correlate with membership in NGBOs. In respect to membership in any NGBO, the significant matter is pressure of competition from foreign producers in Eastern Europe, Baltic countries, Turkey and China. For instance, among the enterprises that have reported about very tough or moderate competition the share of members of associations is 10-12 percentage points higher than among those that feel no or very weak competitive pressure (differences are significant at the 0.032-level). The results of our survey have confirmed that severity of competition with foreign makers is encouraging the enterprises to consolidate their positions in nation-wide associations, which defend common interests of domestic producers.

While in the 2002 survey the correlation between membership in NGBOs and financial condition of enterprises was hard to trace, in 2005 we can state with confidence that successful Russian companies are interested in NGBOs. In general, the better is financial condition of the enterprise by subjective estimate of the respondent, the more likely this enterprise is a member of an association (this is typical only of open joint stock companies and unusual for closed joint stock companies). For instance, in the group of enterprises in “good” or “rather good” financial condition about 60% are members of associations, but in the group in “poor” condition the share of members is two times less (differences are significant at the 0.037-level). In addition to subjective estimates of financial conditions of enterprises by their

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respondents, other indicators also confirm that NGBO members are significantly better off than those outside unions and associations (Table 3). Members of associations have a much higher share of exporters and of fast growing financially well-off companies, which made substantial capital investment in 2000-2004 from their own funds and generously raised (doubled and more than doubled) compensation of their employees.

Table 3 Indicators of Financial Conditions of Joint-Stock Companies and Membership in NGBOs(% of the number of respondents)

Indicator	Share of respondents having reported about their membership % in lines			Statistical significance of differences
	Type of association	Members	Non-members	
Share of companies having doubled and more than doubled sales volume at current prices in 2000-2004	Any	36,4	28,6	0,026
	National	36,4	31,6	No (0,585)
	Trade	36,3	31,6	0,005
	Regional	43,7	30,3	0,016
Share of companies having doubled and more than doubled wages in 2000-2004	Any	42,5	31,5	0,001
	National	46,2	34,3	0,002
	Trade	40,3	36,4	0,061
	Regional	43,7	36,0	0,023
Share of exporters	Any	55,0	41,5	0,000
	National	60,3	44,8	0,000
	Trade	53,7	47,0	0,095
	Regional	52,0	47,4	No (0,301)
Large-scale investment	Any	48,1	29,5	0,000
	National	46,9	37,1	0,013
	Trade	53,3	34,6	0,000
	Regional	51,0	37,0	0,002
Share of own resources in investment is more than 60%	Any	49,5	34,6	0,001
	National	51,8	40,1	0,049
	Trade	50,0	40,7	0,031
	Regional	50,0	40,7	No (0,505)

Source: Survey of 822 joint-stock companies conducted in 2005 by the SU-HSE (Russia) and Hitotsubashi University (Japan).

This tendency is confirmed by other empirical surveys as well. For example, the results of the BEEPS poll (2005) based on a sample of small and mid-sized enterprises also demonstrated that membership of associations usually consists of the more dynamic and larger enterprises, and also of

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exporters. They also look better than the non-members of NGBOs in terms of their innovational activity (Desai, 2006).

What is the vector of the link between membership in NGBOs and economic efficiency of enterprises? In our opinion, in Russian reality it is not entirely correct to assume that membership in associations helps to improve enterprise performance, although such influence certainly exists⁵. Most probably, at the time when the new brand of associations is coming into being the already successful businesses are seeking ways to make their market positions stronger with various mechanisms for lobbying their interests, including the NGBOs. Besides, unpredictable behavior of authorities, which has been mentioned in many surveys, and frequent changes in legal regulation of business activity compel economic agents to consolidate in order to defend their collective interests. Participation in associations (especially in nationwide and large-scale trade associations) gives them opportunities to lobby their interests in a civilized way or at least to adapt themselves well in advance to new conditions in cases when government agencies change the rules of the game.

Members of associations also frequently use other channels for their dialogue with the authorities – such as participation in advisory councils to regional and municipal authorities, to ministries, agencies, presidential administration of the RF (Fig 4).

⁵ W. Pyle reported about strong and positive correlation between restructuring behaviors and membership in business associations. His econometric analysis showed that if we were to compare two firms that were alike in all observable respects but their membership in business associations, the one that belong to business association is more likely to be engaged in investments in their workforce and capital stock, in new technologies and modes of production, etc. (Pyle, 2006a)

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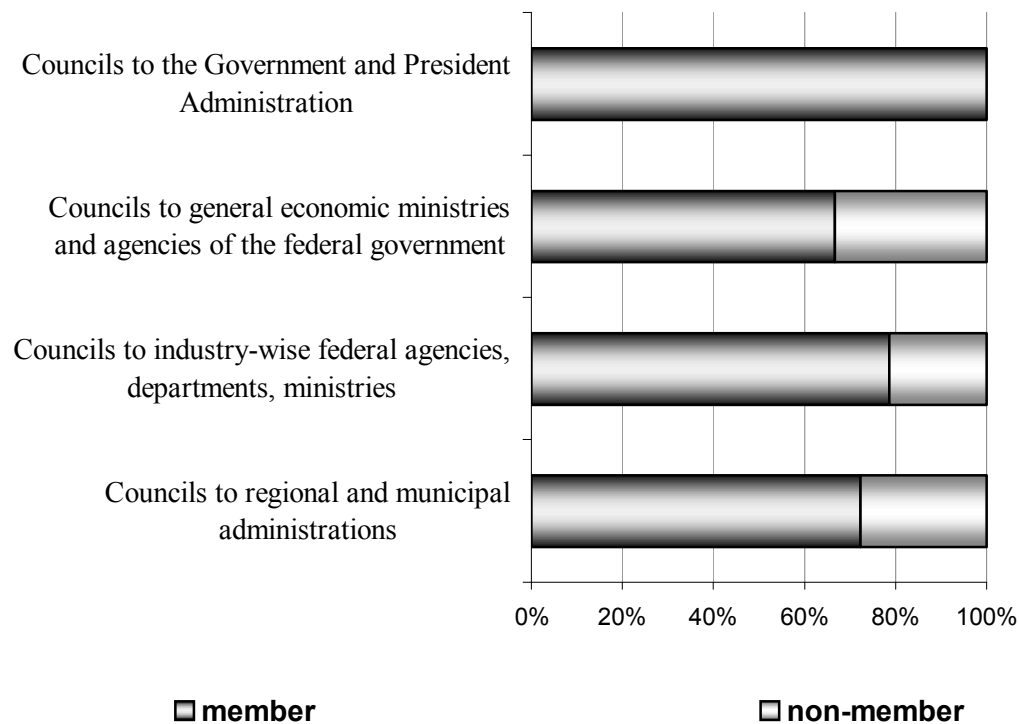


Fig. 4 Participants in Advisory and Expert Councils at Different Levels of Government

The overwhelming majority (more than 80%) of Russian joint-stock companies give support of one or another type to the authorities, mostly local and regional. Our survey has displayed higher activity of members of business coalitions in their relationships with the authorities in comparison with non-members of NGBOs (Table 4). Why is it so? One of possible explanations is that membership in associations, as we have mentioned above, is more typical of financially sound firms, for which the burden of financial contributions to municipal and regional programs is less serious. This is why the authorities ask them for help more often. However, regional and local authorities are not the only beneficiaries in these relations. The survey results give evidence that the NGBO members, along with rendering various services and assistance to local authorities, much more frequently (by factor of 1.5-2 times) received financial and organizational aid from them. These relationships have a quality of an informal bargain, and they make easier for the authorities to perform their public functions and for the firms, to work in a certain area.

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Table 4 Types of Support Rendered to Authorities and Aid through Various Channels Depending on Membership in NGBOs(% of the number of respondents)

Rendering support % in column		Membership in NGBOs		It total sample
		Yes	No	
Rendering support to local authorities by firms	Yes	88,8	74,5	82,4
	No	11,2	25,5	17,7
	Total	100	100	100
	N	430	353	783
Statistical importance of differences is 0.000				
Receiving financial support from the authorities by firms	Yes	27,0	18,1	23,0
	No	73,0	81,9	77,0
	Total	100	100	100
	N	430	354	784
Statistical importance of differences is 0.003				
Receiving organizational support from the authorities by firms	Yes	36,1	19,7	28,6
	No	63,9	80,3	71,4
	Total	100	100	100
	N	421	351	772
Statistical importance of differences is 0.000				

Source: Survey of 822 joint-stock companies conducted in 2005 by the SU-HSE (Russia) and Hitotsubashi University (Japan).

So, membership of Russian joint stock companies in NGBOs is related to a large group of heterogeneous factors which, in turn, correlate with each other. Which factors give most valuable information for making a prediction that a joint stock may be a member of an association? We carried out an econometric analysis, having built a logistic regression model with step-by-step inclusion of variables. For a predictor we took a variable describing membership of a joint stock company in a NGBO, which possesses the value of 1 when a company joins an association (or a concrete type of associations), and the value of 0 when it doesn't.

All co-variant factors were divided into five groups:

1. Basic characteristics of the company that may influence its involvement in any NGBOs (size, industrial affiliation, location in a certain federal district).
2. The factors that are related to the organizational-legal form, the level of integration of the firm (an independent form or a member of a business group), and also its ownership and management (how much is its

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ownership concentrated, is its ownership non-separated from management, how old is its CEO).

3. The factors that are related to influence of competition with foreign producers and globalization of the company's operations (presence of exports and imports).
4. The factors that disclose an established system of relations with authorities (rendering help to local authorities and receiving financial and organizational assistance from them, experience of top managers in government agencies in the previous 10 years, participation in advisory and expert panels to different levels of government).
5. Indicators of financial and economic health of the firm (subjective estimate of financial and economic health by the respondent; large capital investment made in 2000-2004; rates of growth in sales and wages in 2000-2004).

The results of our econometric analysis are given in Table 5. They show that out of basic characteristics of the company, only its size is valid for predicting whether it has a probability to be a member of any NGBO (the larger is the firm the more chances it has to be a member of an association), while industrial affiliation, location, participation in business groups, organizational and legal form of the company are insignificant.

We have found that level of ownership concentration is also insignificant. At the same time, concentration of both ownership and management in the hand of a CEO is important, as well as his or her age: these features can increase by factors of 1.6 and 1.3, respectively, the probability that the company is a member of a NGBO. The combined impact of these two factors gives grounds for an assumption that at the present time the NGBOs are essentially the platforms for presenting the interests of the "old guard" – the CEOs that became owners due to privatization. In the group of factors that describe financial and economic health of the firm, the most important one is whether it made substantial investment in 2000-2004, which can increase the probability

Table 5

Factors to Determine Membership of Firms in Enterprise Associations	Type of association							
	Any		National		Trade		Regional	
	B	Exp(B)	B	Exp(B)	B	Exp(B)	B	Exp(B)
1. Basic characteristics of the firm								
Firm size	0,226*** [0,081]	1,254			0,265*** [0,087]	1,304		
DISTRICT (Central District as a basic category)					**			
(1) North-Western district					0,693*** [0,309]	2,000		
(2) Southern district					-0,215 [0,417]	0,807		
(3) Privolzhsky (Volga) district					-0,218 [0,465]	0,804		
(4) Ural district					0,672** [0,326]	1,958		
(5) Siberian and Far-Eastern district					0,195 [0,330]	1,215		
2. Organizational and legal form integration, ownership and management								
Presence of large shareholders (absence of large shareholders is a basic category)			**					
(1) Presence of a blocking package of shares			1,210*** [0,418]	3,353				
(2) A controlling package is in the hands of more than one owner			0,555 [0,381]	1,742				
(3) A controlling and blocking packages belong to different owners			0,418 [0,416]	1,519				
Ownership and management are separated (CEO is a hired manager as a basic category)	***							
(1) CEO is a large shareholder	0,482*** [0,234]	1,620						
(2) CEO is a shareholder; large shareholders are not managers	-0,032 [0,267]	0,969						
(3) CEO is a managers; large shareholders are managers	-0,639* [0,374]	0,528						
Age of the CEO	0,229** [0,110]	1,257						
3. Intensity of competition and globalization of operations								
Intensity of competition with developed economies of Europe, USA, Japan (1- very high; 2 – not very high; 3 – practically absent)								

Intensity of competition with Baltic countries, Turkey China (1- very high; 2 – not very high; 3 – practically absent)	-0,270** [0,132]	0,763	-0,406*** [0,127]	0,666				
Presence of exports (1 – yes, 0 – no)	0,363* [0,194]	1,438						
Presence of imports (1 – yes, 0 – no)			0,573*** [0,199]	1,774				
4. Interaction with the authorities								
Rendering help to local authorities(1 – yes, 0 – no)	0,854*** [0,260]	2,349			1,002*** [0,363]	2,725	1,010** [0,448]	2,745
Receiving organizational help from local authorities (1 – yes, 0 – no)	0,687*** [0,209]	1,987	0,434**	1,544	0,493** [0,211]	1,637	0,451** [0,229]	1,570
Receiving financial help from local authorities (1 – yes, 0 – no)								
CEO (Chairman of the board of Directors) has experience in government agencies (1 – yes, 0 – no)	-0,547** [0,220]	0,579	0,506** [0,227]				-0,511** [0,239]	0,600
Participation in advisory councils to regional and municipal authorities (1 – yes, 0 – no)	0,574** [0,232]	1,776	0,594*** [0,214]	1,811	0,478** [0,221]	1,613	0,636*** [0,236]	1,890
Participation in advisory councils to ministries, agencies (1 – yes, 0 – no)								
Participation in advisory councils to ministries of the federal government in charge of general economic affairs								
Participation in advisory councils to presidential administration							1,761** [0,764]	5,819
5. Financial condition of the firm								
Subjective estimate of financial condition								
Presence of substantial investment	0,405*** [0,099]	1,500			0,235** [0,102]	1,265	0,233**	1,263
Growth in sales volume, 2000-2004								
Growth in wages, 2000-2004 (1 – doubled and more; 2 – more than by a half; 3 – no more than by a half; 4 – practically unchanged)			-0,260** [0,103]	0,771			-0,305**	0,737
Constant	-1,564** [0,721]	0,209	-1,158** [0,608]	0,314	-3,557*** [0,461]	0,029	-1,727** [0,701]	0,178
Number of observations	582			582		582		582
Nagelkerke's Pseudo-R	0,250			0,142		0,202		0,146

Note: estimation is based on a logistic regression. Variables describing industrial affiliations (9 categories); organizational and legal form (open, closed joint stock company); enterprise status (independent, member of a business group) are included in the regression, but not presented in the Table. Standard error is given in square brackets.

***p<0.01, **p<0.05, *p<0.10

Values of coefficients below the designated threshold of significance are not presented.

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by the factor of 1.6. As for intensity of competition with foreign producers, so far only competition with Baltic countries, Turkey and China has influence on membership of a joint stock company in a NGBO. Significant positive influence of exports means that expansion of global operations of Russian companies is forcing them to seek ways to collectively defend the interests of national producers. In the group of factors that define relations between the business and the authorities, the most important ones for a predictive estimate are the following: rendering assistance by the business to local authorities; receiving organizational help from the authorities; participation in advisory panels to regional and municipal authorities (raising chances by 2.3; 2.0 and 1.8 times respectively). Experience of a CEO (chairman of the board of directors) in public administration during the last 10 years is also significant for the prediction and has positive influence. Financial support from the authorities has no significant influence. What specific types of organizational help are received by members of NGBOs more frequently than by non-members? They are: assistance in the establishment of contacts with ministries and agencies of federal administrations (18.2%) and with Russian partners (15.2%), and assistance in finding financial resources (36.1%). Joint stock companies in the group of non-members of NGBOs have received these types of assistance twice less frequently (the above mentioned differences are significant at the level below 0.01). Consequently, the authorities in their interaction with members of NGBOs provide favorable conditions for expansion of investment by members of associations instead of giving direct financial sponsorship which is seldom effective.

Prediction of probability of joint stock companies' membership in certain types of associations, in general, brings similar results. Among differences, important matters are significance of location in the North-Western and Ural districts for membership in trade associations and concentration of ownership at a level no lower than a blocking package of shares for membership in national unions.

2.3. Estimation of Utility of NGBOs: Opinions of the Respondents

In the 2002 survey, pessimistic assessment of associations prevailed among their participants. For instance, only 28.8% of the respondents gave affirmative answers to the question: “Have non-government organizations of entrepreneurs improved their protection of interests of the business community in the last three years?” 25.9% of the respondents believed that membership in associations brought no benefits to their enterprises (Golikova et al, 2003). In order to evaluate the changes that have occurred within three years, we have compared the assessments given by our respondents in the 2002 and 2005 surveys in a commensurable range of enterprises (open joint stock companies with more than 100 employees in industry), using only the identical wording of answers to this question (Table 6).

Table 6 Utility of NGBOs and Their Contribution to Establishment of Standards and Rules of Conduct of Business, Estimated by Respondents in 2002 and 2005 (% of the number of respondents)

Answers to the question: «What benefits does your enterprise get from membership in non-government enterprise associations? »	2002	2005
	Industry	Industry
Nothing	12,3	17,2
Participation in preparing legislation	9,9	20,2
Establishment of steady contacts with government administration	18,5	30,6
Support to resolution of conflicts	13,6	6,1
Defining new standards of conduct of business	7,4	16,5
Number of observations	127	297

Sources: survey of 204 open joint stock companies conducted in 2002 by the Autonomous Non-profit Organization» Projects for the Future: Scientific and Educational Technologies” in three regions of Russia; survey of 822 open joint stock companies conducted in 2005 by the Institute for Industrial and Market Studies, State University-Higher School of Economics (SU-HSE) and the Institute of Economic Research, Hitotsubashi University (Japan).

Our analysis shows that the general assessment of associations in the compared sub-samples keeps practically unchanged: their activities were considered useless by 12.3% of the respondents in 2002 and by 17.2% in 2005. The negative opinion about the NGBOs is unrelated to organizational and

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legal forms of enterprises, their industrial affiliation and their integration or non-integration into business groups. Much more negative views were given by the enterprises, which are not involved in active interaction with authorities – which render no help to local governments and receive no organizational and financial aid from them. In addition, we have found differences by geographical location: the dissatisfied with associations are much more numerous in the Southern and Ural districts. Finally, more negative assessments have come from the enterprises which have not yet completed separation of ownership and management (the CEO is a hired manager but large shareholders hold key managerial positions).

Although dissatisfaction with the activities of associations is unchanged, demand for law is showing impressive positive changes. For instance, the share of respondents which mention the advantage of associations in preparation of legislation and in defining new standards of conduct of business has more than doubled. Among such respondents, the share of larger enterprises is significantly higher; open joint stock companies are more numerous than closed ones; there are more integrated businesses than autonomous, and many enterprises have listed their shares on Russian or foreign stock exchanges.

At the same time, the share of respondents having pointed at the role of associations in resolution of conflicts has halved. In our opinion, this is the evidence that the number of internal conflicts in the business community in the last three years is on the decline, and the emerging conflicts are more often resolved in a pre-trial mode in negotiations between parties, and in the case of failure the instruments of formal law are being used.

In the past period, the share of respondents which indicate that associations help them to establish steady contacts with authorities has almost doubled (increased from 18.5% to 30.6%). Does it mean that the dialogue between the business and the authorities is going right? We believe that it is too early to make such a conclusion. After the “Yukos affair”, demonstration

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of loyalty to the authorities has become a rational strategy of conducting business for large and midsized companies, which can (if only partly) protect them from excessive “interest” from the part of government. The results of the empirical survey of 147 enterprises in to Russian regions show that enterprises, whether they are association members or not, are equally keen to establish personal relations with people from the government (Table 7). The platforms of associations may possibly serve as one of the channels for such communication in the underdeveloped civil society.

Table 7 Assessment of Chances for Resolution of Problems in Government Agencies Depending on Personal Contacts (% of the number of respondents)

<i>Answers of respondents to the question: “How difficult is it to solve problems without personal contacts?” % in column</i>	<i>Membership in a NGBO</i>		<i>In total sample</i>
	<i>Yes</i>	<i>No</i>	
<i>Very difficult (practically impossible)</i>	<i>30,4</i>	<i>36,7</i>	<i>34,6</i>
<i>Personal contacts almost always make resolution of problems easier</i>	<i>47,8</i>	<i>50,0</i>	<i>49,3</i>
<i>Personal contacts sometimes make resolution of problems easier</i>	<i>21,7</i>	<i>12,2</i>	<i>15,4</i>
<i>Resolution of problems doesn't depend on personal contacts at all</i>	<i>0,0</i>	<i>1,1</i>	<i>0,7</i>
<i>Total:</i>	<i>100,0</i>	<i>100,0</i>	<i>100,0</i>
<i>Statistical significance of differences is absent</i>			

Sources: survey of 147 open joint stock companies conducted by the Autonomous Non-profit Organization» Projects for the Future: Scientific and Educational Technologies» in 2005

In the 2005 survey of 822 joint stock companies, the respondents evaluated the benefit of membership in a NGBO for their enterprises (Table 8). As in 2002, for most of them this benefit is related to informational support they are getting from associations (as mentioned by about a half of the respondents – members of ant NGBO); every fourth respondent gives a positive opinion about establishment of steady contacts with authorities; every fifth mentions success of associations in making their position in the Russian market stronger. However, efforts of all types of Russian NGBOs for promotion of Russian enterprises in foreign markets are barely noticed by the

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overwhelming majority of the respondents, which means that these efforts are insufficient.

From the answers we can see that our respondents are better satisfied with the activities of trade associations, which gained the highest integral estimation and were also positively viewed by every fourth or fifth respondent in ix out of nine assessed directions. At present, the least developed institution is regional associations, whose directions of activity in total, excluding informational support and establishment of contacts with authorities are appreciated low by the participants. As we believe, this low appreciation may be due to the fact that in most cases these regional associations were not by the business community but by initiated by regional authorities, and they most probably reflect the interests of regional governments rather than of entrepreneurs.

Table 8 Evaluation of Contribution of NGBOs in Solution of Important Problems of the Business Community by the Respondent Joint Stock Companies(% of the number of respondents)

Answers to the question: «What benefits does your enterprise get from membership in non-government enterprise associations? »	In total sample	Members of national associations*	Members of trade associations*	Members of regional associations*
Nothing	17,8	20,3	12,6	28,9
Participation in preparing federal and local legislation	19,6	18,0	24,4	11,8
Establishment of steady contacts with government administration	27,9	27,3	19,3	32,9
Informational support	53,4	57,8	52,1	46,1
Strengthening of positions in the Russian market	20,0	18,8	27,7	11,8
Strengthening of positions in foreign markets	5,1	4,7	5,9	5,3
Assistance in resolution of conflicts	6,2	1,6	6,7	10,5
Protection from unfair competition and unscrupulous bureaucrats	9,0	10,9	10,1	7,9
Chance to take part in establishment of new standards of conducting business	14,5	12,5	18,5	10,5
Participation in preparation and supervision of industrial quality standards	12,1	8,6	24,4	6,6
Number of observations	455	128	119	76

* non-members of other associations

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Source: survey of 822 open joint stock companies conducted in 2005 by the Institute for Industrial and Market Studies, State University-Higher School of Economics (SU-HSE) and the Institute of Economic Research, Hitotsubashi University (Japan).

2.4. Conclusions

The survey shows that about a half of mid-sized and large Russian joint stock companies are members of various unions and associations (national, trade, and regional). In the last three years, the share of companies having joined NGBOs has rather increased, which is a sign that economic agents have positive interest in this institution of civil society. More interest in using the platforms of associations is expressed by larger companies; by exporters; by the enterprises under pressure of competition from foreign producers from Baltic countries, China and Turkey; by the joint stock companies that made substantial investment in 2002-2004. Among the members of associations, a significantly greater place belongs to the enterprises that are rendering help to local authorities and receiving organizational aid from them. Agencies of regional and local government give support to NGBO members twice as frequently as to non-members in establishment of contacts with agencies of federal government, in search of Russian partner enterprises, in attraction of financial resources.

In the last three years, the integral estimation of the NGBOs as an institution by their members underwent little change. In general, approximately one out of five member enterprises believe that the membership is useless for them. Much more negative judgments are given by the enterprises that are not involved in active interaction with the authorities – rendering no help to local agencies and receiving no organizational and financial assistance from them, and also by the enterprises that have not yet completed separation of ownership and management. Moreover, the influence of geographical location of the joint stock companies is also observed.

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Although satisfaction with the activities of associations is unchanged, realization of rising demand for law has achieved substantial progress. The share of respondents which mention that the platform of associations has been useful for improvements in federal and local legislation and in defining in defining new standards of conduct of business has more than doubled. The larger enterprises are more deeply involved in these activities: open joint stock companies rather than closed; integrated businesses rather than independent; and also the enterprises that have placed their securities on Russian and foreign stock exchanges.

According to the results of our survey, at present the most advanced and efficient institution representing interests of large and mid-sized joint stock companies are trade associations which successfully gained respect in the business community. At the opposite pole are regional associations, which are being used mainly as a channel for communication with authorities.

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Chapter 3

Relationship Between Russian Corporations And Financial Institutions: The New Role Of Sberbank

Fumikazu SUGIURA

3.1. Introduction

There has been continuous positive economic growth in Russia since 1999. Over the last several years, economists have been exploring the factors behind this growth. According to them, an import- substitution effect, resulting from a drastic depreciation of the Ruble, and the high prices on the world market of such major export commodities as crude oil, are supposed to have brought about this growth. Now that the depreciation effect of exchange rates has faded away, they wonder whether or not Russia can maintain the growth, in the event of a future drop in international crude oil prices; in other words, whether or not Russia has succeeded in formulating a self-supporting economic development system. This is required for the creation of a strong economic structure, in which each economic subject can continually produce profits, and which is able to withstand external shocks, carry out optimal decision-making in a competitive environment, and improve the efficiency of enterprises. For this purpose, a number of "structural reforms" should be promoted, and pro-growth institutions should be introduced and allowed to operate in an effective and stable manner. Russia has a large number of "structural reforms" to be implemented, of which legal, administrative, social, and banking reforms are the most urgent (Berglöf *et al.* 2003). From a macro-economy viewpoint, it is important not only to encourage investments in natural resource sectors, so as to maintain exports of such natural resources as oil and gas, but also to diversify economic structures, with the aim of

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developing other sectors of the economy. For that purpose, investment is desperately needed. The institutional environment for investments cannot be regarded as being sufficient, in terms of the protection of ownership rights, and corporate governance mechanisms. Furthermore, a developed financial sector, enabling the supply of investment capital to the economy, is also an indispensable physical condition. Therefore, our intention in this paper is to approach these issues, by means of an analysis of corporate finance structures.

Development of the financial sector is one of the top priorities of Russian economic policy. Numerous are the problems in this sector. It is necessary to establish public confidence and to create money-flow mechanisms which allow people's savings to be converted into investments in industry. However, Russia's financial sector of the 1990s did not constitute a significant source of funds, since, under conditions of political turmoil and economic crisis, there existed other sources of profit, such as speculation in foreign currencies and government bonds. In fact, according to macro statistical data regarding sources of investment, the banking sector (not to mention the securities market) was not a major supplier of funds. Russia's financial crisis of 1998 did not bring about the extent of economic crisis foreseen by some experts, and was even followed by a certain degree of positive economic growth¹. Just after the financial crisis, it was thought that, under the influence of the hard-hit financial sector, the crisis of the whole economy might well be amplified further. Nevertheless, the problem of financial institutions did not affect other segments of industry, and, because of the devaluation effect of the ruble, the real sector began to record positive growth rates, with disregard to the confusion of the financial sector. Therefore, it must be made clear to what extent the present financial sector of Russia has become invaluable to industry since then. On the other hand, after the crisis of 1998, a number of big banks started strengthening loans to real sectors, driven by the

¹ The low level of monetization is also an indicator of the underdeveloped nature of Russia's financial sectors.

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strong growth present therein. Macro data show that banking institutions, which occupy the top five positions on the scale of total assets, have expanded their share of loans in the banking sector as a whole. The biggest bank is Sberbank. Sberbank has often been the target of criticism concerning such factors as its huge size, its monopolistic position in the deposit market, its opaque ownership structure, ineffective and sometimes corrupt management and the high level of state participation in its stock shares, which seems to have been an obstacle to reform in the banking sector. But it should be also mentioned that Sberbank, to some extent, has served as a shock-absorber against the destructive effects of the crisis of 1998². Founded as a specialized deposit bank in the Soviet era, Sberbank continued pursuing the plan of universal banking throughout the 1990s. It is an important fact that Sberbank supported large-scale industry, which lapsed into a financial crisis after 1998, by using its vast funding ability. Moreover, the Central Bank of Russia also wants to support its development, since it hopes to advance the growth of banking institutions with lower levels of capital, and Sberbank, since the 1998 crisis, has strengthened its presence within the economy in an outstanding manner. The growth of credit granted to enterprises by Sberbank by far exceeds the growth rate of the whole economy. Therefore, it is indispensable to analyze in detail the present conditions of new corporate finance, in order to forecast the medium- and long-term development potential of the economy.

In order to throw light upon this situation, an analysis from a macro-economic viewpoint is not sufficient. Micro-analysis, by means of company surveys, is also needed for a suitable approach to the Russian economy. We conducted, in the spring of 2005, interview research of more than 800 Russian companies, in collaboration with Russia's State University, the Moscow Higher School of Economics. We found that the relationship

² Sberbank received 440 thousand deposit accounts from 6 bankrupt commercial banks, and also provided credit to companies short of liquidity.

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between companies and financial institutions still had to be developed, but that it has clearly played a greater role than we had at first expected. One out of every three surveyed firms replied that it did not obtain finance from outside sources at all, while 27% of them replied that their biggest supplier of funds is Sberbank, and 22% said that local banks were the most important source. Only 10% borrowed most from banks located in Moscow and St. Petersburg (except for Sberbank) (See Figure 1). It thus became clear from our survey that for about 1/3 of Russian companies, external funds are not raised at all, while the remaining 2/3 borrow from external sources. The question which has to be answered is therefore that of the characteristics of each group of companies. In this paper we will try to clarify whether or not companies with a high potential for growth, and a huge demand for funds, can develop by receiving finance from the financial sector. This is an important issue in this paper.

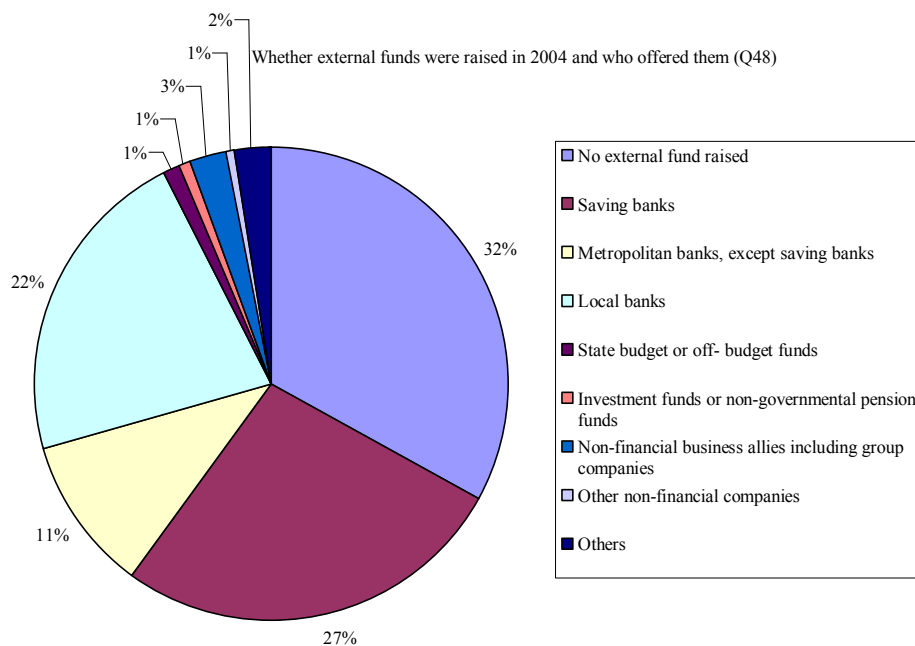


Figure 1: Who is the biggest supplier of funds for Russian corporations?

Source: Authors' interview survey result

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The structure of this paper is as follows. First, the present situation of the Russian economy is briefly surveyed, focusing on investment activities and the role of the banking sector. Next, after introducing an outline of our survey results, we will analyze the financing activities of companies. Last of all, we will conclude our discussion and evaluate some implications in terms of policy-making.

3.2. Booming Economy And Corporate Finance Of Russia

The economic boom continues. The growth rate of the economy has been positive since 1999, and reached 6.1% in 2005. Although this represents a certain slowing down of the economy, as compared to the 7.2% recorded in 2004, favorable conditions have been maintained, and the government forecasts a growth rate of 6.2% in 2006. Since growth in the fuel sector fell notably in 2005, industrial output was also affected in a negative way. The slowing down of growth in the fuel sector is considered to have partly stemmed from the insufficient capacity of pipelines, and it is highly likely that without maintenance and expansion of this capacity (not to mention the exploration of new oil and gas fields), the fuel sector could very well become a bottleneck for the development of the national economy.

3.2.1 Investment supports economic growth, but from which sources is it obtained?

At the same time, there has also been a continuation of the investment boom. Growth in investment activities recorded 10.5% in 2005, following the positive trends of 2003 and 2004 (12.5% and 10.9% respectively). Capital-intensive infrastructures and resource exports accounted for approximately 60 percent of total investments. In particular, the transportation sector, which is closely connected to the fuel-exporting industry, experienced growth of more than 14%. However, since a reexamination of investment programs has accompanied the reorganization of Yukos and Sibneft, the fuel energy sector has undergone a decline in investments, as compared to the previous year.

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Investments in the machine assembly and communications sectors have also posted negative growth rates. If conditions are in line with the $I=S$ balance analysis, then the country's investment potential could evolve still further (TsMAKP).

We should now examine which types of fund supports investment activities. According to available macro data of sources of investment (with the exception of small businesses), it can be clearly seen that the ratio of internal sources, such as profits and depletion, is falling (See Table 1). The share of internal sources of finance, which represented 53.2% in 1998, fell to 47.6 % in 2005. On the other hand, concerning external sources, there has been a continued decline in budget and off-budget funds. Together, these funds accounted for 29.8% in 1998, but fell to 19.6 % in 2005, while the ratio of loans from banks and borrowing from other companies almost doubled over the same period, from 4.8% to 6.5 % and from 4.3 % to 7.3 %, respectively. One should therefore take into account the fact that, since external funds are increasingly important in investment activities, development of the banking sector is of the utmost importance.

Table 1: The share of sources of investment finance (%)

	1998	2000	2002	2003	2004	2005
Total investment in fixed capital	100.0	100.0	100.0	100.0	100.0	100.0
Internal Fund	53.2	47.5	45.0	45.2	45.4	47.6
Borrowed Fund	46.8	52.5	55.0	54.8	54.6	52.4
of which						
Bank borrowings	4.8	2.9	5.9	6.4	7.9	6.5
Other loans	4.3	7.2	6.5	6.8	7.3	7.3
Federal budget	6.5	6.0	6.1	6.7	5.3	6.7
Budget of subjects of Russian Federation and local	12.6	14.3	12.2	12.1	11.6	12.4
Off- budget fund	10.7	4.8	2.4	0.9	0.8	0.6
Other	7.8	15.6	19.0	21.1	20.7	21.7
of which						
Parent companies	na	na	11.6	13.0	12.7	10.8

Source: Rosstat, Investitsii 2006

In spite of the fact that the CBR's strengthening of banking regulations, for the purpose of controlling money-laundering, and the withdrawal of the banking licenses of two small banks, led to the liquidity crisis of the interbank

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market in the summer of 2004, the positive tendency of loans granted by banks to companies and organizations did not change. This crisis led to a rise of the status of two state banks and foreign banks; the former, namely Sberbank and Vneshtorgbank (VTB), both of which are state-owned, the deposits of which are guaranteed, while the latter was regarded as being the most reliable in the Russian banking sector. This tendency continued in 2005.

3.2.2 Changes seen in account report data

We will now check the above-mentioned tendencies, using account report data. If possible, this aggregated data of accounting reports should be corrected according to the size of each business, because difference in asset size would influence the structure of the whole sector. However because of the lack of the accessibility of the individual data, we should only rely on the aggregated data. In spite of this defect, a certain tendency can be seen in the analysis of these reports, mainly in terms of the asset and debt composition of companies. Due to a lack of the most recent data³ (we can provide data only up until 2003), the ratio of bank loans in total assets grew rapidly from 4.1% in 1998 to 14.1% in 2003 (See Figure 2). In the mining and industrial sectors, this tendency is even more remarkable, increasing from 7.0% in 1998 to 17.3% in 2003. Generally speaking, due to the volatility and uncertainty of the transition economy, the ratio of accounts payable in liabilities is somewhat high, due to difficulties encountered when obtaining bank loans. However, it would seem that this tendency in liability structures has begun to lessen in recent years. The same tendency was also clear to see in the mining and manufacturing sectors, in which a remarkable degree of decline was recorded, going from a peak of 30.6% in 2000 to 23.6% in 2003. Since an account payable is usually short-term, it can only serve the function of compensating current financial shortages. On the contrary, it can be pointed out that in the case of assets,

3 This was calculated on the data provided by “Finansy Rossii 2004,” which is published once in two years. The next version will be published in December, 2006, according to the Rosstat.

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long-term investment even increased from 2.9 % in 1998 to 11.5 % in 2003, and that current liabilities in the form of bank loans showed almost the same trend. However, as we have already mentioned, the accounting reports of enterprises reflect only a rough tendency as a whole, and cannot clarify differences in detail. For this reason, analyzing on a micro level becomes even more indispensable.

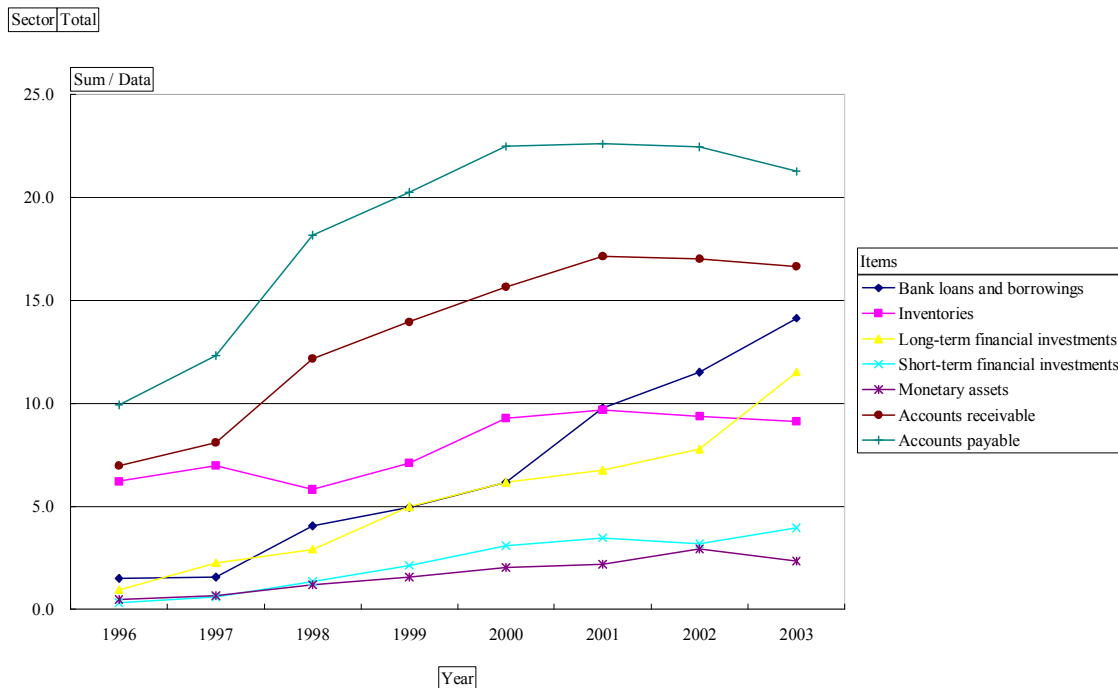


Figure 2: The structure of assets and liabilities in Russian enterprises
Source: Author's calculation from Finansy Rossii, 2002, 2004

3.2.3 New trends in the financial sector

In recent years, there has been a remarkable tendency towards an increase in loans for consumers and a rapid development of the corporate bond market. The former reflects the fact that VTB has entered into retail market (by setting up the recently-acquired VTB-24), and there has been a significant increase in the number of credit cards issued by banks. As for the corporate bond market, although it is still in its early stages of development, as far as costs are concerned, the environment is already prepared. Measures to reduce tax rates connected with the issue of bonds have been introduced, and bond issue may well become a possible alternative to bank loans, because the costs

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involved have been reduced to a reasonable level. In addition, Russian companies on the whole do not like information on corporate activities to be disclosed, for fear of being taken over, and it has been seen that enterprises have a tendency to prefer debentures to loans from banks. On the other hand, a part of large-scale industry, especially the fuel and communications sectors, is highly motivated in financing its needs abroad, rather than domestically. Domestic banks are therefore exposed to competition with foreign markets and/or foreign financial institutions, with regards to the biggest industries, which are considered to be the most profitable and creditworthy in the domestic market. This has also led to a reinforcement of the transition to loans for individuals. Housing loans from banks have been sustaining the housing market boom in big cities. In addition, bank loans have been playing a big role in the purchase of (mainly imported) consumer durables, too. Due to the value of collateral, there has been a tendency towards promoting the consumption of expensive imported goods, and there is a concern that the present consumer boom will not help the activities of domestic industries. However, it is true that the banks have anyway adopted a positive position towards loans, and it is necessary to point out that such a tendency is now led by the two biggest banks in Russia, namely Sberbank and VTB.

As seen above, it has become certain that since 1998, the market transition in the Russian economy has proceeded by means of the division of labor. In the following section we will analyze, from a more micro-level perspective, the relationship between financial institutions and companies, thereby helping to clarify part of the financing activities of Russian companies.

3.3. Can The Ministry Of Cash Succeed In Financing The Russian Economy?

Tompson, in a paper published in 1998, called Sberbank a 'Ministry of Cash', and claimed that it was financing the Russia economy as a whole (Tompson 1998). Before the crisis of 1998, it can be said that it had fulfilled the function

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of financing the federal government budget, since Sberbank massively purchased federal government bonds with the abundant funds it had raised through people's deposits. The bank aimed at becoming a "universal bank", by expanding its portfolio to the corporate sector, and as a result, it had a very high ratio of overdue claims (Sugiura 2005). Though it is true that the scale of its assets was unquestionably the largest, it was after the financial crisis of 1998 that loans for companies came to represent a prominent part of its activities (Renaissance capital, 2003).

Immediately after the crisis, Sberbank granted loans to the country's major companies, such as Gazprom, Transaero, Unified Energy System of Russia, and MPS, and also started dealings with Rostelecom, Baltika, LUKOIL, Vimpelcom, and Rosvoordgenie. The list of companies benefiting from such emergency loans exceeds 20, including not only the fuel-energy sector, but also, very extensively, metallurgy, communication, transportation, and so on.

At the same time, a large number of major banks lapsed into a deep crisis, and were transformed in the reorganization process. Promstroi bank, which had its origin in the Soviet era (as was the case of Sberbank) and which was the main provider of credits to the heavy industry sector after the collapse of the Soviet Union, lost its license in July, 1999. SBS Agrobank, which was a successor of the Soviet-born Agroprombank, and which had assets in the agricultural and food-processing sectors, was also closed down. Major banks formed by financial industrial groups were also strongly affected by the crisis, although some of them were revitalized, thanks to "bridge banks". Meanwhile it was also a chance for Sberbank to develop its portfolio in the corporate sector. In fact, it expanded its loans to major Russian companies by making up for shortages, but lacked reliable screening capacities due to its history of providing mainly for government budgets. It had a preference for major corporations, in accordance with quantitative standards. What's more, Sberbank also radically reformed its organizational structure, with the consolidation of autonomous regional banks into a small number of territorial

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banks. This enabled the bank to mobilize its financial resources more efficiently. Moreover, it reduced its portfolio of interbank loans, and tried to prolong the maturity of its portfolios as a whole and to become positively involved in project finance.

Here, however, it is necessary to draw one's attention to the direct financing from abroad obtained by major Russian enterprises of non-financial sectors, which has become rather significant over the last few years. Nine out of the 26 biggest companies to which Sberbank grants loans have already successfully issued Eurobonds (See Table 2). The most important Russian companies are now actively trading with western financial institutions, in the wake of the BRICs boom, and such a situation has obliged Sberbank to change its development strategy with its emphasis on major corporate borrowers. Accordingly, Sberbank is also undertaking SME finance, while at the same time increasing credit for individuals. Although Sberbank is a state-owned bank, and its decision-making is said to be strongly influenced by the state authorities, it also has its own economic interests as a commercial organization, and survives in a competitive environment with its own interests at stake.

Table 2: Major borrowers of Sberbank and Eurobond issuance

Sberbank's largest borrowers	
Acron	Rosneft
Aerofloat	ROSTAR
Alrosa	RUSAGRO
Baltika Brewery	RusAl
Borsky Glass Factory	Severstal
Energomashkorporatsiya	Siberian Coal Energy Company
Evrocement	Sibir Airlines
Gazprom	Svyazinvest
IRKUT	TNK
Kuzbasspazrezugol	TVEL
Magnitogorsk Metals Works	UES
Norilsk Nickel	Vimpelcom-R
Petersburg Oil Terminal	Wimm-Bill-Dann

Sources Sberbank's annual report

Note: Names in red had issued Eurobonds

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3.4. Analysis Of Interview Survey Results Of Russian Corporations

3.4.1 Analysis of companies without external finance

As we have already seen, 1/3 of the companies upon which we conducted the interview survey did not borrow funds from external sources. Here we should clarify the reasons behind this: whether these companies have a low growth potential and cannot accept financing from external sources, or if it is due to an underdeveloped financial sector that cannot provide enough financial resources for their investment needs. Generally speaking, in Russia, the size of enterprises tends to reflect their creditworthiness. The size of companies (regardless of how inefficient they may be), dictates the likeliness they have of being bailed out by the government, which fears job losses and social unrest connecting with their bankruptcy. Therefore, financial institutions tend to set the criterion for granting a loan not on the concrete profitability of a company's projects and its capacity to pay back, but rather on the political power it enjoys. Moreover, it is also very important to consider the management attitude of a company. Information disclosure is required for obtaining external funds. If a company is reluctant about information disclosure, it may be considered as not being apt for receiving such funds. Although an incorporated company is expected to play the role of a modern and democratic mechanism of mobilizing public capital, in Russia, an overwhelming number of companies have chosen closed-type incorporated company forms (Iwasaki, 2006), and this is seen to be one of the most important factors for which enterprises do not accept external funds. Such companies are extremely likely to be insider-dominated, to have a lot of employees, and to be inefficient. The hypothesis which we should therefore verify is as follows:

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Table 3: The regression result of corporations without external sources of funds (NEXFIN)

	I	II	III
CORFOR	0.144	0.137	0.170
	1.17	1.10	1.35
OWNOUT	-0.086 ***	-0.068 **	-0.085 ***
	-2.99	-2.32	-2.88
COMSIZ	-0.277 ***	-0.249 ***	-0.274 ***
	-4.92	-4.33	-4.68
COMD	0.261	0.335	0.253
	1.20	1.53	1.12
CORPER	0.051	0.102 **	0.084 **
	1.34	2.50	2.09
INVACT		-0.300 ***	
		-3.82	
EQPINV			-0.334 ***
			-2.66
Const.	1.322 ***	1.448 ***	1.510 ***
	3.68	3.96	4.05
	probit	probit	probit
Number of observation	602	597	590
LR chi2	59.84	73.90	67.97
Pseudo R2	0.08	0.10	0.09

Sources: Author's calculation.

Hypothesis: A company without external funds tends to be small in size, and even efficient companies suffer from fund shortages due to the underdeveloped financial system. It tends to take a closed-type incorporated form, and the management fears losing controlling rights and is reluctant about information disclosure.

In order to verify these hypotheses, the results of our survey data are empirically analyzed, using an explained variable (NEXFIN) and a discrete quantity which sets to 1 companies which do not raise external funds, and to 0 companies which do. The following explaining variables are used: the size of the company (COMSIZ), corporate performance (CORPER), the form of incorporation (CORFOR), and the share of outsider ownership (OWNOUT). A probit estimation of the qualitative selection model is carried out. As a proxy variable showing the efficiency of a company (CORPER), a principal

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component analysis is done of such variables as the natural logarithm of 2004 sales per employee (LABPRO), the growth rate of sales between 2000 and 2004 (SALGRO), the growth rate of average wages during the same period (WAGGRO), the growth rate of employees between 2001 and 2005 (EMPGRO), and financial and economic conditions perceived by the management (FINECO). In addition, the communication sector dummy (COMD) is taken as a dummy for a different sector. Table 3 shows the estimation result (See the Column I).

From this result, it becomes clear that companies without external funds have a small share of outsider ownership and are small in size as well. In terms of company performance and incorporation forms, the signs of each coefficient match our hypothesis, but are not statistically significant. We then add as a variable the investment dummy (INVACT), because those companies are restricted in the investment activities due to the lack of access to the external sources of funds. Interestingly, we were able to obtain a favorable result, which shows their inactivity in investment (See the Column II of Table 3). When we add as a variable the equipment investment dummy (EQPINV), the result is as favorable as the former (See the Column III of Table 3). However, as for the form of incorporation we cannot say anything due to the statistical insignificance.

From these regression analyses, it is shown that because of the underdeveloped financial sector of the country, the financial needs of small-scale companies may not be fully addressed.

3.4.2 Analysis of companies that obtain external sources of funds

Now we are going to see what kind of firms in Russia has received external finance. When we look at the distribution among different sectors, food industry seems to have a good access to the external funds. In fact, both metropolitan banks and local banks tend to give credit more likely to food industry (See Table 4). Sberbank on the other hand is more likely to provide

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loans to the sector of wood, paper and wood product⁴. It should also be mentioned that metropolitan banks are eager to lend money to the fuel and energy industry.

Table 4: The sectoral distribution of EXFIN companies (%)

	Total	Exfin	Sber	Mbnk	Lobnk	Other exfin
Fuel and energy	8.0	6.9	4.1	10.3	6.7	13.1
Metallurgy	4.4	5.1	4.1	4.6	6.1	6.6
Machine-building and metal working	31.0	31.1	32.4	32.2	31.1	24.6
Chemical and petrochemical	4.0	4.2	3.6	2.3	4.4	8.2
Wood, paper and wood product	7.7	6.9	11.3	5.7	3.3	3.3
Light industry	6.2	5.5	6.8	4.6	4.4	4.9
Food industry	20.6	24.5	21.6	26.4	28.9	19.7
Construction materials	9.5	7.3	6.3	4.6	10.0	6.6
Communication	8.6	8.5	9.9	9.2	5.0	13.1
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: Author's calculation based on the interview survey result.

When we see the regional distribution, it is quite natural to find that metropolitan banks have larger share in Moscow city and Moscow region. At the same time the firms in Moscow have alternative sources of fund rather than bank lending, which include bond issuance and so forth (See Table 5). In focusing regional disparity among federal districts, we can see that Sberbank has much influence in the Northwest and Privolzhsky federal districts, while local banks have much to do with the Ural federal district.

⁴ According to the press release of Sberbank, it has provided 15-million-dollar credit to the wood product complex “OOO Komi- Permi wood product corporation” on September 2003 to introduce a brand- new equipment.

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Table 5: The regional distribution of EXFIN companies (%)

	Total	Exfin	Sber	Mbnk	Lobnk	Other exfin
Moscow	4.0	4.5	1.4	14.9	0.6	13.1
Moscow region	2.8	2.5	3.2	6.9	0.6	0.0
Saint-Petersberg	4.5	4.7	5.0	4.6	3.9	6.6
Leningrad region	0.1	0.0	0.0	0.0	0.0	0.0
Other	11.4	88.2	90.5	73.6	95.0	80.3
Central fed district	32.2	34.2	26.6	44.8	40.0	29.5
Northwest fed district	11.8	11.3	14.4	11.5	7.8	9.8
South fed district	8.6	7.8	8.6	10.3	6.1	6.6
Privolzhsky fed district	24.0	24.0	29.3	13.8	21.7	26.2
Ural fed district	10.1	10.5	9.5	4.6	14.4	11.5
Siberian fed district	10.3	9.6	9.5	11.5	8.9	9.8
Far East fed district	2.9	2.5	2.3	3.4	1.1	6.6
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: Author's calculation based on the interview survey result.

Finally the distribution of corporate size should be identified (See Table 6). The result shows a very vague picture. Metropolitan banks are more eager to provide loans to the bigger firms than Sberbank, while they are also more positive to the smaller firms than Sberbank. This may imply that creditworthiness of the firms has not necessarily much to do with their size, or the number of workers. In fact, as we have seen in the previous section, Sberbank aimed at becoming the "universal bank" after the collapse of the Soviet Union, and started providing corporate loans, for which until then it had no competency. Such a tendency has become much more significant since 1998, when the Russian government's bond market collapsed. When we calculate the share of the government bond in the asset structure of Sberbank, at the beginning of 1998 the share amounted to 53.7 % but it decreased to 27.4 % toward the beginning of 2002. As for that of outstanding loans, it has increased from 20.6 % in 1998 to 69.9% in 2005 (See Table 7). This clearly corresponds to the fact that funds previously allocated to government bond purchases can now be used as credit for the private sector. Loans have been increasingly granted to important sectors of the national economy.

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Table 6: The distribution of number of workers of EXFIN firms (%)

	Total	Exfin	Sber	Mbnk	Lobnk	Other exfin
100-299	30.2	24.2	22.1	25.3	26.7	23.0
300-499	21.9	20.2	23.4	12.6	21.7	14.8
500-999	19.0	20.7	15.8	20.7	23.3	31.1
1000 or more	29.0	34.9	38.7	41.4	28.3	31.1
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: Author's calculation based on the interview survey result.

Table 7: Asset structure of Sberbank (%)

	1998	1999	2000	2001	2002	2003	2004	2005
Cash and deposit at CBR	10.7	9.8	10.1	14.1	9.9	6.8	5.6	6.9
Government bond	53.7	54.6	38.9	31.7	27.4	na	na	na
Investment in securities for sales	0.8	0.5	0.3	0.5	0.3	11.6	14.8	12.2
Net outstanding loans	20.6	20.0	40.0	47.6	52.1	52.2	55.9	69.6
Investment in securities for holding	na	na	na	na	na	2.5	4.2	2.3
Material assets	8.8	7.4	5.3	3.9	7.7	6.1	5.1	4.5
Other asset	4.2	2.0	1.7	0.8	1.5	0.5	1.4	0.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Author's calculation based on the accounting data of the bank.

Note: Because some of the items are omitted, the sum of each item doesn't make one hundred.

But how these funds have been allocated? Now we want to look into the role of Sberbank more closely. The principal borrowers of Sberbank naturally consist of both big businesses and small enterprises, in accordance with the intentions of the government⁵. As we have seen in the Table 6, Sberbank does not necessarily enjoy its market power in the bigger enterprises. It may suggest that due to the lack of its competency in credit screening and relating skills, it might lag behind powerful metropolitan commercial banks. In this regard, we should bear in mind that Sberbank expands their loan portfolio at the cost of competitiveness of the borrowers. Also from the viewpoint of the borrowers the inter-relation with governmental organization is regarded as the key to withdraw assistance from authorities, that is credit from Sberbank. A large number of companies are, regardless of their size, pursuing connections with state agencies. Therefore, the hypothesis which we should verify is as follows:

Hypothesis: Companies whose principal source of credit is Sberbank have a good access to the state agencies, with high state ownership rights.

⁵ It is, of course, very difficult to distinguish government policies to support SMEs from supporting big businesses.

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They are not necessarily competitive in the world market but enough to be in domestic market.

In order to verify these hypotheses, empirical analysis is conducted using the results of our survey. A probit estimation of the qualitative selection model is also conducted. As for the explained variables (SBER), a discrete quantity is used, which sets to 1 companies whose biggest lender is Sberbank, and to 0 the rest. The explaining variables are the share of state ownership (OWNSTA) and competitiveness in the domestic market (CMPDOM). As a proxy for the nexus with government, we take the index whether the any of the executives of the firms takes part in the advisory committees of state organs (ADVCOM). In addition, the communication sector dummy (COMD) and closed-type incorporation dummy (CORFOR) are added. The regression result is shown in the Table 8.

From this regression analysis, we can see that companies with Sberbank credits tend to have a large share of outside ownership, which is contrary to our expectation. It is also found that the participation of the executive members in the advisory committees of state organs plays a certain role in receiving Sberbank loans. Competitiveness in the domestic market implies that they are more competitive than firms with local bank credits but less competitive than firms receiving metropolitan bank loans. This wide distribution of borrowers of Sberbank credit means how big a role Sberbank will play in the development of Russian economy.

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Table 8: The regression result of corporations receiving Sberbank credit (SBER)

	I	II	III	IV	V
CORFOR	-0.25 *	-0.21	-0.21	-0.21	-0.31 **
	-1.94	-1.53	-1.50	-1.59	-2.19
COMD	0.16 **	0.19	0.17	0.17	0.23
	0.80	0.82	0.75	0.74	0.96
ADVCOM	0.26 **	0.28 **	0.27 **	0.26 **	0.27 **
	2.15	2.14	2.12	1.99	2.02
CMPDOM	0.20 **	0.22 **	0.23 **	0.22 **	0.21 **
	2.30	2.36	2.52	2.41	2.17
OWNSTA		-0.02			
		-0.42			
OWNFED			-0.02		
			-0.24		
OWNREG				-0.01	
				-0.11	
OWNOUT					-0.08 ***
					-2.60
Cons.	-0.60 ***	-0.62 ***	-0.65 ***	-0.63 ***	-0.41 **
	-3.73	-3.57	-3.80	-3.63	-2.14
	probit	probit	probit	probit	probit
Number of observation	520	458	464	462	441
LR chi2	14.76	12.82	13.48	12.71	17.54
Pseudo R2	0.02	0.02	0.02	0.00	0.03

Sources: Author's calculation

3.5. Conclusion

We have analyzed the situation of corporate finance and relationship between corporations and financial institutions in present-day Russia, on both macro and micro levels. We have found that since 2000 the role financial institutions (especially banks) have had in corporate finance has been increasing. However, borrowing from outside sources is not always possible and 1/3 of the companies which were surveyed report that they have not received any such funds. Therefore, the banking sector still has room for further developments in this direction. Financing for small but competitive enterprises by the banking sector could help achieve the present government's goals in terms of economic policy, diversifying the economy and fostering the activities of small and medium-sized enterprises. Since the 1998 crisis,

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Sberbank has successfully increased its loan portfolio in the corporate sector, by satisfying part of the flourishing demand from domestically competitive industrial firms, but sooner or later it will reach its limit, because the more competitive and valid borrowers have an access to more market instrument. In recent years, we have seen Sberbank starting to aggressively grant loans to small-and-medium-sized-enterprises, as well as giving loans for the retail market. It is still very important for Sberbank to improve its screening skills when it comes to loan projects, so that it can promote management efficiency in the firms benefiting from its credits.

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Chapter 4

The Russian Corporation And Regional Authorities: Models Of Interrelations And Their Evolution¹

Andrei Yakovlev

4.1. Introduction

Relations between enterprises and authorities in Russian regions attracted attention of many researchers from the mid-1990s. At present, this subject is still urgent as before because it is related to two trends.

On the one hand, growing pressure from the global market is an objective reason for the business community in this country to ask for government support. However, after the Yukos affair the Russian business in general found itself in a subdued posture towards authorities on the federal level. For this reason, Russian companies may be expected to more closely cooperate with regional and local administration in pursue of more favorable conditions for business

On the other hand, our fiscal system was reformed and powers between the federal center and units of federation were redistributed in such a way that financial capacities of regional governments were reduced while the scope of their past liabilities was left almost unchanged. In this situation, regional authorities, in turn, may find incentives to change their policy posture towards the business community.

¹ This chapter is based on results of Joint Research Project on Corporate Governance and Integration Processes in the Russian Economy that is being carried out by the Institute for Industrial and Market Studies, State University-Higher School of Economics (SU-HSE) and the Institute of Economic Research, Hitotsubashi University. Author is grateful to Tatiana Dolgopyatova, Ichiro Iwasaki, Victoria Golikova as well as to Bruno Dallago, John Litwack and other participants of 9th EACES conference in Brighton, UK in September 2006 for their comments and suggestions.

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In this paper we are going to assess, using the results of a new empirical study of Russian joint stock companies, to what extent these two trends affected real mechanisms of interaction between the business and the state on the regional level.

4.2. Models Of Interaction Between The State And The Business In Russia

Two adjacent lines can be found, as we believe, in the studies of interaction between the government and the business community in Russia that were carried out in late 1990s and early 2000s. The first discusses seeking and receiving rent by various agents who act on the sides of the business or the state, and the second deals with opportunities and prospects for implementation of industrial policy.

In the first line of studies, best known model was formulated by Joel Hellman and his colleagues (Hellman et al, 2000) and continued in the studies at the CEFIR (Slinko, Yakovlev, Zhuravskaya, 2005). It describes the so-called phenomenon of “state capture”. This model can appear when the state is too weak to stand against the influence of private interest groups. Consequently, this model involves active redistribution of resources from the state to specific companies or business groups. The presence and relatively wide expansion of this model in Russia and the CIS countries with reference to large corporations was proved by a number of empirical studies in the late 1990s.

This practice of rent-seeking behavior was, in a sense, completed with formulation of a “grabbing-hand model” by T. Frye and A. Shleifer for Russia in contrast to the “helping-hand model” that had been implemented in a variety of shapes in Central and Eastern Europe and in China (Frye, Shleifer, 1997). The “grabbing-hand model” implies creation of artificial barriers to doing business, which force entrepreneurs – small and midsize ones, in the first place – to bribe bureaucrats. In the absence of any control mechanisms for ensuring observance of law, overregulation generated a process of negative selection

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among enterprises and pushed their businesses into shadow economy (Johnson, Kaufman, Shleifer, 1997; Yakovlev, 2002). Meanwhile, even in the absence of effective mechanisms for law enforcement, widespread informal business relations in the business community enabled the authorities to impose selective sanctions on the companies that attempted to resist the government pressure.

In the early 2000s, with general consolidation of the state and considerable bureaucratic consolidation of the state machinery, this model could be extrapolated from the regional to the federal level and applied not only to small companies but to large corporations as well. As a result, we believe that now it is possible to speak about a “business-capture model” as an alternative to the “state-capture model” (Yakovlev, 2003; Yakovlev, 2006). The Yukos affair was the most striking example of this model in action.

However, results of a number of other studies gave evidence to suggest that there are alternative models of relations between enterprises and authorities. In particular, referring to the data of a survey of 500 Russian enterprises conducted in 2000 T. Frye spoke not about “state capture” but rather about a system of “exchange” between the state and the business and about parallel existence of two groups of companies that were involved or not involved in this system (Frye, 2002). Those that participated in this system of “exchange” found that their proximity to regional authorities and their opportunities for getting assigned to one or other type of subsidies were related to a great burden of social liabilities. On the contrary, those in the second group that kept a distance from the state were given no support, but also bore no extra expenses. One of the reasons why this model is spread relatively widely in Russia is the phenomenon of large enterprises in one-factory towns. ²

² According to the data provided by the “Expert Institute”, Russia had about 800 such enterprises in the late 1990s. The Institute of Urban Economy was actively engaged in exploration of ways of their interaction with municipalities in practice (See: (Ivchenko, Liborakina, Sivaeva, 2003). A large joint project of BOFIT and CEFIR included a study of influence of this interaction on behavior of industrial enterprises

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They have inherited bulky social assets and infrastructure from the planned economy and still provide heating and other public utility to inhabitants of their cities and townships in exchange to support from local and regional authorities.

The matter under discussion in all three above mentioned models is flows of resources between the state and the business with no regard for enterprise efficiency. The only essential point here is the prevailing direction of this flow of funds – either from the state to the business (rent-seeking or “state-capture”), or from the business to the state (rent-extortion or “business-capture”), or in a relative balance under the system of “interchange”. Many experts and observers in academic environment believe that government aid is usually granted to enterprises and projects of low efficiency in an effort to smooth social tensions and enlist political support from related social groups (Mau, 2002; Zhuravskaya, Makrushin, Slinko, 2002).

However, this thesis also needs a more accurate definition. In particular, a number of studies made in recent years demonstrate that new approaches have appeared in the interaction between regional authorities and the business (Locke, 2001; Kuznetsov, 2002, etc). These approaches are generated by globalization, which is destroying the borders of product markets, creating opportunities for production transfer not only to other regions, but also to foreign locations and consequently, objectively draws the regions into ever more bitter competition for capital investment. This new situation of competitive pressure on the state at national and regional levels is creating preconditions for the government to seek a capacity to support the emerging, growing and rather efficient enterprises. At the same time, the very mechanisms of granting support are also changing, so that risks of rent-seeking and corruption are on the decline.³ In sum, these tendencies can be labeled

and main indicators of their performance (See: (Haaparanta et al, 2003), (Juurikkala, Lazareva, 2006), (Solanko, 2006).

³ These mechanisms were examined in details in Drebensov (2004); Rodrik (2004), as well as in Yakovlev, Gonchar (2004)

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with a term “new regional industrial policy”, and certain studies based on Russian data⁴ enable us to see this set of events as another model of interaction between the state and the business.

We made an attempt to test the adequacy of the above mentioned models to the present realities in Russia using the data of a special survey of enterprises.

4.3. Initial Data And Basic Hypotheses

Our investigation is based on a survey of large and medium-sized enterprises in mining, manufacturing and communications operating in the organizational-legal form of Joint Stock Company. This survey has been conducted in spring and summer 2005 under a Joint Research Project on Corporate Governance and Integration Processes in the Russian Economy that is being carried out by the Institute for Industrial and Market Studies, State University-Higher School of Economics (SU-HSE) and the Institute of Economic Research, Hitotsubashi University, and has covered 822 joint stock companies in 64 regions of the Russian Federation. The survey tools including the full version of the questionnaire, a description of structure of the sample, and general results of the project are given in the paper (Dolgopyatova, Iwasaki, 2006).

To test the models that we have singled out above for their consistency with reality, our main criterion is the data telling who gains and what is gained from this interaction. With this end in view, a number of special questions was included in the questionnaire to describe forms and intensity of government support given to enterprises by regional (local) authorities, and also the assistance rendered by the enterprises to the authorities and of forms of this assistance. These two arrays of questions were the basic ones to our analysis. All questions of this kind were related to 2001-2004. As far as we know, for the

⁴ Cases by region see in: (Smirnov et al, 2005); (Poletayev, 2006); and (Kozlovskaya, 2006); and in a broader context, in: (Grigoriev, Urozhayeva, 2003); and (Zubarevich, 2005).

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first time in the practice of surveying enterprises in Russia the enterprises were asked not only about financial aid but also about organizational support. In addition to the very fact of having obtained financial and/or organizational support, the enterprises were invited to name concrete forms of backing from local and regional authorities.

The respondents were also asked about participation in the programs of federal and regional procurement on products. Here we have to point out that in general, government procurement on products is not a direct method for supporting enterprises. Nevertheless, in recent years, government procurement on products is gaining importance for enterprises because its volume is increasing and reliability of the state as a payer is rising. It is well known from foreign experience that the state can reasonably use procurement on products to influence enterprise behavior – for instance, by giving preference to domestic producers or to small and midsize enterprises. In this context, government procurement on products was regarded in our project as one of the ways of giving indirect support to enterprises.

Along with regular data on enterprise size, industrial affiliation and structure of ownership, two more blocks of questions from the questionnaire were important for our investigation:

- Characteristics of performance and behavior of the surveyed joint stock companies (rates of output growth in 2000-2004; financial condition; borrowing from banks; scale of capital investment; introduction of new production facilities; existence and scale of exports; efforts for innovation). Answers to these questions enabled us to construct a block of data on the enterprises, which we could name “business activity and performance”.

- Participation in advisory bodies that are acting under different levels of government, membership in business associations ⁵, inclusion of

⁵ This question was included in the block because contacts with government agencies were recognized by the respondents as second on the list of important functions of business associations.

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representatives of regional authorities in the boards of directors. Answers to these questions enabled us to classify the enterprises into having or not having “steady contacts with the authorities”.

Using answers to these blocks of questions as our base in a regression analysis, we will try to define below the models that are prevailing in the interaction between enterprises and regional authorities. We will go forward from the following interpretation of possible results of the regression analysis:

1. A close correlation between gaining support from the government and negative performance of an enterprise (poor financial condition; stagnant or low rate of increase in output; lack of investment, etc.) can be regarded as a proof of a traditional hypothesis about inefficiency of regional industrial policy.

2. On the contrary, a positive correlation between support from the government and good performance of enterprises can give grounds to believe that a “new industrial policy” is taking shape in Russian regions, which implies giving support to growing and successfully developing firms.

3. A positive correlation between government support given to enterprises and assistance rendered by the enterprises to the authorities can offer evidence in favor of a hypothesis about existence of a “system of interchange”.

4. Dependence of gaining government support from continuation of close contacts with the authorities can be an outcome of the “state capture”.

5. Clear prevalence of “assistance to the authorities” over getting government support can be an indicator of a “business capture” and of extraction of an administrative rent.

4.4. Intensity And Forms Of Government Support Of Enterprises From Regional (Local) Authorities And Assistance To The Authorities By Enterprises

According to the results of the survey, in 2001-2004, 23% of the respondent firms received financial support from regional and local authorities, and 6% of

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the firms got their backing through two or more channels. Tax relieves and tax deferrals can be mentioned among the most important forms of financial support (they were reported by 12% of the respondents). Low interest credits or bankers' guarantee and fiscal subsidies were mentioned by another 5% of the respondents each. Other forms of support (land rental advantages, preferential tariffs for electric power and services of other public utilities) were mentioned by 1.5% to 4% of the surveyed enterprises.

Organizational support in various forms covered a larger number of enterprises: 19% got this support at least through one channel, and another 10%, through two or more channels. The most widespread means of organizational support is assistance in establishment of contacts with federal authorities and agencies (reported by 14%, or practically every second respondent among those who were covered by this support). Let us point out that a very small number of the respondents chose variants of answers related to help in establishment of contacts with investors (2 variants, less than 5% in total) and to assistance in contacts with foreign partner firms, investors, financial institutions (3 variants, about 3% in total). On the contrary, there is a very high share (more than 11%) of the respondent firms which received help from local and regional authorities in their contacts with Russian partner enterprises. This may have happened because the authorities, since efficiency of judicial system is inadequate, take part in resolving conflicts between suppliers and customers within their regional boundaries.

The program of government procurement on products involved participation of 24% of the enterprises in 2001-2004, including 15% that were suppliers to the federal government and 12% were filling orders of regional and local authorities. Interestingly, these groups practically never intersected – only 3% of the respondent firms in these four years had both federal and regional government orders. Taking into account that this paper deals with interaction of enterprises with regional and local authorities, we will further

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consider only the facts of fulfillment of regional government orders by the respondent firms.

Comparing structure of recipients of various types of support, we find that in total almost 45% of the surveyed enterprises were receiving some kind of support from regional and local authorities. Support of two or three types was received by 15% of the respondents.

Results of our survey demonstrate that assistance was granted by the enterprises to local and regional authorities on a massive scale, involving more than 4/5 of our respondents in 2001-2004. Top managers of the respondent firms most frequently chose from the offered variants such answers as “sponsoring regional/municipal programs” (63%); “repairs of roads, school, hospitals, and so on” (35%), and “maintenance of social facilities and housing” (28%). At the same time, many enterprises try to donate money to charity for concrete organizations and social groups (orphanages, disabled people, and pensioners). We have also to mention quite a large group of enterprises (14%), which carried out commercial projects in the social sphere in cooperation with regional and local authorities. In our opinion, these data are an indirect confirmation of leading development of mechanisms of private and public partnership at the regional level. Let us also emphasize that most enterprises typically employ multiple channels for rendering assistance to regional and local authorities. For instance, 35% of the respondents were using only one channel for giving assistance; 24% were using two, and another 23%, three and more channels.

4.5. Exploration Of Links Of Government Support And Assistance To The Authorities With Other Indicators Of Activity Of The Surveyed Enterprises

Verification of the above formulated hypotheses was made with logistic regressions, which enabled us to assess the likelihood for enterprises to get government support and their propensity to render help to local and regional

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authorities. For this purpose we took for explanatory variables a fairly wide range of indicators, which could be combined into three blocks:

- Block 1. Objective characteristics of enterprise, ownership and corporate governance;
- Block II. Patterns of behavior and development;
- Block III. Interaction with the state.

The indicators included into each group and their descriptions are given in Table 1 of the Appendix. Results of logistic regressions are given in Tables 2-6 of the Appendix. Their substantial interpretation in brief is the following:

There is a significant positive correlation between obtaining various types of government support. In particular, the chances for acquiring an order from regional administration are higher if an enterprise is already a recipient of financial or organizational support (and vice versa). This is especially true about the enterprises that get support of the same type through two or more different channels.

Grant of financial support by local and regional authorities is unrelated to patterns of behavior of an enterprise (Block II), except borrowing from commercial banks in 2001-2004 (which can be regarded as an indicator of relative financial stability of the enterprise in question). At the same time, financial support is significantly related to holding of a package of the enterprise shares by regional authorities and participation of the enterprise representatives in advisory bodies acting under different levels of government (Block III).

There is a significant positive correlation between delivery under regional contracts and the level of competition from domestic producers and joint ventures with foreign capital–residents of the Russian Federation (Block II). Differences by industry were found insignificant (excluding the industry of communications).

The largest number of significant correlations occurs in the cases of granting organizational support. In particular, this type of support is more

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often received by the enterprises that are members of business associations; by joint stock companies controlled by the state (both indicators are from Block III); by the firms with planning horizons longer than five years; by the firms that have faced a substantial reduction in their staff; by the enterprises that have successfully introduced the standards of the International Organization for Standardization (Block II). In the Block 1, we have observed a correlation between the grant of organizational support and the existence of a controlling shareholder at the enterprise, and a reverse correlation with certification of financial statements of the company by an international auditor. While these two correlations can be explained logically (in the presence of a definite owner, the enterprise policy is more definite; joint-stock companies that invite international auditors are usually large, they operate in global markets and have no need for support from local authorities), the positive correlation with frequent change of a CEO is hard to explain.

This interlacing pattern of various types of support was a reason to for us carry out a regression analysis not only with partial indicators of government support, but also with an integral indicator reflecting the number of various types of government support received by a concrete enterprise. Using this approach we have found that the highly significant matters (on a 1%-level) are borrowing from banks, membership in business associations, and also government holding in a joint stock company (coefficients grow higher when we turn to government-controlled firms). The fact of having given help to local and regional authorities is also significant and positive for receiving government support, but only in the cases when this help is given through two or more channels.

The likelihood of giving help to local and regional authorities also goes higher when we refer to the largest enterprises (nevertheless, this correlation remains statistically insignificant) and in the cases when their CEOs were not changed in 2001-2004; when the respondent firms were members of business associations; when they borrowed from banks and made capital investment.

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Moreover, the enterprises that are located in the regions with low and meager investment potential have helped the state much more often. We also have observed a link with intensity of competition with producers from the CIS countries and from outside the CIS, but it is beyond a meaningful interpretation.

To simplify the perception of our results, we present them in a scheme (see Table 1) where numbers of ‘X’ show the intensity of the revealed correlations with corresponding blocks of indicators of activities of the respondent enterprises.

Table 1 Revealed Correlations between Government Support, Help to the authorities and Indicators of Activities of Respondent Firms

	Blocks of indicators		
	Scale, industry, region, corporate governance	Patterns of behavior	Interaction with the state
Financial support	-	X	XX
Government procurement on products	-	X	-
Organizational support	X	XXX	XX
General indicator of government support	-	X	XXX
Assistance to the authorities	X	XX	X

Summarizing our results we can note the following. The first hypothesis about definitely inefficient and politically engaged nature of industrial policy of regional authorities has no positive proof in general. There are no signs that support is being systematically given to enterprises with poor current indicators of performance. Reduction in employment for 20% and more in 2001-2004 is the only indicator in this set, but it can possibly be the outcome of aggressive restructuring measures taken by the enterprises in question. Moreover, this indicator is significant only in relation to organizational support.

The second hypothesis (about the “new regional industrial policy”) is partly confirmed. For instance, organizational support is being given more

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often to the firms with planning horizons longer than five years and to those that have successfully introduced the standards of the International Organization for Standardization (ISO). What is more, government support is generally more often given to the enterprises that borrowed from commercial banks in 2001-2004 (this can be regarded as an indirect confirmation of their financial soundness).

The third hypothesis (about existence of a system of “interchange”) has got a number of proofs. The enterprises that are actively engaged in assistance to the authorities (through two and more channels) were much more frequently mentioned among the recipients of government support. To all appearances, business associations regularly act as one of organizers of the “interchange”, because their members are often involved into the system of government support and at the same time, regularly give assistance to the authorities.

Referring to the proportion between “state capture” and “business capture”, the regression analysis, as we believe, gives more grounds in favor of the latter hypothesis. On the one hand, the existence of numerous enterprises that give assistance to the authorities but get no support from them at all, as well as the fact that assistance to the authorities has been more often given by the firms that made capital investment, may be indirect evidence of administrative barriers and likelihood of rent-seeking behavior of bureaucrats. On the other hand, the fact that the firms with government stakes in their capital are the first to get government support while they show no prominence in assistance to the authorities can be understood as evidence of “state capture”. However, a reverse understanding is also possible here: bureaucrats are more inclined to support the firms under their control, because it is easier to arrange rent seeking through them.

In general, the results of the regression analysis give no definite confirmation of any individual model. Rather, we can suggest there is a

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coexistence of different models of interaction between the state and the business at the regional level.

4.6. Description Of Possible Models Of Interaction Between Corporations And Regional Authorities

Using the results of a simple pair distribution over two integral variables “getting government support” and “rendering assistance to the authorities” we have obtained the following matrix (See Table 2):

Table 2

		Assistance to the authorities	
		Wasn't given	Was given
Support from local and regional authorities	Haven't obtained	98 firms	347 firms
	Have obtained	39 firms	319 firms

Taking into account this distribution we have constructed a new variable, which reflects four possible correlations between the two initial parameters, and conducted a correlation analysis of links between the new variable and key indicators of activities of the surveyed enterprises. The results of this analysis are given in Table 3. Let us emphasize that Table 3 presents the data referring only to those indicators that have statistically significant differences in the pair distribution over two integral variables “getting government support” /“rendering assistance to the authorities”.

As seen from the above data, the four groups that we have singled out are different in terms of size. The group that keeps a distance from the state (no government support, no assistance to the authorities) includes about 12% of the respondents. The groups that render assistance to the state without and with getting government support are comparable – 43% and 40%, respectively. Finally, the group of firms that are getting government support without giving assistance to the authorities has a weight of less 5% of our sample.

The first group is of small size (average number of employees is 1015, the median is 300) and is oriented towards local markets (only 9% have substantial exports; 53% face practically no competition from foreign

Table 3. Main Characteristics of Groups of Enterprises Classified by Type of Interaction with the Authorities

Parameters	Groups of enterprises (by type of interaction with the authorities)				Statistical significance of differences between groups
	№1. Rendering no help, getting no government support	№2. Rendering help to the authorities without getting government support	№3. Rendering help to the authorities in the presence of government support	№4. Government support without help to the authorities	
Number of respondent firms attributed to the group	98	347	319	39	
Objective characteristics of the enterprise, ownership and corporate governance					
Sales volume in 2004 – median, million rubles	100	190	300	130	X
Number of employees in 2004 - average	1015	1519.	2708	844.	
Number of employees in 2004 - median	300	410.	617	390	
Output per employee in 2004 – median, 1000 rubles	289	414	396	311	
Firms with less than 300 employees.	47%	33%	22%	33%	0,000
Firms with more than 1000 employees	23%	24%	37%	18%	
Members of business groups (holding company groups)	31%	38%	45%	28%	0,028
Foreign investors have a block of shares	8%	14%	17%	7%	0,101
Patterns of enterprise behavior					
Firms with output growth in 2001-2004 by 50% and more	47%	57%	59%	33%	0,003
Firms with increase in wages in 2001-2004 by 50% and more	53%	68%	69%	34%	0,000
Firms exporting more than 10% of production	9%	19%	28%	23%	0,000
Firms facing moderate and strong market competition with foreign producers	47%	47%	55%	62%	0,011
Firms with planning horizon less than 1 year	40%	34%	20%	42%	0,000
Firms with planning horizon of 5 years and more	4%	7%	11%	5%	
Firms having made capital investment in 2001-2004	54%	74%	84%	71%	0,000
Firms having introduced the ISO in 2001-2004	33%	38%	50%	42%	0,004
Firms having borrowed from banks in 2001-2004	62%	77%	94%	84%	0,000
Indicators of enterprise interaction with the state					
Firms with government interest (stakes of 5% and more)	12%	13%	28%	22%	0,000
Regional authorities have a stake in capital	4%	5%	15%	10%	0,000
Regional representatives are in the board of directors	2%	8%	17%	5%	0,000
Rendered help to authorities through two and more channels	X	50%	65%	X	0,000
Participation in advisory bodies under government agencies (at the regional level)	13%	21%	29%	24%	0,000
Take part in trade associations	35%	49%	71%	33%	0,000

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producers in their markets). The enterprises of this group have the weakest connections with the state in terms of all characteristics (general participation of the government; shareholding by local authorities; participation of representatives of regional authorities in their boards of directors; participation in advisory bodies acting under different levels of government). Their distinctive feature is that in a sense, they are autonomous – they less regularly join business groups and business associations and less frequently borrow from commercial banks. They typically have shorter planning horizons (at 40%, less than a year) and lower investment and innovational activity. Nevertheless, these firms can be considered relatively successful: in 2001-2004, about a half of them managed to have increased their output and wages by 50% and more.

The enterprises that give assistance to authorities (the second and third groups) are large, aggressively expanding companies, members of business groups, and they have longer planning horizons. Regional authorities can have representatives in their boards of directors even in the cases when the region has not a single share in the stock of these companies. Meanwhile, the firms that get no government support (the second group) have typically low rates of state interest in their stock and show little activity in advisory bodies that are acting under different levels of government. They less often are members of business associations. The share of dynamic exporters is also lower in this group. On the contrary, the third group (the firms that help the authorities and get support from them) has high levels of absolutely all indicators in question, including the indicators of development (planning horizon, capital investment, managerial innovations, rates of increase in output and wages, exports etc.). In comparison with the second group, they are also more active in rendering assistance to local and regional authorities. As a result, in our opinion, this group can illustrate both the model of the “system of interchange” and the model of “new industrial policy”.

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The last one, the fourth group – the firms that get government support without giving assistance to the authorities – is prominent in terms of share of companies with government stakes, active participation in advisory bodies under government agencies and high share of exporters. At the same time, this group shows the lowest average rates of growth in 2001-2004 (only 1/3 of the firms could increase output and wages by 50%). The enterprises of this group are much rarely members of business groups (holding company groups) and seldom take part in activities of business associations. Generally speaking, this is probably the group that can be considered an example of an ineffective “personified” type of industrial policy pursued by regional authorities. It is also possible to assume that redistribution of benefits and subsidies from regional and local budgets to private hands goes through these “close-to-the-authorities” companies. However, we have to state that this group of firms is of marginal scale – their number is 1/8 of the population of the most dynamic and efficient third group, which also closely cooperate with regional authorities.

So, the results of our correlation analysis confirm our assumption that interaction of enterprises and regional authorities has a great variety of models. In the whole range of surveyed enterprises we can single out those that are closely related to local and regional authorities (in terms of government stakes in their capital, participation of their top managers in advisory bodies under government agencies, membership in business associations). Such enterprises receive government support much more often. There are inefficient outsiders among them, but their overwhelming majority is dynamically evolving firms. They are indeed the most active ones in helping local and regional authorities.

4.7. Concluding Remarks

Summarizing our analysis, we can make the following conclusions:

1. The scale of the phenomenon. Although fiscal reform and delimitation of powers between the federal center and units of federation reduced financial capacities of regional governments, coverage of enterprises

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with various measures of support at the regional level is sufficiently wide. According to the survey data, in 2001-2004 the share of respondents having received some or other kind of aid was about 45%, including 29% recipients of organizational support, 23% - of financial aid, and 12% suppliers to regional authorities. Assistance to regional and local authorities was also carried out on a massive scale – it was rendered by more than 80% of the respondents, including 24% that were using two, and another 23%, three and more channels.

2. Factors of granting government support. Local and regional authorities much more often support joint stock companies with government stakes, as well as the firms that are present in advisory bodies under government agencies and are members of trade associations. Therefore, we can speak about a kind of “personal union” between regional authorities and the enterprises receiving their support. On the other hand, the results of the survey do not give sufficient evidence to prove the widespread opinion that measures of industrial policy pursued by regional authorities are generally inefficient. The majority of firms that received the support in 2001-2004 are dynamic firms, which make capital investment, modernize their organization schemes and management, and export their goods and services. At the same time, these firms were the most active ones in giving help to local and regional authorities.

3. Models of interaction. Our data show that there is a parallel existence of a number of different models of interaction between enterprises and regional authorities. The most widespread one is probably the model of “interchange”. In the framework of this model the enterprises that receive benefits, subsidies and other support from regional authorities also bear a greater burden of social liabilities and more frequently give help to the authorities. Along with the firms that are involved in this system of “interchange”, there are enterprises that keep a distance from the state. Nevertheless, a large part of them regularly help local and regional authorities. This help can be regarded as one of mechanisms of extraction of administrative rent by bureaucrats. Finally, there is also a group of enterprises that receive

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support without giving help to the authorities. These enterprises are close to the authorities in terms of a number of indicators, but their rates of growth in output and wages are low, planning horizons are short, etc. This group can probably be considered an example of ineffective “personified” industrial policy pursued by regional authorities. It is also possible to assume that redistribution of benefits and subsidies from regional and local budgets to private hands goes through these “close-to-the-authorities” companies. However, this group makes less than 5% of the sample.

In general, the results of our survey demonstrate that a more equal and more civilized style of relations is developing between enterprises and regional authorities. We can also state that regional authorities are active in their support of enterprises, and that their efforts are relatively successful. Let us emphasize that reliance on mechanisms of organizational support (which in many cases is more important today than direct financial aid) is growing in scale in the regions of the Russian Federation. In this situation, more detailed study of mechanisms and instruments of regional industrial policy along with further dissemination of the “best practice” is becoming an urgent need.

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Appendix

The Used Variables and the Results of Logistic Regressions

Table A4.1

Selected explanatory variables	Possible values of selected indicators
Group 1. Objective characteristics of the enterprise, ownership and corporate governance	
Industry	Communications; fuels and electric power; metals; machinery and metalworking; chemicals and petrochemicals; logging, woodworking, pulp and paper; light industry; food; building materials
Size (by number of employees)	100-299; 300-499; 500-999; 1000-4999; 5000 and more
Regional investment potential (data of the Expert Rating Agency, 2005)	High; medium; lowered; insignificant (all – at a moderate level of risk)
Presence of foreign shareholders	Foreign shareholders are present; no foreign shareholders
Presence of controlling shareholder	Controlling shareholder is present; no controlling shareholder
Stability of top enterprise management	CEO unchanged in 2001-2004; CEO changed once; CEO changed several times
Type of accountant auditing company's financial statements	International auditing firm; auditing firm from the same region; auditing firm from another region of the RF
Group 2. Patterns of enterprise behavior	
Planning horizon	Less than 1 year; 1-3 years; 3-5 years; more than 5 years
Assessment of general financial condition	Good; rather good; fair; rather poor; poor
Borrowing from banks	No borrowing in 2001-2005; made borrowing
Output growth in 2001-2004	Output more than doubled; grew by 50-100%; unchanged (changes in the range of $\pm 5\%$); declined (more than by 5%)
Changes in employment in 2001-2004	Grew by more than 20%; grew by less than 20%; unchanged (changes in the range of $\pm 5\%$); declined by less than 20%; declined by more than 20%
Handling of export operations by the respondent firm	The firm was not engaged in exports; the firm was engaged in exports
Intensity of market competition from Russian producers and joint ventures with foreign capital - Russian residents	High level; moderate level; practically no competition
Intensity of market competition from producers from CIS countries and from countries outside CIS	High level; moderate level; practically no competition
Capital investment in 2001-2004	No capital investment; investment was made
Introduction of new production facilities in 2001-2004	Yes, new facilities were introduced; no new facilities
Introduction of ISO standards in 2001-2004	Successfully introduced ISO standards; failed to introduce or did not engage in it
Group 3. Interaction of the enterprise with the state	
Participation of regional authorities in the enterprise stock	Regional and local authorities are among shareholders; there are no such shareholders
Presence of government control	Government control; government shareholding; private ownership without government shareholding
Regional representation in the boards of directors	No regional and local representatives in the board of directors; there are regional and local representatives in the board of directors
Participation of top managers in advisory bodies under government agencies	No participation; participate at the regional level; participate at the federal level
Membership of the enterprise in trade associations	The enterprise did not join any trade association; the enterprise is a member of one or several trade associations
Participation of the enterprise in regional government procurement of goods in 2001-2004	Did not take part; took part through 1 channel; took part through 2 channels
Receipt of financial support from the region in 2001-2004	Received no support; received support through 1 channel; received support through 2 and more channels
Receipt of organizational support from the region in 2001-2004	Received no support; received support through 1 channel; received support through 2 and more channels
Rendering help to regional and local authorities in 2001-2004	Rendered no help; rendered help through 1 channel; rendered help through 2 and more channels

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Table A4.2

Financial support		B	Sig.
Step 5(e)	q45_gr1 – borrowed from banks	1,592	,010
	q60b_gr2 – regional authorities have a block of shares	1,246	,001
	q102_svd – participation in advisory bodies at the federal level		,034
	q102_svd(1) – no participation in advisory bodies under government agencies	-,916	,057
	q102_svd(2) – participation in advisory bodies at the regional level	-,310	,541
	q98_sum1 – received organizational support through 2 and more channels		,039
	q98_sum1(1) – received no organizational support	-,774	,035
	q99_reg1 – participation in regional government procurement through 2 channels		,005
	q99_reg1(1) – did not take part in regional government procurement	-1,024	,483
	Constant	-2,390	,230
Pseudo-R ² = 0,211			

Table A4.3

Organizational support		B	Sig.
Step 10(j)	q15 – reduction of employment for more than 20%		,048
	q15(3) – unchanged number of employees (-/+ 5%)	-,823	,055
	q21 – planning horizon over 5 years		,025
	q21(1) – planning horizon less than 1 year	-1,428	,007
	q21(2) – planning horizon up to 1-3 years	-,997	,042
	p43_2 – introduction of the OSO	,448	,075
	q60_svd3 – no government stake in capital		,009
	q60_svd3(1) – government control	1,692	,003
	q65 – presence of a controlling shareholder	,716	,053
	q100_sv1 – membership in a trade association	1,130	,000
	q83 – CEO was changed several times		,017
	q83(1) – CEO was unchanged in 2001-2004	-1,021	,005
	q83(2) – CEO was changed once	-,964	,019
	q99_reg1 – participation in regional government procurement through 2 channels		,106
	q99_reg1(1) – did not take part in regional government procurement	-23,080	,999
	q97_sum1 – financial support through two channels		,004
	q97_sum1(1) – there was no financial support	-2,059	,003
	q97_sum1(2) – financial support through 1 channel	-1,432	,047
	q72 – auditor from another city in the RF		,004
	q72(1) – international auditor	-1,501	,016
	q72(2) – auditor from the same city	,460	,153
	Constant	23,903	,999
Pseudo -R ² = 0,323			

Table A4.4

Government procurement in the region		B	Sig.
Step 4(d)	q2 – communications		,024
	q2(1) – fuels and electric power	-,286	,788
	q2(2) – metals	-1,199	,343
	q2(3) – machinery and metalworking	-1,287	,106
	q2(4) – chemicals and petrochemicals	-,464	,651
	q2(5) – logging, woodworking, pulp and paper	-,625	,504
	q2(6) – light industry	,188	,824
	q2(7) – food	,580	,429
	q2(8) – building materials	-,971	,337

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gr_20ab – absence of market competition from Russian producers and joint ventures with foreign capital - Russian residents		,012
gr_20ab(1) – strong market competition from Russian producers and joint ventures with foreign capital - Russian residents	1,856	,004
gr_20ab(2) – moderate market competition from Russian producers and joint ventures with foreign capital - Russian residents	1,793	,004
q97_sum1 – financial support through 2 channels		,000
q97_sum1(1) – there was no financial support	-2,752	,000
q97_sum1(2) – financial support through 1 channel	-1,841	,006
q98_sum1 – received organizational support from 2 and more channels		,008
q98_sum1(1) – received organizational support	-1,236	,010
Constant	-,082	,936
Pseudo -R ² = 0,301		

Table A4.5

General government support		B	Sig.
Step 4(d)	q45_gr1 – borrowed from banks	1,352	,000
	q60_svd3 – no government stake in capital		,000
	q60_svd3(1) – government control	1,797	,001
	q60_svd3(2) – have a government stake in capital	,990	,002
	q100_sv1 – membership in trade associations	,919	,000
	q96_sum1 – rendering help to the region through 2 and more channels		,034
	q96_sum1(1) – rendered no help to the region	-,409	,214
	q96_sum1(2) – rendering help to the region through 1 channel	-,596	,011
	Constant	-3,211	,000
Pseudo -R ² = 0,213			

Table A4.6

Help to local and regional authorities		B	Sig.
Step 7(g)	gr_pers2 – 5000 and more employees		,170
	gr_pers2(1) – 100-299 employees	-18,823	,998
	gr_pers2(2) – 300-499 employees	-18,669	,998
	gr_pers2(3) – 500-999 employees	-17,703	,998
	gr_pers2(4) – 1000-4999 employees	-19,110	,998
	gr_20cde – no market competition from producers from CIS countries and from countries outside CIS		,029
	gr_20cde(1) – strong market competition from producers from CIS countries and from countries outside CIS	,483	,225
	gr_20cde(2) – moderate market competition from producers from CIS countries and from countries outside CIS	-,613	,087
	q34_1 – investment was made	,756	,027
	q45_gr1 – borrowed from banks	1,053	,004
	q100_sv1 – membership in trade associations	,694	,026
All- with moderate risk	reg_expt – regions with high potential		,003
	reg_expt(1) – regions with medium potential	,559	,285
	reg_expt(2) – regions with lowered potential	1,746	,000
	reg_expt(3) – regions with insignificant potential	,908	,027
	q83 – CEO was changed several times		,020
	q83(1) – CEO was not changed in 2001-2004	1,189	,005
	q83(2) – CEO was changed once	,941	,052
	Constant	15,099	,998
Pseudo -R ² = 0,236			