Corporate Governance Mechanisms and Outcomes: Russian Federation[1]

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The theory of corporate governance describes a number of mechanisms ensuring realization of the shareholders rights and forming the system of relations between the shareholders, managers, employees, creditors and other participants of firm operations concerning the order by assets disposition and distribution of the incomes.3 The various aspects of operation of these mechanisms are studied by the economic theory, jurisprudence, sociology, psychology and other sciences. Researchers mark the tendency to shaping the interdisciplinary approach in the theory of corporate governance (see Prentice, Holland, 1993).

The mechanisms of corporate governance are traditionally differentiated as internal and external: internal procedural mechanisms of governance within corporation and the influence of an external environment (external mechanisms of governance) respectively. External mechanisms usually include :

- Corporate legislation (codes, special company laws, conjugate laws, departmental acts, rules and instructions) and, what is more important, its executive infrastructure (enforcement);
- Control via financial markets, i.e. mass "dumping" of securities of ineffective corporation on liquid financial markets (accordingly managers meet an intractable problem of search for new resources in conditions of falling interest of financial investors to corporate securities);
- Threat of corporation's bankruptcy as a result of invalid policy of managers (in the most rigid variant - transition of control to creditors);
- The market of corporate control (threat of a hostile take-over and replacement of the managers).

Below we review the key mechanisms and obstacles for the development of a national model of corporate governance in Russia. The present study mostly focuses on open joint-stock companies set up in the industrial sector on the basis of medium and large public enterprises in the course of their corporatization and privatization.

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[3] See, for example: Corporate governance: the shareholders, directors and employees of joint-stock company. M., 1996; Entov, 1999; Andreff, 1995,1996; Charkham, 1994; Clark, 1986; Monks, Minow, 1995; OECD, 1999; Prentice, Holland, 1993; Wouters, 1973.

1. Internal mechanisms (Corporate governance structures within an enterprise: Legal aspect)

Following the classification of J.Tirole (Tirole, 1999), it is possible to indicate at least three internal mechanisms regulating the coordination of decisions within the corporation with interests of the shareholders: 1) preservations of a manager's post for the manager (and, clearly, its business reputation in the appropriate market in case of successful activity of corporation); 2) maintenance of stimulus for effective (from the point of view of the shareholders) management with the help of specially elaborated systems of payment; 3) direct monitoring realized mainly by large shareholders and their representatives.

In some countries a role each of these mechanisms may essentially differ. At the same time - with all differences in existing structures of corporate governance - in each developed country checks and balances were generated in order to ensure interests of the investors and to provide sufficient independence and initiative of the managers. In countries with transitional economy rather weak development of "external" mechanisms of corporate governance objectively stipulates the special significance of the "internal" mechanisms.

According to the Russian law "On joint stock companies", a joint stock company is managed by the following bodies: the General Shareholders' Meeting; the Board of Directors (the Supervisory Board); and Executive bodies: the General Director (the single-member executive body), the Management (collective executive body).

The supreme management body of a joint stock company is the **General Shareholders' Meeting.** The following *issues shall be considered at the Annual Shareholder Meeting*: election of the Board of Directors; election of the Inspection Commission (Inspector) of the company; approval of the company's External Auditor; approval of the annual report, annual bookkeeping accounting including profits and losses reports (profits and losses accounts) of the company, as well as distribution of profits, including payment (announcement) of the company's dividends, and losses resulting from the financial year; issues which fall within the competence of the General Shareholders' Meeting may also be considered.

The following issues fall within the jurisdiction of the General Shareholders' Meeting: incorporation of amendments and additions to the company's Charter or approval of a new version of the company's Charter; reorganization of the company; liquidation of the company, appointment of the liquidation commission and approval of the intermediary and final liquidation balance sheets; determination of the number of members of the company's Board of Directors, election of the members thereof and early termination of their powers before time; determination of the quantity, nominal price, category (type) of the declared shares and rights granted by these shares; increase/decrease in the Charter Capital of the company and some others.

The General Shareholders' Meeting shall have legal power if shareholders possessing in aggregate over half of the votes of the company's distributed voting shares have participated in the meeting. The decision of the General Shareholders' Meeting on the issue set to vote shall be taken by a majority of votes of the shareholders – owners of the company's voting shares participating in the meeting.

The company shall notify its shareholders of the General Shareholders' Meeting no later than 20 days prior to the date of holding the meeting, if the agenda of the meeting includes the item on the reorganization of the company - not less than 30 days prior to the date of holding the meeting. If the agenda of the Extraordinary General Shareholders' Meeting includes the item on electing the members of the company's Board of Directors (are to be elected by cumulative vote), the shareholders shall be notified of the Meeting not less than 50 days prior to the date of holding the meeting. A shareholder (shareholders) owning at least 2% of the voting shares have the right to make proposals with respect to the agenda of an Annual

General Shareholders' Meeting, and to nominate candidates to the Board of Directors of the company, collective executive body, Inspection Commission (Inspector) and Counting Commission of the company (the number of such candidates should not exceed the number of members of the respective body). The shareholders (shareholders) may also nominate a candidate to the single-member executive body.

The company's **Board of Directors (Supervisory Board)** shall carry out overall management of the activity of the company within its jurisdiction. Only a physical person may become a member of the company's Board of Directors. A member of the Board of Directors shall not necessarily be the company's shareholder. The company with less than fifty shareholders owning voting shares may provide in its Charter that the functions of the company's Board of Directors shall be executed by the General Shareholders' Meeting.

The exclusive jurisdiction of the company's Board of Directors includes the following issues: determination of priority areas for the company's activity; calling the Annual and Extraordinary General Shareholders' Meetings; approval of the agenda of the General Shareholders' Meeting; increase of the company's Charter capital by distribution of the shares within the limits of the quantities and categories (types) of declared shares; 6) distribution by the company of bonds and other emissive securities, recommendations on the amount of the dividends on shares and some others. Issues relegated to the jurisdiction of the company's Board of Directors may not be transferred to the company's executive body.

Members of the company's Board of Directors shall be elected by the Annual General Shareholders' Meeting for a period untill the next Annual General Shareholders' Meeting. Members of the company's Board of Directors with over a thousand shareholders owning common shares shall be elected by cumulative vote. By the decision of the General Shareholders' Meeting the powers of any member of the Board of Directors may be early terminated, insofar, if members of the Board of Directors were elected by cumulative vote, the decision on the termination of powers may be taken only with respect to all members of the Board of Directors. For an open joint stock company with over a thousand shareholders owning common stock and other voting shares of the company, the Board of Directors should be composed of at least seven members, while for the company with over ten thousand shareholders - at least nine.

The law prohibits to combine the positions of the Chairman of the Board of Directors and General Director (a single-member executive body). The Law also provides that the members of the company's collective executive body may not account more than one quarter of the company's Board of Directors.

An independent director is a member of the company's Board of Directors who is not and was not during a year preceding the adoption of resolution (on the approval of an interested-party transaction):

- a person carrying out the functions of the single-member executive body, including the functions of its manager, a member of the collective executive body, a person holding a position in the bodies of the managing company;

- a person whose spouse, parents, children, brothers and sisters, adoptive parents and adopted children are holding positions in above-mentioned company's management bodies, of the managing company, or being the Manager of the company;

- the company's affiliate, excluding the member of the Board of Directors.

Decisions at the company's Board of Directors shall be adopted by a majority of votes of the members of the company's Board of Directors participating in the meeting, unless provided otherwise by the Federal Law 'On Joint Stock Companies' or by the company's Charter. Remuneration and compensation of expenses related to the execution of duties by the members of the Board of Directors shall be paid by the decision of the General Shareholders'

Meeting. The amounts of such payments are established by the decision of the General Shareholders' Meeting.

The jurisdiction of the **company's executive body** includes all issues relating to the management of the company's current activity, and implementation of decisions adopted by the company's General Shareholders' Meeting and the Board of Directors, except for the issues relegated to the exclusive jurisdiction of the company's General Shareholders' Meeting or the Board of Directors.

The General Director (Director) shall be elected, and shall also early terminate his/her duties, by the decision of the General Shareholders' Meeting or the Board of Directors, depending to whose jurisdiction the resolution of the specific issue is relegated. The powers of the General Director, by the decision of the General Shareholders' Meeting, may be transferred under a contract to a commercial organization or an individual entrepreneur (Managing Company).

The company's collective executive body shall be formed and shall early terminate its powers by the decision of the General Shareholders' Meeting, unless the company's Charter delegates the right to resolve such issues to the company's Board of Directors. The Charter of the company which provides for both a single-member and collective executive bodies should specify the powers of the company's collective executive body. In this instance, the person executing the functions of the company's single-member executive body (Director, General Director) shall also execute the functions of the Chairman of the company's collective executive body (Management Board, Directorship).

Members of the management bodies are liable to the company for losses inflicted to the company by their culpable actions (omissions), unless federal laws establish other grounds and scope of liability. Insofar, members of the collective executive body and the Board of Directors who voted against the decision which caused losses to the company or who did not participate in the voting procedure shall not be held liable. In determining the grounds and scope of liability one should take into account normal course of business and other circumstances material for business.

The company or a shareholder (shareholders) owning in aggregate at least 1 percent of the company's distributed common shares may file a suit to court against the member of the management bodies and claim compensation of losses inflicted to the company. The representatives of the State or a municipal organization in the Board of Directors of an open joint stock company incur the same liability as other members of the Board of Directors of an open joint stock company.

To supervise financial and business activity of the company, the General Shareholders' Meeting elects **the Inspection Commission (Inspector)** of the company. The inspection of the company's financial and business activity is conducted upon the results of the company's activity for the past year, and at any time at the initiative of the Inspection Commission, by the decision of the General Shareholders' Meeting, of the Board of Directors, or at the request of a shareholder (shareholders) of the company, holding in aggregate not less than 10% of the company's voting shares.

The members of the company's Inspection Commission (Inspector) may not be at the same time the members of the company's Board of Directors, or occupy other positions in the company's management bodies. The shares in possession by the members of the company's Board of Directors or persons occupying positions in the company's management bodies may not participate in election of the members of the company's Inspection Commission.

The **External Auditor** audits the financial and business activity of the Company on the grounds of the contract concluded therewith. The company's External Auditor shall be approved by the General Shareholders' Meeting. The amount of compensation for its services shall be determined by the company's Board of Directors.

Stockholders' rights depending on their share in the paid-up capital

The threshold of participation	Stockholder's powers
1 share	1) the voting right at the general meeting 2) eligibility for dividends on the given category of stock 3) eligibility for receipt of a part of property (an adequate value) in the course of liquidation of the AO 4) the right to demand the stock redemption under certain circumstances 5) the right to appeal to the court concerning decisions passed by the general meeting 6) the right to have an access to documents related to the AO's operations, as per the law except those associated with accounting and protocols of meetings of the AO's collegial executive body 7) the right to receive an extract from the AO's register 8) the right to receive an extract from the list of individuals who are eligible for participation in the general meeting of AO's stockholders
1 %	1) the right to get oneself familiarized with the list of individuals who are eligible for participation in the general meeting of AO's stockholders 2)the right to file a lawsuit against a member of the Board of Directors, право на обращение в суд с иском к члену совета директоров, individual executive board, member of a collegial executive body of the company and a managing organization or manager on recovery of losses caused by in the event stipulated in the law
2 %	1) the right to include his questions to the agenda of the annual general stockholder meeting. 2) the right to propose candidates to the board of directors, revision commission, and accounting commission of AO
10 %	1) the right to request an early general stockholder meeting 2) the right to demand at any time to inspect the AO's economic and financial operations
25 %+1 share	1) the right to bloc decisions passed by the general stockholder meeting with regard to introducing amendments to, or approval of a new version of the company's Charter, placement of stock (closed subscription, placement of ordinary stock through open subscription, if over 25% of earlier placed ordinary stock are to be placed, placement through open subscription of issued papers that can be converted into ordinary stock and account for over 25% of earlier placed ordinary stock), reorganization and liquidation of AO, appointment of the liquidation commission, approval of liquidation balances, computation of the quantity nominal value, category (type) of stated stock and rights provided by them, the company's acquisition of placed stock in the vent provided by the law, and approval of decisions on concluding large deals. 2) the right to familiarize himself with accounting papers and minutes of the AO collegial executive body's meetings.
30 %+1 share	The right to hold a repeatedly convened general stockholder meeting (instead of the one failed due to the lack of quorum)
50%+1 share	1) the right to hold a general stockholder meeting 2) the right to make a decision at a general stockholder meeting (except the issues that require qualified majority
75%+1 share	Full control over AO

In cases, when the company distributes its shares and emissive securities convertible into shares by a public subscription, **the company's shareholders** (see also table below) shall have the preemptive right to acquire the above shares in the amount proportionate to the number of shares of this category (type) belonging thereto. Shareholders of voting shares shall have the right to demand that all or part of their shares be redeemed by the company in the following circumstances:

- in the event of the company's reorganization or conclusion of a major transaction by decision of the General Shareholders' Meeting, provided they voted against such decisions or did not participate in the vote on such issues;

- in the event of introduction of amendments and additions to the company's Charter or approval of a new edition of the Charter which restrict their rights, provided they voted against the adoption of the corresponding decision or did not participate in the vote.

Shareholders-owners of preference shares shall participate in the General Shareholders' Meeting and have the right to vote on issues concerning the company's reorganization or liquidation, in the event of adopting a decision to introduce amendments and additions to the company's Charter which limit the rights of preference shareholders of such type, including instances of the determination of or increase in the size of a dividend and/or the determination of or increase in the liquidation value payable on preference shares of the higher priority, as well as the granting to preference shareholders of this type of a higher priority during the payment of dividends and/or the liquidation value of shares.

The company is obliged to provide its shareholders with the following **information on the Company**: the agreement on the establishment of the company; the company's Charter, amendments and additions to the Charter and registered in accordance with the established procedure, decision on the creation of the company, certificate of state registration of the company; documents certifying the rights of the company for the assets shown on its balance sheet; internal documents of the company; provisions on a branch or a representative office of the company; annual reports of the company; accounting documents; voting ballots, as well as power of attorneys (copies of power of attorneys) to participate in the company's General Shareholders' Meeting; independent appraiser' reports; lists of the company's shareholders entitled to participate in General Shareholders' Meeting, having the right to collect dividends as well as by other lists drawn up by the company for the exercise by its shareholders of their rights; issue prospects, issuer's quarterly reports and other documents containing information to be published or disclosed by other means in accordance with the Federal Law 'On Joint Stock Companies' or in accordance with other federal laws; lists of the company's affiliated persons; other documents stipulated by the Federal Law 'On Joint Stock Companies' in force, the company's Charter, the company's internal documents and decisions of the General Shareholders' Meeting, the company's Board of Directors, its management bodies, as well as other documents provided by legislative acts of the Russian Federation. Only those shareholders (shareholder) holding in aggregate no less than 25% of the company's voting shares have the access to the company's accounting documents and the minutes the meeting of the company's collective executive body.

The latest amendments to the Federal Law "On Joint Stock Companies", in effect since January 1, 2002, includes a number of important new imperative provisions representing effective safeguards for minority shareholders' rights and statutory interests:

- The Law provides for extra guarantees for shareholder rights during joint stock company restructuring by way of split-off or split-up;
- Changes to a holding company's corporate structure by means of issues of shares or other securities convertible into shares are now much more difficult to effect.
- The Law offers a new precaution against unfair buy-outs of shareholders' assets upon the emergence of fractional shares during stock consolidation, which were previously subject to obligatory repurchase.
- The Law expands the competence of a general shareholders' meeting.
- The Law also updates some procedures involved in the convocation and conduct of general meetings, thus further securing stockholders' rights to share in the governance of their companies.
- The Law sets a period of limitation for appealing decisions made by general shareholders' meetings.
- It is now easier to dismiss the company's executive authorities.

- The Law establishes new rules for the approval of interested-party transactions, which reduce the risk of the company being governed in the interest of a limited group of parties.

- The list of documents which the company is obliged to keep and copies of which it is required to submit at shareholder requests is much longer than earlier.

2. External mechanisms of corporate governance

2.1. The corporate securities market

The importance of the corporate securities market for the formation of any specific model of corporate governance is quite obvious and requires no further comments. Under the conditions of an illiquid developing market, the problem of a choice between the mechanism of "vote" and the mechanism of "withdrawal" loses the character of dichotomy[4] and becomes, in fact, predetermined: if it is impossible to sell one's shares, one would face the necessity to increase the role of the "vote" mechanism. When the major object of trade is the securities issued by 10-15 issuers, the mechanism of "withdrawal" (selling of shares) as an element of a model of corporate governance would not work in an absolute majority of cases. The liquidity of the market of securities of one specific issuer, as a rule, is rather short-term; moreover, it is one-sided: small share-holders can only carry out "withdrawals", and only during the periods of consolidation of the controlling block of shares, or at the time of an aggravation of corporate conflicts between major share-holders and managers. In a number of situations, this problem could not emerge in principle (when absolute control is established and/or the enterprise is simply of no interest to anybody).

Consequently, the formation of a model of corporate governance would actually become predetermined: if the mechanisms of "withdrawal" do not work (it is impossible to sell one's shares), the development would, objectively, take the course of strengthening the role of the mechanism of "vote". If any problems emerge even in this respect (the managers can still preserve the ideology of "principals"), then there will be no other recourse but to address the government executive and judicial systems.

At the same time, there is also a certain feedback. According to a number of estimates, violations of the norms of corporate governance in Russian corporations became one of the dominant factors resulting in the departure of investors and the collapse of the securities market in 1998. [5]

The years 1999 and 2000 did provide certain reasons for optimism regarding the prospects for the development of the Russian securities market (Table 1). The favorable estimates, first of all, were related to the industrial recovery resulting from the devaluation of the rouble and the growth of oil prices and the price of gas which led to an increase in tax receipts on the part of the budget and a rise in the exporters' income. According to the estimates made by the majority of agencies and influential financial publications, in the first post-crisis year, that is, in 1999, the Russian equity market became one of the three most rapidly growing markets in the world. In just one year, the capitalization of the blue-chip-stock market had increased by

[4] Hirschman A.O. Exit, Voice, and Loyalty: Response to Decline in Firms, Organisations and States." Cambridge: Harvard University Press, 1970, pp.15-54.

[5] The contribution of this factor in the decline of capitalisation of the market is estimated in the range between 30% (Federal Security Commission of Russia) and 100% (Brunswick Warburg), though it is clear that such estimates are very arbitrary.

182%. In 2001 and 2002, the "Russian equity market was, in general, characterized by a positive dynamics. [6]

Table 1. Major indicators of the development of Russia's equity market, 2000-2002

	1995	1997	1999	2000	2001	2002
RTS index, points (annual change in %)	100 as of 1.09.95	572 – history. maximum 6.10.97	98	143.29 (-19.95)	260.05 (98.5)	359.07 (34.1)
Capitalization, $ million	5-8	60-65	about 20	40	82	110
Trade turnover, $ billion (share in total volume, %)	0.2 (Sept.-Dec.)	16.7-17	5.7	20.8 (100)	28.04 (100)	41.07 (100)
Incl. RTS	-	-	-	5.8 (28)	4,44 (16)	4.57 (11)
MICE	-	-	-	15 (72)	23.6 (84)	36.5 (89)
Number of issuers whose shares participate in transactions, units (including quotation lists)	70-80 (-)	260-300 (100-120)	350-400 (50-60)	300-350 (30-35)	370-400 (30-35)	370-400 (30-35)
Number of broker and dealer companies, units	3176	5045	1628	924	618	619
Number of credit institutions, units	2295	1764	1375	1320	1320	1331
Trade systems wherein over 90% of trade volume is concentrated, units (all in Moscow)	2	3	3	3	3	3

Source: RTS, MICE, FSC, BAE, Bank of Russia, Ia. M. Mirkin's and Iu. A. Danilov's data.

Among the most important negative (restraining) factors are the absence of significant structural changes in the economy (the reform of natural monopolies [7] and housing-and-communal facilities), the slow progress of the reform of government service, the remaining nontransparency of businesses and the absence of any visible interest to the reform of corporate governance, the substantial role of political and administrative factors in the process of regulation of economic disputes, etc. An important influence on the state of Russia's financial market is undoubtedly exerted by the prospects of realization of the banking reform in general and the possibility of bank crediting for medium-sized and small companies. The forecasts made by the world finance markets also give no grounds for any excessive optimism despite the active growth of Russia's credit ratings and the rise in the interest in Russian securities in the year 2002, as demonstrated by foreign institutional investors oriented towards longer-term investments and fundamental indicators of the companies.

It is also necessary to take into consideration that quite a distinctive feature of the processes of restructuring and consolidation experienced by largest industrial groups in 2002-2003 has become the newly emerged clarity of their intermediate goals - in particular, that of entering the Russian and the international equity markets. Apparently, the consolidation of property and managerial control represents an important, though not the only one, precondition for the realization of such programs. An equally important precondition is the formation of the

[6] For more details, see: Rossiiskaia ekonomika v 2002 godu. Tendentsii i perspektivy. (The Russian economy in the year 2002. The tendencies and prospects). M., IEPP, 2003, pp. 116-125; Sostoianie finansovykh rynkov Rossii v 2002 godu i perspektivy ikh razvitiia v 2003 godu. (The state of Russia's financial markets in the year 2002 and the prospects for their development in the year 2003). BEA, informatsionno-analiticheskii bulleten' No 37, aprel' 2002 g. (BEA, The information and analytical bulletin No 37, April 2002.

[7] Nevertheless, for example, it is the prospects for restructuring of the electrical power industry that were responsible for the process of intensive purchasing of shares of the Russian joint-stock company "UES of Russia" and a number of joint-stock energy producers.

image of “transparency” for potential investors. In this respect, it is also possible to foresee a growth of potential demand for innovations in the sphere of corporate governance dealing with disclosure of information and financial accountability of the companies.

In 2002, the role played by the Internet on the market of private internal investors was growing in importance. In the financial section of the MICE, 77% of the turnover went through the so-called “Internet-portal”: the turnover of transactions carried out via the Internet was 711 billion roubles. Approximately 75% of these transactions was conducted by physical persons. By the end of 2002, the trading system of the MICE had been joined by 191 broker systems, which permitted the investors to be served via remote terminals or other Internet technologies.

At the same time, we presume that that *the medium-term prospects of the market's development should not be overestimated*. First of all, the Russian equity market is still incapable to adequately perform the functions of moving the investment resources. The most probable variant of the market’s development is a rather moderate activity on the part of external and internal investors. One should also point out a number of disproportions and specific features that have become typical of the Russian market in the several past years.

Firstly, despite the fact that, for example, the RTS index had approached the maximum values by the time of the 1998 crisis, while in the year 2002 its growth was 35%, the market's capitalization still had not exceeded 160 billion dollars by mid-2003.[8] The share of oil and gas companies in the general volume of capitalization of the RTS amounts to approximately 60%, which clearly demonstrates the presence of structural distortions in the Russian economy and its orientation towards export of raw material resources.

Secondly, the market remains highly concentrated. In 2002, the securities issued by five issuers accounted for 72.18% (76.91% in 2001) of the total turnover of the RTS.[9] Ten companies provide 90% of the turnover, and approximately 45% of it falls on just two companies - LUKoil and the RJ-SC “UES of Russia”. The maximum amount of transactions involving the shares circulating in the RTS falls on UES (11,400), while LUKoil ranks second (6,200).

Thirdly, all the important trade remains concentrated in Moscow, where it is conducted on two trading floors - the RTS and the MICE. In the recent years, there has also emerged a definite tendency towards the MICE's dominance on the market (Table 1).

Fourthly, highly important is the problem of the objective limitation of the scope of possible sources of financing open to corporations (see above). Another factor restraining external joint-stock financing is the fact that a lot of companies are still underestimated by the market (whatever the reasons are).

Fifthly, in recent years, the tendency of the Russian market to be debt-based has become especially apparent. Under the conditions of an intensive process of post-privatization re-

[8] According to the RTS data as of the end of December, 2002, the hierarchy of the five Russian companies leading in the sphere of capitalization has undergone certain changes by comparison with the year 2001. The J-SC “YuKOS” ranks first (21 038 million USD) followed by J-SC “Gazprom” (18 039 million USD) and the J-SC “LUKoil” (13 099 million USD). The last-year leader, the J-SC “Surgutneftegaz” occupies only the fourth place (11 409 million USD), while the J-SC “Sibneft” is the last on the list. As for the companies outside of the oil & gas and the power industries, the J-SC “Sberbank” is most highly capitalized (3 629 billion USD), while among the “Blue Chips” the one with the smallest aggregate value of shares is the J-SC “Rostelecom” (870 million USD). The aggregate share of capitalization of the “Blue Chips” in the total volume of capitalization of the RTS is approximately 78%.

[9] The share of ordinary stock of the RJ-SC “EUS of Russia” in the total RTS turnover has slightly decreased as compared to the year 2001, sliding down to 26.3% (from 32.86% in the year 2001), and that of “LUKoil” has increased to 19.31% (from 16.65%); the share of “Surgutneftegaz” has risen to 10.65% (from 9.02%), while "YUKOS" which was virtually catapulted into the “Big Five” last year, has maintained its positions by demonstrating a rise to 10.41% (from 13.2%), whereas the results of the J-SC “Tatneft” are 5.51% (against 5.06% in the previous year).

distribution of property, corporate bonds are becoming, in fact, the only safe method to attract external financing.

Sixthly, the still isolated cases of IPOs are too few to allow us to share the euphoria of rather numerous analysts (and especially their interpretation of the year 2003 as the "IPO year" which followed the year 2002, the "year of rouble-denominated corporate bonds"). It is typical that by now, all the relatively successfully realized placements have been related to those companies which were private from the very beginning and owned well-known brands; the bidders were not strategic investors, but financial institutions.

Seventhly, the Russian market is a "market of large blocks of shares". At the same time, the relatively high degree of concentration of joint-stock capital (and the existing tendency for a rise in the degree of concentration) makes it possible to envisage the formation in Russia of a model of a highly liquid and broad-based market only as a long-term prospect.[10]

From the very beginning, Russia's securities market has been developing as a market of corporate control. The existing situation is characterized by a decrease in the volume of transactions forming portfolio investments, and by an increase in the scope of redemption of shares which is aimed at re-distribution of property.[11] Nevertheless, mergers and takeovers have practically no impact on the organized equity market, and the market price of shares at the secondary market is of no significant importance. The major "blue chips" with a relatively liquid market have the least chances to become an object of takeover, even if their market value is substantially undercut in comparison with the potential one.

In a *short term perspective*, the securities market is likely to be characterized by the following basic tendencies:

- by a further reduction in the number of professional participants of the securities market, their enlargement (through mergers), and sharper competition among them;
- by the continuing process of consolidation and reorganization in the midst of financial groups and corporations which will preserve the acuteness of corporate conflicts and the gravity of violations of the shareholders' rights;
- by a low probability of any substantial increase of interest in the Russian market on the part of foreign investors (both because of the absence of clarity in respect to restructuring of the banking system and because of the general state of the world financial markets);
- by the search for new instruments and by the development of those which have already occupied a certain segment of the market (corporate bonds irrespective of their time of maturity, warehouse receipts, mortgage documents, etc.); this process can develop both in response to demand on the part of investors and issuers and "from above", for example, on a regional basis;
- by the development of new forms of collective investment (closed mutual funds in the sphere of real estate, etc.);
- by the competition between government agencies and market participants for the funds accumulated by the pension system.

At the same time, it should be clearly understood that in a medium-term perspective this market will not become a serious source of investment recourses for the enterprises due to a number of objective and subjective reasons. Therefore, when elaborating a socio-economic strategy, the practical importance of this segment should not be overestimated. [12]

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[10] See: Uirh.in la.M. Synok tsennykh bumag Rossii. (The securities market of Russia). M., AL'PINA, 2002, p. 319.

[11] Rudyk N.B. , Semenkova E.V. Rynok korporativnogo kontrolia: sliianiia, zhestkie pogloshcheniia i vykupy dolgovym finansirovaniem. (The corporate control market: mergers, aggressive takeovers and buyouts by means of debt financing). M., Finansy i statistika, 2000, p. 9.

[12] Despite the fact that this point of view is shared by an absolute majority of Russian experts, a more optimistic opinion is represented in the following work: Danilov lu.A. Rol' fondovogo rynka na makro- i miikrourovne (ili o mifakh fondovogo rynka). (The role of the stock market or- the macro- and the microlevels (or a

2.2. Bankruptcies

The role of bankruptcy as a means to exert pressure on corporate managers under the conditions of a market economy is well known in all its aspects (both positive and negative) and has been thoroughly described in numerous studies. The risk of bankruptcy facing each corporation whose managers are pursuing an erroneous market policy (in the worst-case scenario it can mean the transfer of control to the creditors) is routinely considered as the most important external instrument of corporate governance. It is apparent that the expected result of this mechanism being applied (irrespective of all the pluses and minuses of all the specific country-oriented models - pro-creditor and pro-debtor) should be financial recovery and a rise in efficiency of the corporation which has become the object of the procedures in question.

At the same time, the specific objective limitations hampering the effective and widespread application of this mechanism in Russia and some other countries with economies in transition are also common knowledge. These limitations are as follows:

- an unfavorable financial position of a large number of newly established corporations;
- the traditionally soft budgetary restrictions;
- the preservation of a large number of corporations with government participation;
- the necessity to establish an adequate and qualified executive and judicial infrastructure;
- socio-economic barriers hampering the conduct of real bankruptcy procedures in respect to unprofitable corporations, especially in the case of largest or city-forming enterprises;
- numerous technical difficulties hampering an objective estimation of the finacial position of potential bankrupts;
- corruption and other criminal aspects of the problem including those dealing with the processes of property redistribution.

In the 1990s, the institute of bankruptcy was used in Russia either as a method of redistribution (seizure, detention, privatization) of property, or as a highly selective method of political and economic pressure exerted on the enterprise by the state. There exists a paradoxical situation: the enterprises with a sufficient safety margin become the object of bankruptcy procedures (because the competitors have good chances to seize control over them), while hopeless enterprises elude this procedure (because nobody wants to seize them enterprises, since the chances to recover the debts in the course of the bankruptcy procedure are rather slim).

The first Law "On insolvency (bankruptcy) of enterprises" was enacted in Russia in November 1992 – approximately at the same time as in other countries with economies in transition. Though during the years 1995-1997 the number of petitions for a bankruptcy filed at arbitrage courts was growing at a rather rapid rate, the bankruptcy procedure has not become a commonly applied one, as compared to other countries with economies in transition (see Table 2). The principle on which the Law was founded was that of nonpayment. The practice of implementing the Law has demonstrated that the creditors' rights were considerably limited by the difficulties associated with the need for a realistic estimation of the cost of property and the actual carrying-out of the latter by an arbitrage court, and, accordingly, the court's decisions concerning the bankruptcy of a debtor were delayed.

The second Law "On insolvency (bankruptcy)", No 6-FZ of 8 January, 1998, was enacted from 1 March, 1998. The founding principle of this law was that of insolvency: an enterprise's failure to fulfill its obligations at the time of repayment, in that case the enterprise is recognized as insolvent on a cash basis. This has resulted in a considerable lowering of the barriers for initiating bankruptcy procedures.

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few words about the myths of the stock market). A report at the seminar of the SU-HRE "The institutional problems of the Russian economy", April 25, 2003.

Table 2. Bankruptcies in some countries with economies in transition, 1991-1998

	1990	1991	1992	1993	1994	1995	1996	1997	1998
Russia (progressive total):									
Petitions filed	-	-	-	100	240	1108	3740	5687*	12 781*
Recognized as bankrupt	-	-	-	50	no data	469	1226	2269 **	4747**
Czechia:									
Cases considered	-	-	350	1098	1816	2393	2990	no data	no data
Cases completed (***)			5	61	290	482	725		
	-	-	(0)	(1)	(2)	(2)	(6)	no data	no data
Hungary:									
Cases considered	-	-	14060	8229	5900	6461	7477	no data	no data
Cases completed (***)			1302	1650	1241	2276	3007		
	-	-	(740)	(510)	(90)	(21)	(9)	no data	no data
Poland:									
Cases considered	151	1327	4349	5936	4825	3531	3118	no data	no data
Cases completed (***)	29	305	910	1048	1030	1030	984		
	(1)	(8)	(98)	(179)	(235)	(287)	(173)	no data	no data

* Petitions filed at arbitrage courts

** Importantly, in the first few months after the enactment of the new law only (March-June 1998) 800 petitions were filed. By early November 1998 the number of petitions grew tenfold, up to 8000, which can explain the dramatic growth demonstrated by the results of the year 1998.

*** (reorganizations included)

Sources: data provided by FUDN; Commentary to the RF Law "On insolvency (bankruptcy)". M., 1998; EBRD Transition Report 1997. Enterprise Performance and growth. London, 1997; EBRD Transition Report 1998. Financial Sector in Transition. London, 1998; EBRD Transition Report 1999. Ten Years of Transition. London, 1999.

Obviously, no other Russian law has become the focus of so heated arguments and discussions as the second law concerning insolvency. In principle, this law is to a markedly greater degree was oriented at enforcing payment discipline and equal opportunities for creditors to initiate the bankruptcy procedure. However, for several economic and legal reasons this law when implemented in practice became, instead of an instrument for debt repayment, the means of struggling for achieving control over large and relatively well-functioning enterprises. The way this law was being implemented in the years 1998-2002 has demonstrated its vulnerability to abuse from many directions, as well as the complexity and disputability of the court decisions.

In a situation of rampant corruption and an ongoing redistribution of property, the decision-making scheme and the spectrum of possible decisions have become a convenient instrument of manipulating and exerting pressure in the interests of various participants in the process (however this, certainly, is not a problem pertaining to the quality of the law proper). Primarily, these are issues dealing with nomination of different types of arbitrage managers and the objective criteria for the choice between liquidation and rehabilitation. The noticeable simplification of the procedure of initiating a bankruptcy (in the event of debt in the amount of 500-fold minimum monthly wage for juridical persons) meant also that it became much more easier to initiate this scheme of seizing property. The Russian experience has well demonstrated that by nominating "their own" arbitrage manager (temporary, trustee or external), the participants can almost guarantee that "their" problems are going to be solved, no matter whether they need protection or plot an aggression. At the same time, the problem of legal and practical insurance of protection for the rights and interests of all types of shareholders within the framework of a bankruptcy procedure has remained unsolved. In particular, the danger of enforced bankruptcy of many big corporations with outstanding debts to the federal budget in the year 1998 became one of the factors responsible for a rapid outflow of portfolio investors from the corporate securities market.

Some specialists have also noted the problem of deliberate bankruptcy which can be used as a way to protect the director from shareholders. CEOs may relatively easily have their trusted partners consolidate the enterprise's deliberately made debts, buy out its bills and have it declared bankrupt, and nominate a representative of the former directorate the new manager. Some representatives of the Ministry for State Property of Russia[13] have stated that bankruptcy is becoming also an instrument of protecting the state's ownership rights. For example, in some instances, during preparations for the privatization of an enterprise, potential buyers attempted to "dump" the price by threats of initiating a bankruptcy procedure concerning the object of privatization; in other instances, when the state attempted to apply her shareholder's rights to replace a director, the latter initiated a bankruptcy procedure as regards the enterprise in question.

As a result, the incidence of applying a bankruptcy procedure to enterprises has dramatically went up. Thus, as of 1 January, 1998, the proceedings concerning about 4200 bankruptcy cases were being carried out, as of 1 January, 1999 this figure went up to 10200 cases, as of 1 January, 2000 – up to about 15200 cases, as of 1 January, 2001 – up to about 23800 cases, and as of 1 January, 2002 - up to as many as 42800 cases. Further growth in the number of petitions was associated, in particular, with the task of "clearing the field" of the actually abandoned enterprises by means of declaring the absentee debtors bankrupt. The burden imposed on the infrastructure for applying bankruptcy procedures was growing accordingly (see Table 3).

Table 3. Movement of bankruptcy cases

	1998	1999	2000	2001
Uncompleted cases left as of beginning of year	4210	10171	15211	21080
Cases accepted for arbitration during year	8337	10933	19041	37916
"Total turnover" of cases during year	12547	21104	34252	58996
Completion of proceedings during year	2628	5959	10485	16194
Uncompleted cases left by end of year	9919	15145	23767	42802
Uncompleted cases left by end of year, in % of turnover of cases during year	79	72	69	73

These changes meant, obviously, not only the creditor's enthusiasm in connection with the legal prospects that had opened up before them, but rather the trials of new takeover schemes (seizure of assets), or, on the contrary, the protection of managers from hostile takeovers. The coincidence of this process with a general activation of property redistribution during and after the 1998 crisis has not been accidental, either.

The imperfection and vagueness of insolvency procedures, in combination with the temptation to use them to achieve dishonest aims, result in *a high degree of controversy* as regards their realization. While the number of conflicts in respect to the proceedings in bankruptcy has been visibly declining, the disagreements now coming to the fore are those occurring between the parties within the framework of the procedure of external control in the course of which the main events concerning property redistribution generally take place..

The new (third) Federal Law "On insolvency (bankruptcy)" No 127-FZ of October 26, 2002 contains the following major innovations:

- stronger protection of the creditors' rights and legal interests;
- widening of the scope of rights of the law-abiding owners (founders and participants) of an indebted enterprise, and also strengthening the protection of their interests in bankruptcy procedures;

[13] Bekker A. Pogonshchiki slonov. (Interv'iu s V. Pyl'nevym). (The elephant drivers: an interview with V. Pyl'nev). Vedomosti, 7.06.2000

- protection of law- abiding participants in bankruptcy procedures from any illegal actions on the part of other persons;

- a change in the status of the trustee in bankruptcy;

- a change in the status of government bodies participating in the bankruptcy procedure;

- an introduction of a new bankruptcy procedure applied to the debtor in order to restore solvency and provide for debt settlement (financial recovery).

Nevertheless, it should be pointed out that no laws can be perfect enough to immediately solve the problem. Specialists in the sphere of law note that regulation of insolvency is the most rapidly progressing field of law in developed countries, and that the economy itself necessitates constant renovation of the corresponding norms. The same approach is all the more objectively unavoidable for Russia's economy in transition.

Substantial, though apparently rather distant, prospects are associated with improving the whole of judicial practice in general. For example, in the interests of protecting the enterprises from illegal seizures of control over them (or some part of their assets) by means of bankruptcy procedures, it is necessary to widen the practice when judicial authorities refuse to use bankruptcy procedures as a usual method of debt settling. Such a use of the afore-said procedures should be considered an abuse of right in accordance with Article 10 of the RF Civil Code, and should require transparency of the judicial procedure and responsibility on the part of the judicial body.

2.3. The corporate control market

Over the whole course of the 20th century, mergers and takeovers always attracted considerable interest from academic and social points of view. [14] Many economists ant politicians see them as one of important manifestations of market discipline; at the corporate control market, competition can lead to the passage of a firm into the hands of economic managers who would materialize a more effective strategy of the firm's development. "The corporate control market" (the threat of a hostile merger and replacement of the managers) as well as the threat of bankruptcy represent one of the key external mechanisms of corporate control. A number of researchers consider the mergers market to be the only mechanism to protect the shareholders from the managers. It is noted that mechanism is most efficient when it is necessary to "break" the resistance of a conservative board of directors not interested, in rationalization (splitting-up) of the company especially when the latter is highly diversified.[15]

At the same time, the efficiency of this method as a means for subsequent improvement of corporate control time and again comes under fire. In particular, it is pointed out that the danger of take-over stimulates the managers only to realization of short-term projects because of the fears that the market value of their shares would go down. Other skeptics presume that mergers serve just the interests of shareholders without taking into consideration the interests of all the "participants". And finally, there is always a risk of destabilization as regards the activities of both the purchaser company and the company taken over. The voluminous theoretical literature also thoroughly analyzes the interrelation between the takeovers yielding pri-

[14] For more details, see: Radygin A. D., Entov R.M. , Shmeliova N.A. Problemy sliianii i pogloshchenii v korporativnom sektore. (The problems of mergers and takeovers in the corporate sector). M., IEPP. 2002;

Rudyk N.B., Semenkova E.V. Rynok korporativnogo kontrolia: sliianiia, zhestkie pogloshcheniia i vykupy dolgovym finansirovaniem. (The corporate control market: mergers, aggressive takeovers and buyouts by means of debt financing). M., Finansy i statistika, 2000; Chirkova E.V. Deistvuiut li menedzhery v interesakh aktsionerov? Korporativnye finansy v uslovilakh neopredelionnosti. (Do managers act in the interests of shareholders? Corporate finances under the conditions of uncertainty). M., OLIMP-BIZNESS , 1999; Kulagin M.I. Izbrannye trudy. (Selected works). M. , Statut, 1997. etc.

[15] Coffee J.C. Shareholders Versus Managers. Oxford University Press, 1988

vate (special) gains to big shareholders and the rise in economic efficiency after the passing of control into the hands of a new owner.

All this have resulted in active arguments concerning the role of mergers and takeovers in a modern economy as well as in the discussion regarding the optimum forms of regulation of the said processes. In the course of institutional and economic transformations taking place in Russia and other countries with economies in transition, the discussion on the role of mergers and takeovers and their specific features in conditions of transition to a market economy has become equally timely.

The first (isolated) experience of hostile takeovers in Russia (bearing in mind not the seizure of control by means of various mechanisms of privatization but public operations at the secondary market, dates to as early as the mid-1990s.[16] In the summer of 1995, there was a famous though failed attempt of the "Menatep" banking group at taking over the "Red October" confectionary by means of a public tender offer. Another equally well known event was the purchase of a controlling block of shares of the confectionary joint-stock company "Babaevskoe" by the "Inkombank" holding. Also worth mentioning is the public share auction notified by the "Menatep Bank" which aimed at buying 51 % of shares of the pulp-and-paper joint-stock company "Pitkiaranta" from several shareholders. Some controlling blocks of shares were also bought through the stock exchange. An example is the purchase of 59% of shares of the "Vladivostokskii likero-vodochnyi zavod" (the Vladivostok distillery) by "Ussuriiskii balsam" (Ussurian balsam). And there was an attempt of the "Ghernogorneft" oil-extracting company to work out - with the help of "The Salomon Brothers" – "a program of measures to protect the interests of shareholders" in the event of any changes in control over the oil company "Sidanco" which was its parent undertaking.

During the same period (and later on), many largest banks (financial groups) and portfolio investment funds practiced takeover of companies operating in every imaginable field and did it for their own needs or for subsequently reselling those companies to non-residents or strategic investors. Thus, starting in 1992, "Alfa-bank" and "Alfa-kapital" (structures of the group) have carried out more than 30 deals in the sphere of mergers and takeovers both for the sake of the group and for its clients (chemistry, communications, the glass industry, oil, etc).[17] In the years 1997 and 1998, the food industry once more was the arena for takeovers in the pharmaceutical and tobacco branches as well as in the sphere of production of consumer goods.

In the mid-1990s, takeovers of the classical type were taking place, first of all, in the branches not requiring any substantial concentration of financial resources. The positive character of this tendency is primarily related to the fact that, firstly, there emerges a certain regulation of the structure of joint-stock capital, and secondly, that this regulation is beneficial because of the all-around effect: other enterprises are also forced to take restructuring measures in order not to become the object of the next takeover (attempt at taking over).

Thus, the *first (initial) stage* between the mid-1990s and the 1998 crisis was characterized by isolated attempts to use the classical methods of takeovers. If all the privatization deals are taken into consideration, it is this period that the takeovers by means of privatization were most typical of. The above method was used both as mechanism in its own right and as an element of the expansionist strategy pursued by the first financial and industrial groups (first of all, the informal banking groups).

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[16] Radygin A. Ownership and Control in the Russian Industry. OECD/World Bank Global Corporate Governance Forum. OECD: Paris, 1999.

[17] According to the data on the official site of the bank, though the actual number of the afore-noted operations within the framework of the whole group is apparently significantly higher if the operations carried out by the partners and the affiliated structures are taken into account.

The second stage (post-crisis boom) dates to the period between mid-1999 and the year 2002 inclusive. It is during this period that the specific causes for the wave of mergers and takeovers were most vividly manifesting themselves. The major stimulus for their activization in the first post-crisis years was the continuing consolidation of joint-stock capital (see Chapter 9). Nevertheless, due to certain specific features of the methodology used, some analysts prefer not to use the tern "mergers and takeovers" and to limit themselves to the habitual expression "redistribution of property". In the period under consideration, the expansion of industrial groups was combined with the intensification of the process of asset consolidation.

The post-crisis financial situation conduced to a pronounced rise in the rate of mergers and takeovers in those sectors of the economy which, had already been potentially ready for them before the crisis. During this period, the process of mergers and takeovers initially touched off by the largest oil companies was most typical of ferrous and non-ferrous metallurgy, chemistry, the coal industry, machine building, the food-, the pharmaceutical- and the timber industries. The introduction of a single stock by oil companies can be also considered as a kind of merger.

The third stage (reorganizational "slump") is beginning at the present time. It is characterized by a certain deceleration of the rate of expansion demonstrated by the fully-fledged groups, the completion of the consolidation processes, the first signs of restructuring amid the groups, and the beginning of juridical reorganization (first of all, legalization of amorphous holdings and groups).

Certainly, the estimation of the scope of the process of mergers and takeovers in Russia depends on the choice of a methodological approach. Thus, if the most extensive approach is used, many big privatization deals may be estimated either as friendly or hostile takeovers, and in that case the significance of this process for Russia's corporate sector throughout the whole decade of its large-scale development (1992-2002) would be extremely high.

If a standpoint of the most strict and traditional definitions is selected, then, as far as Russia is concerned, one can speak only of the post-privatization period, isolated secondary transactions and large corporations. Alternative restrictions in this case would be of an objective character (both for mergers and takeovers): the need for substantial cash funds (credits) available only to the largest companies (banks), a possibility to mobilize substantial blocks of shares for exchanges, an absence of "legally clean" objects to be taken over as a legacy of privatization (possible breaches of law, unregistered first issue, limitation period for privatization deals, etc.).

Mergers as such *(friendly takeovers)* of corporations, strictly speaking (i.e., participation of firms of equal status, friendly and coordinated transaction between big companies without buying out small shareholders' shares, exchange of shares and creation of a new company), have not yet become a noticeable phenomenon in Russia, although for this particular form no highly developed capital market is required. This process traditionally becomes activated at the stage of economic growth and a tendency of shares' market rates to go up, whereas in Russia it traditionally is regarded as a possible anticrisis mechanism, in a political context or as an institutional formalization of technological integration (restoration of old economic ties, struggle for market space, vertical integration).

Despite a whole number of restrictions (the need for consolidating big blocks of shares, clear and fixed property structure within a corporation, substantial liquid resources), in Russia it is hostile takeovers, i.e. the corporate control market proper, that have become better developed. Its activization during various periods is associated, primarily, with the expansion of largest groups (holdings). Nevertheless, if one takes into consideration the whole spectrum of both classical (common for international practice) and specifically Russian methods of takeover (e.g., bankruptcy), then the volumes of such transactions, especially after 1998, would become very substantial.

The task of identifying the peculiarities of mergers and takeovers in Russia is of interest in itself. In this context it would be reasonable to distinguish several groups.

Group 1 of the peculiarities deals with the different causes of these processes.

Although waves of mergers and takeovers traditionally accompany the stages of economic growth, in the situation of a post-communist Russia, irrespective of any particular stages, great impact is produced by factors like post-privatization distribution of property, expansion and reorganization of large groups, and financial crises. An undisputable proof is provided by the spontaneous process of equity capital consolidation and takeovers of control within corporations after the 1998 crisis.

The direct influence of state regulation (as different, e.g., from the USA where the modification of the forms and methods of mergers was associated, beside other factors, with the introduction of new government regulation procedures) plays a very insignificant role. The process of mergers and takeovers, as far as specific forms and directions of integration are concerned, occurs mostly spontaneously. At the same time, mergers and takeovers (integration, consolidation) in an indirect way represents a self-protective response to the consequences (costs) of privatization, lack of protection of ownership right, and the taxation policy.

It is also necessary to take into account general factors like the initial preservation of the conditions for monopolization of the economy, the orientation (in fact) of the main export flow toward 2000 Russian enterprises, inclusion of most of the exporters in specific groups, and the relatively stable structure of their shareholders (by August 1998). These factors have accounted for the "frequency" of such operations.

Group 2 has emerged due to the specificity of Russia's stock market. The securities market in Russia from its very onset has been developing as a market of corporate control. The present situation is characterized by a lowering volume of transaction aimed at forming portfolio investments and by an increase in the scope of buy-outs of shares with the purpose of property redistribution. Nevertheless, mergers and takeovers in actuality have little to do with the organized stock market, and the market price of shares on the secondary market is of little significance. The biggest "blue chips" with a relatively liquid market have the least chances to participate in a merger, even if their market value is much lower than their true potential.

Group 3 of the specific features is associated with the specific structure of the property owned by Russian companies and the participants in transactions:

- despite the existence of certain legal mechanisms, minority shareholders of a target company play a passive role and cannot act as full-capacity participants of the corporate control market. They can either gain due to a higher price offered for their shares ("merger premium"), or lose (if the new owner is going to implement a policy that would encroach on their rights). Besides, non-liquidity of their shares, in most cases, would not allow them to estimate the profitability of sales;
- especial significance of the factor of the CEOs' personal considerations (although such motivations are usually not voiced publicly and are assessed very negatively as having nothing to do with economic efficiency). The almost total identity of enterprises' managers and owners (in addition to the usual ambitions of hired managers that are also common for other countries) results in a situation when the merger with a bigger competitor is often perceived as losing to this competitor;
- the intricate and non-transparent structure of (the property of) companies accounts for a minimum of openness when carrying out such transactions;
- the corporate organization as "a group of companies" makes the buyout of the assets of an already active enterprise a much more "technological" and less risky deal than the reorganization of two merging companies;

- comparatively higher requirements to the stake in a stock capital needed for achieving control over an enterprise (ideally – up to 100 % of the stock capital);

- the relationships between companies, including those within group structures, are only slightly and relatively inefficiently regulated by legislation;

- quite often, informal control (through "contact groups", control over cash flows, "give-and-take" mechanisms, agreements for using "surrogate money", etc.) is more preferable than legally registered mergers or takeovers. In addition to the financial cost of legal registration, it is often necessary to overcome the opposition of regional authorities, competitors, and criminal structures, which often can be managed only by very big structures with connections in federal power agencies;

- regional authorities are not able to directly regulate the integration processes by means of legislation (in contrast to the practice applied in the USA), however they usually participate in transactions in favor of one of the parties;

- private creditors can benefit in a certain way from buying out their claims from the taking-over company, and creditors representing certain government institutions are often used to initiate a bankruptcy procedure;

- as a "white knight", any structure can be used (not only a "friendly" buyer of shares, but also a federal agency, regional administration, a crediting bank, a judicial agency, or a criminal group, who obviously do not need to buy the shares of a target company).

Group 4 of the specific features contains the most typical forms of mergers and takeovers:

- there are no mergers on the basis of equality, which may also be accounted for by the underdeveloped stock market (correspondingly, payments are more often effected in cash and bills, instead of shares);

- the aggressive buyouts of companies underestimated on the stock market, with the purpose of a short-term increase of their market value and subsequent resale, often after a split-up, with applying leveraged buy-out (LBO), and issue of "trash bonds" ("business raiders"), which has been a known practice in the USA since the 1980s, occur very seldom, if ever;

- despite the rare appearance of business raiders, the voluntary "friendly" mergers and takeovers (which were a common occurrence in continental Europe at least until the 1990s) are also rare);

- there exist financial restrictions for an aggressive takeover of companies through offering a premium to shareholders on the value of their shares;

- a prevalence (since 1998) of aggressive takeovers through bankruptcy and various debt schemes);

- exchange of shares has in fact not been applied yet in the Russian practice of takeovers;

- financing for the deals of purchasing shares has been provided mostly at the expense of a company's own shareholders;

- among the protective measures, the methods of applying administrative force and the judicial system prevail (before and after a takeover), though this can equally be said about the aggressor's tactics;

- the creation of conglomerates is relatively common, although internationally this type of mergers has already lost its former significance. [18]

[18] For the specific features of mergers and takeovers in Russia also see: Materials of the Conferences at the PH "Kommersant": Restrukturizatsiia kompanii, aliansy, sliianiia, pogloshcheniia (Restructuring of companies, alliances, mergers, takeovers) (2000), Uspeshnaia restrukturizatsiia predpriiatii. Problemy i taktika reshenii (Successful restructuring of enterprises. Problems and tactics of decision-making) (2001), papers by T. Andreeva, O.Belen'kaia, I.Vladimirova, R.Leonova, and others.

Russia's key feature is *the prevalence of "hard" hostile takeovers (in essence, "seizures" in the language of some researchers) by applying "an administrative resource".* In a most general way, the methods of mergers applied in Russia demonstrated no marked changes during a decade, though some accents were shifting, no doubt. In fact these can be reduced to six main groups: buying-up of various blocks of shares on the secondary market, lobbying of privatization (trusteeship) deals with government blocks of shares, administrative involvement in holdings or other groups, buying-up and transforming debts into shared participation in property ownership, seizure of control through bankruptcy procedures, initiation of court decisions (for recognizing certain previously concluded deals as null and void, restricting voting right or the right to own blocks of shares, to call general meetings, to nominate bankruptcy commissioners, etc.). Especially common is taking advantage of issuer's inaccuracies in registering the results of securities issues.

It is commonly believed that Russian legislation grants to an enterprise's owner almost unlimited opportunities to protect a business from takeover. Therefore, firstly, almost any takeover technique is available primarily to those structures that possess the resources necessary to exert a political pressure on an owner. Secondly, Russia is characterized by a comparatively rare phenomenon – the existence of companies whose purpose is to effect mergers and takeovers. The scheme of their activity is as follows: a company merged with the client who "has ordered" a takeover is created, then the whole group is restructured, and next there occurs participation in the profits and assets of a unified company, or the stake in its equity is sold to the client.[19]

The principal "protective measures" applied in Western practice by the managers (shareholders) of a company being taken over are well known and can be subdivided into two main groups: preventive ("shark repellents", "poison pills", various "parachutes", employees' participation in the capital, register protection and change of the location of a corporation's registration, creation of strategic alliances, etc.) and those to be applied after the declaration of a tender offer (filing a lawsuit, inviting a white knight, agreement of a non-takeover, repurchase with premium, counterattack on the capturer's shares, restructuring of assets or obligations, PR protection, etc.).[20] Among the known in Russia methods of resisting a potential aggressor that have been applied by the managers (shareholders) of a target company there may be encountered almost any of the internationally known methods (adjusted by the markets' specificity). Nevertheless, preventive protective methods (if one disregards methods like register control, maximum concentration of equity ownership or "dispersion" of assets within a group) are comparatively rare. Among the measures applied in the presence of a direct threat the protective role of "administrative resource" is especially important (federal and regional authorities, local courts of justice, power structures, the employees of an enterprise), as well as that of counteractive "black PR", restructuring of assets and liabilities, counterattacks on the enemy's shares and counterclaims ("lawsuits"). [21]

As world experience has shown, the problem of mergers and takeovers, from the point of view of state regulation, may involve several areas: compatibility with industrial policy and

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[19] See: Materials of the Conferences at the PH "Kommersant": Restrukturizatsiia kompanii, aliansy, slianiia, pogloshcheniia (Restructuring of companies, alliances, mergers, takeovers), 2000.

[20] Herzel L., Shepro R. Bidders and Targets: Mergers and Acquisitions in the U.S. Basil Blackwell, Cambridge, Mass.,1990; Ruback R. An Overview of Takeover Defences. Working Paper № 1836-86. Sloan School of Management, MIT. September. 1986. Tab. 1-2.

[21] Of a specific interest are the applied in Russia methods and forms of financing the deals of hostile takeover of enterprises, as well as the methods of evaluating the target companies in the process of hostile takeovers. For more details, see: Vrazhdebnye pogloshcheniia. Materialy spetsial'nogo seminara zhurnala "Rynok tsennykh bumag" i kompanii "InterFinans AV" (Hostile takeovers. Materials of a special seminar of the journal "The Securities Market" and the company "InterFinans AV". In: Rynok tsennykh bumag (The Securities Market), 2001, No 11, pp. 8-17.

the overall reorganization strategy within the framework of appropriate sectors and branches, support of active functioning of competition mechanisms in an economy, ensuring transparency of operations on the corporate control market, protection of shareholders' rights (including minority shareholders), regulation of social conflicts resulting from mergers and takeovers.

Existing Russian legislation, beside the general norms contained in the RF Civil Code, focuses (to a considerable degree, quite formally) primarily on antimonopoly aspects (economic concentration) and some selective issues dealing with transparency and protection of shareholders' rights. The problems of compatibility between the requirements established by legislation on mergers and takeovers, and industrial policy are unlikely to be worth considering, due to the absence of any concept of industrial policy in the RF. Social conflicts emerging as a result of reorganization are very well known from practice, however there is no any specific regulation (as does exist, for example, in several of the EU's directives).

It should be also noted that the forms of reorganization of juridical persons, as established by the RF Civil Code, do not reflect the whole spectrum of various economic forms of restructuring.[22] At the same time, the economic forms of restructuring that differ by their economic motivations and the resulting structures of ownership often are classified as a unified form of reorganizing a juridical person. Presently there has emerged an obvious need to reconsider the existing basic legislation along several lines:

- enactment of the federal law "On reorganization and liquidation of commercial organizations", or, at least, considerable renewal of the corresponding norms within the RF Civil Code and some other acts;
- improvement of the regulation of economic concentration within the framework of antimonopolistic legislation;
- development and more detailed elaboration of the legal mechanisms ensuring protection of the rights of both the offeror and of minority shareholders in the event of a merger (public offer, the right of decision-making, "fair price", the right for "ousting" small shareholders when purchasing a certain percentage of the stock, etc.), of creditors and other interested parties;
- development of the norms (requirements) for disclosing the information concerning the procedure of a merger or takeover;
- ensuring coordination on the part of regulating agencies (conformity between departmental acts, a unified control system, etc.);
- ensuring "transparency" of the judicial practice of resolving conflicts arising in the process of mergers.

2.4. Enforcement

By today Russia has entered the group of leaders among transitional economies in terms of level of comprehensiveness of economic law. At the same time, the country still demonstrates a far greater backwardness, as far as 'efficiency' of its application (the court system, etc.)[23] is concerned. Enforcement now constitutes one of the weakest components in the system of protection of property rights and honoring contract obligations. Should there be no radical change in this particular area, other measures on protection of property rights appear senseless.

At the same time, comprehensive development of the enforcement system suggests further improvement of legal provisions, judicial regulation (including the quality of court's rul-

[22] L'vov Iu.A., Rusinov V.M., Saulin A.D., Strakhova O.A. Upravleniie aktsionernym obshchestvom v Rossii (Managing a joint-stock company in Russia). M., Novosti, 2000.

[23] For greater details, see: EBRD Transition Report "Ten Years of Transition". London, EBRD, 1999

ings and material penalties it sets for the failure to honor contractual obligations, among others), shaping new judicial and legal establishments (arbitration courts, etc.), development of professional associations that ensure implementation of the said provisions (self-regulating organizations). More specifically, the latter should focus on such a key objective as fostering a civilized 'culture of contract'.

The judicial statistics does not single out cases associated with corporate governance (protection of stockholders' rights), which makes it impossible to cite accurate figures on this particular category of trials. The Chairman of the Supreme Court of RF V. Yakovlev reckons that categories of trials change depending on the particular economic processes. Given that in the early 1990s there were numerous disputes on recognition the nullity of privatization acts, the number of such trials has fall substantially by now. It should be noted that given that arbitration courts until recently have had to deal with disputes in the area of legal relations and bankruptcy, while those falling within the corporate governance area accounted for a minor proportion of the overall number of trials, the latter demonstrated a considerable growth over the past two years.[24]

Complexities associated with the application of law in the corporate governance area arise due to both 'flaws' in, and inconsistency of the procedural law and imperfection of the material law. According to O. Kozyr, as long as the application of means of legal enforcement of protection of stockholders' rights and legal interests is concerned, it is evident that to the greatest extent it is attributed to minority stockholders[25]. As concerns majority stockholders, they can (at least, formally) protect their rights efficiently enough by means of 'pushing' their decisions at a general meeting as well as through individuals they elect into the company's board. At the same time, speaking of preclusion of loss-making actions undertaking by elected managers, any stockholder, including those in possession of the control bloc, can appeal to the court of law with the request to consider such deals null and void. As the judicial and arbitration practices have just begun taking shape, they do not always form the base sufficient to draw conclusions on judicial interpretation of these or those complex or disputable provisions of the law on joint-stock companies. As well, many disputable situations have not yet matured and formed an object of judicial consideration, or they have not passed through all its stages.

Nevertheless, likewise the whole structure of cases considered by arbitration courts, the situation changes quickly. More specifically, by the late 1990s one could usually single out the following provisions of the law 'On joint-stock companies' that stockholders could use to protect their interests and rights (a lawsuit against or to protect the company): appealing against a decision ruled by the general stockholder meeting or other AO's governing bodies; 2) lawsuits to force the company to redeem stock in the case when a stockholder has such a right as per the law; 3) to recover in favor of the company the losses that were caused by its executives or any other company or entity controlling its operations; 4) lawsuits on recognizing the nullity of transactions bearing an element of interest of the individuals that exercise influence on the company's operations; 6) lawsuits on charging the company with sums of dividends; 7) lawsuits associated with an abuse of the stockholder's right for information the access to which is stipulated by the law. At the same time, there were practically no suits listed under the 2nd, 3rd and 7th positions. Overall, the practices of the period between 1996-the early 2000 allow singling out a few most widespread categories of cases[26].

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[24] Yakovlev V.F. Stabilizirovat otnoshenia sobstvennosti. In: "Zhurnal dlya aktsionerov", 2002, # 4, P. 5-9.

[25] On judicial practices as of the late 1990s, see: Kozyr O. Prava aktsionerov v Rssiyskoy Federatsii:sudebnaya practika. An introductory report..- The Round Table on corporate governance in Russia. M., OECD and the World Bank, with the support of USAID, February 24-25, 2000.

[26] The examples cited below do not mirror any stands or partiality for the issuers concerned – they were selected from the perspective of maximal highlighting on disputes characteristic of the corporate sector. In addi-

In his first Address to the Federal Assembly of RF 'The State of Russia (2000), the incumbent President cited just humiliation of courts (local authorities' ignorance of their rulings) as a particular manifestation of the general decentralization trend, while 'Priority Objectives of the Government of the Russian Federation for 2001-02' did not contain any reference to this problem at all, and the fundamental document 'Main Long-term Guidelines of the Socio-economic Policy of the Government of the Russian Federation' tackled the problems facing the judicial system only selectively, along with other concrete challenges.

The concept *for judicial and legal reform* developed specifically for the President in 2000 (which has not become official program document as yet) suggested the following judicial reform avenues: a 2-fold increase in the number of judges over 5 years and in their salaries along with a simultaneous reduction in the current burden per judge, to enhance the quality of consideration of cases, an introduction of the 15-year tenure instead of the lifetime appointment, solving the problem of imposition of disciplinary responsibility measures on judges and differentiation of judicial responsibility measures applied to them, ensuring the 'transparency' of the judicial corpse and their operations, refusal from the practice of clearance of judges' appointments with the legislature of the Federation's Subjects, unification of the three supreme court instances (The Supreme Court, Constitutional and Supreme Arbitration courts), creation of a single judicial system by merging general courts with arbitration ones, transition to a system that should mostly imply an inconsistence between circuits and of the country's administrative division, introduction of appeal provisions to the national judicial process, reforming the procedural law, and development of a system of a pretrial consideration of disputes.

It should be noted that legislative acts passed between 2001-2003 have already fixed many provisions of the above concept: more specifically amendments were introduced to the Federal Constitutional Law 'On the Constitutional Court of the Russian Federation (of December 15, 2001, # 4-FZ); Federal Law 'On Introducing Amendments to the Federal Law 'On the Status of Judges in the Russian Federation' was passed on December 15, 2001, # 169-FZ; Federal Constitutional Law 'On Introducing Amendments to the Federal Constitutional Law 'On Judicial System' was passed on December 15, 2001, # 5-FZ. As well, after several years of discussion, on March 14, 2002, Federal Law # 30-FZ 'On Judicial Community Bodies in the Russian Federation' was passed, and in the framework of the judicial reform on December 18, 2001, instead of the obsolete Criminal Code of RF whose provisions would often conflict with the effective law, practices and the RF Constitution, the new one was enacted.

Despite the adoption of a number of important statutes (that still contain disputable provisions), yet a lot should be accomplished to implement the judicial reform. More specifically, it is the Civil Procedural (in force as of February 1, 2003) and Arbitration Procedural (effective as of September 1, 2002) that need further improvement. It was hoped that the enactment of these Codes would allow to solve a very pressing problem: that is, the competence of general courts of law and arbitration courts with regard to disputes in the corporate law area as a whole and particularly protection of stockholders' rights. . However, the changes introduced to the Arbitration Procedural Code of RF and the Civil Procedural Code of RF have failed to solve the problem of the ambivalent judicial competence in the area of corporate disputes. The arbitration courts' competence extends only to the cases 'involving disputes between the shareholder and the joint-stock company'. At the same time, for example, the disputes that often arise between stockholders within the given company are not qualified for the noted category of disputes.

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tion, due to objective reasons, the disputes associated with amendments to the law 'On joint-stock companies' of August 7, 2001 (became effective as of January 1, 2002) have not been considered in this regard.

It should be noted that on 30 December 2001 the RF Code of Administrative Abuses was adopted[27], which provides the following innovations, among others: regulation of liability for violation of property rights (unauthorized occupation, use, reassignment of a land or forest site or a water object), unlicensed use of sub-soil reserves, etc., penalties for the failure to comply with procedures of the state registration of rights for real estate and transactions, the system of penalties for violation of investors' rights on the securities market. Nonetheless, the Code still lacks measures against civil servants' arbitrariness (according to some estimates, that is related to the Code maintaining the possibility for a civil servant to opt for a reprimand or a fine, the size of the latter, etc., rather than fixing a concrete liability for a concrete abuse).

We believe that the next steps should imply ensuring the 'transparency' of the judge corpse and in judicial operations, a full transition towards the system of exterritorial courts, furthering the reform of the procedural law, and development of a system of the pretrial consideration of disputes. To deal with the cases concerning infringement of property (investors and shareholders') rights, it would be expedient to form specialized court compositions to consider, particularly, administrative cases, establishment of a specialized division of arbitration courts to deal with corporate suits and those involving securities, development of the institution of arbitration assessors, investigation of serious fraudulent activities of top executives of the companies whose stock are quoted on the open market, dissemination and provision of a free access to court's rulings and verdicts executed in writing in the corporate law area, thus contributing to both the control over, and judges' interpretation of the law.

The establishment of a specialized and centralized court as per the law 'On the court system in RF' should be based upon the following prerequisites: a strict limitation of powers (for instance, the specialization exclusively in the law on securities, bankruptcy and corporate governance), impartial procedures of appointment of highly qualified (acknowledged by the professional community) judges, increase of the judicial system's funding, implying particularly wage rise of the judge corpse[28].

Development of a system of self-regulating organizations in different professional spheres appears of fundamental importance to the emergence of a private civilized enforcement. It is already today that arbitration courts *can diminish the public courts' workload without increasing budget costs* for maintenance of the latter and provide them with highly professional materials on the cases they consider.

Such structures should further form a crucial component of the system of pretrial consideration of disputes. The bill 'On self-regulating organizations' submitted to the State Duma is far from being perfect, nevertheless. Apparently, one needs first to arrive to the conceptual decision as to whether SROs should form a bureaucratic appendage to federal agencies that would just realize their interests through them, or there would be the principle of their independence of the public agencies underlying their operations.

The uncertainty on the above still contributes significantly to high risks associated with investing in Russia. Accordingly, the judicial reform (the ideal of which should be an independent and transparent court that should form the only instance where in polemics with defense prosecution has to prove the necessity of certain procedural acts approved by the court of law only) still is a crucial indicator of the institutional reform as a whole.

[27] Federal Law of December 30, 2001, # 195-FZ

[28] See also: Belaya kniga po voprosam korporativnogo upravlenia. Paris. OECD, 2002; Strakhota R. Principy corporativnogo upravlenia OECD: budut li oni rabotat v Rossii. Theses of presentation, the FSC workshop, NAUFOR, 1999.

3. Outcomes in practice

During the first years of the post-privatization redistribution of ownership (1993-1996) the most widely used were different methods involving transactions at the primary (privatization) and secondary markets. Although during 1997-1999 we still cannot speak about any significant improvement as regards the protection of shareholders rights, it was during the period of 1993-1996 when the violations of the corporate legislation resulting from the struggle for control were taking their most "savage" forms (undesirable shareholders were deleted from the registers, the voting during the general assembly was done by raising hands and not according to the principle "One share – one vote" etc.).

It should be pointed out that these processes were typical mostly for that part of the Russian enterprises where, first, was a potential for competition between insiders and outsiders (that is, profit-making or those with good prospects) and, secondly, the managing board itself had concrete strategic plans for the future. If the managing board continued to lead a passive existence paying little attention to the future of the company, then, such a company in the best possible case could only expect a takeover by an outsider and in the worst – the use of its assets by the managers for their personal needs.

Actually the key conflict of all these years was the conflict between the old managers trying hard to defend their positions and the newcomers, who could potentially seize control. This was true in case of the majority of the Russian enterprises, although for different reasons (financial flows and profits, accounting, export orientation, the site or other real estate, segment of the market or branch specialization which is of interest to a foreign company with the same production profile etc.).

Obviously the initial strategy and motives may differ significantly depending upon who is interested in this particular shareholding. For example even in case of a few largest Russian oil and gas companies the strategies they resorted to at the initial stage in order to cut off outside shareholders were completely different: LUKoil tried to disperse the issued shares to the maximum possible extent with the subsequent buy-up through the affiliated and friendly companies, RAO Gazprom introduced rigid limits for outsiders and organized a dual (domestic and foreign) market for its stocks, Surgutneftegaz used its own pension fund for the "self-buy-out" and tried to dilute the outsiders' stakes through new issues, oil company YUKOS resorted to a "friendly" take-over by the bank with the subsequent legalized dilution of the government stake using the debt restructuring schemes as regards its arrears to the federal budget.

In a number of cases consistency in creating and privatising many of the largest holding companies, primarily vertically integrated ones, turned out to be a separate source of tensions between shareholders. So, in the oil industry the process of institutional restructuring started with the creation of separate oil production companies and their privatisation in 1992-1993. Subsequently state-owned blocks of shares were merged into corresponding holdings (similar trends in a number of industries were also typical of 1999-2000 – see below) that were privatised in a new wave of privatisation in 1995-1997. The "second-wave" purchasers who obtained a majority control in such holding companies inevitably found themselves at loggerheads with minority shareholders of the "first wave." It is estimated that this conflict held up the emergence of "efficient owners" in the oil industry for at least 3 years. The LUKoil oil company appears to be an exception of sorts, since it switched to a single share as far back as 1995. This conflict of "two privatisations" became a symbol of corporate wars in Russia in 19997-1999, and also a constant source of destabilisation in the area of ownership rights.

The well-known conflict between the management and foreign minority shareholders of RAO UES in 2000 was also caused by an ownership structure that dates back to the mid-

1990s. It is well known that RAO UES' shareholders include the state, which holds a controlling interest in it (long-term strategic interests coupled with a powerful social factor, but at the same time realisation of the need for a radical technical and technological restructuring), minority shareholders (short-term interests related to the dynamics of share prices), employee shareholders (immediate interests of keeping their jobs and wages). Conflicts involving the last group have prospects of their own[29], but they also have a bearing on RAO's relationship with regional authorities (social interests and control of regional utility structures). Although it is the non-optimised ownership structure that generates potential conflicts, a certain compromise can be found in formulating still non-existent principles of corporate governance.

When the law "On joint-stock companies" went into force and a whole number of other legislative and regulatory documents were enacted and the situation in law enforcement somewhat changed for the better[30], the purely procedural methods began to be used more and more often including those which constitute a violation of the corporate law:

- shareholders are either not getting notified at all about the shareholders meetings or are not notified on time or are not notified about the substantive issues on the agenda of the meeting;
- boards of directors are not elected at the general meeting as is required by the law;
- outside investors under different pretexts are not allowed to become members of the board, which are "closed" to outsiders;
- there is an opposition to the independent audit of the financial activity of the company although outside shareholders insist on it;
- the procedural requirements concerning the voting during the general meetings are not observed;
- the rights of small shareholders are infringed upon during the distribution of dividends;
- the rights of shareholders are violated during the exchange of shares (when shares of the holding solely are introduced) etc.

Nevertheless, the most widely used way to get rid of outsiders was still the dilution of the outsider's share (both in the Board of Directors and in the issuer's equity) in favor of the majority shareholders (of a holding). The derivative mechanisms may also be used for this purpose: convertible bonds, fractionalization or consolidation of shares, transition to a single share etc. In the holding companies in case if an outsider has the veto right (more than 25% of the voting stock) and can block the additional issues the so-called transfer prices are used and the assets are redistributed between the parent company and affiliates without taking into account the interests of minority shareholders.

The more widely known conflicts of 1997-1998 took place in the oil companies YUKOS (transfer of funds from the subsidiaries), SIDANCO (an attempt to issue convertible bonds at the price lower than the market one and place them with the friendly entities), Sibneft (transfer of assets to the holding and discrimination of the minority shareholders of subsidiaries during the transition to a single share).

Among the violations of the shareholders rights are the widely-spread practices when the managers unrestrainedly "pump over" the assets of the company they work for into their own companies and their accounts both in Russia and abroad or, in the best possible case, fix exorbitantly high salaries for themselves (while the rank and file employee-shareholders are not being paid their wages and /or dividends for months and months).Such behavior is primar-

[29] A similar example can be found in the year 2000, when workers of the AvtoVAZ joint-stock company held a strike to protest the announced plan of restructuring and converting the company into a holding.

[30] In this context we do not have in mind any real achievements in the field of enforcement or positive shifts in the judicial system but rather the declarations about turning the screw on the violators and the use of demonstrative measures (because of the objective impossibility to control all the violations).

ily explained by the unstable situation in the corporate control, which provides an incentive to the management to prepare the "golden parachutes" for themselves.

The financial crisis of 1998 brought about more active use of the additional issues of shares and derivatives, debt schemes (securitization of debt), the mechanism of bankruptcy (starting from March 1, 1998, when a new law came into force) and company's reorganization. The most common of these types of violations was an attempt to squeeze out individual shareholders into newly-created companies beset by all sorts of financial problems. Under such conditions the attempts by the regional elite to establish control over the major enterprises of their regions became more noticeable and successful. These tendencies are going to continue, what may increase the instability of the property rights and would demand a tighter policy of the investors (shareholders) rights protection. Existing loopholes in the Russian corporate and privatisation legislation make it possible to give a semblance of legality to what in essence amounts to unlawful tricks.

According to the Federal Securities Commission, the following violations by issuers were most typical:

- Violation of the procedures for keeping a shareholders register (if the register is kept by the issuer);
- Violation of requirements that amendments be made to constituent documents in connection with changes in the nominal value of the Russian legal tender or the scope of prices;
- Violation of the procedure for acquiring shares placed by the issuer;
- Failure to publish in the mass media annual reports, accounting balance sheets, profit and loss accounts, and lists of affiliated persons;
- Violations in the payment of dividends;
- Issuance and circulation of securities that have not been properly registered.

Table 4. Main Risks of Corporate Governance

Risk	Risk Degree ("+++" - maximum risk)	Is it this Risk Unique to Russia	Similarities in Other Emerging Markets
"Dilution" of authorised capital	+++	No (but is more manifest and aggressive until 2002)	Korea
Asset stripping and transfer pricing	+++	No (but is wider spread)	Indonesia, Malaysia, Korea, Mexico
Information disclosure	++	No (but considerably worse than in other countries)	Virtually everywhere
Mergers and reorganisations	+++	No (but conditions are often arbitrary and not transparent)	Malaysia, Korea, Indonesia
Bankruptcy	+++	No (but is often used as a means of takeover or asset stripping)	Virtually everywhere
Attitude (behaviour) of managers	++	No (but many companies have vague idea about corporate governance)	Lots of examples in all countries
Restrictions on share ownership and exercise of voting rights	+	No (restrictions are relatively rare in Russia)	Korea, Mexico, Thailand
Registrar	+	No (in rare cases but is more manifest and aggressive in 2002-2003)	India (partially)

Source: Brunswick Warburg.

Although the legislative framework of corporate governance was steadily expanding in the second half of the 1990s, the main risks relating to corporate governance have largely retained their importance up to this day (Table 4). In that respect it is important to point out that

Russia is not an exception: many of these risks are typical of other transition economies and emerging markets.

As has already been noted above, with the emergence of corporate legislation in the second half of the 1990s one can speak about some stabilisation in the area of ownership rights – the struggle has shifted to the *legal domain*. Although the factor of corrupt courts and state institutions has left its mark on the results of this struggle, mostly quasi-legal – or borderline – methods (or loopholes in legislation) have been used for this purpose. These methods, as was the case before, are mostly procedural in nature: keeping a double register, establishing dual power in the joint-stock company (two meetings, two boards of directors, two general directors), switch to a single share, and also the buying-up of shares and debts, bankruptcy, bribing of managers (not owners), and so forth.

Yet breaches of shareholders rights have again turned into an acute problem in 2000. In a number of cases, the *armed takeover* of companies, a reminder of the "no-holds-barred" period of 1993-1995, has again become a wide-spread means of gaining control over corporations. More often than not such conflicts are characterised by legal nihilism, where the conquerors ignore the actual equity structure and procedural nuances of management. In order to step up pressure, tensions are often ratcheted up in "workers collectives" (up to staging demonstrations, organising pickets, and armed resistance by workers). Such aggravated situations occurred in a number of large companies due to the desire to complete the redistribution of property *by hook or by crook* before the presidential election of 2000, so as to present the new federal government with a fait accompli. There were also more profound grounds for doing so: corporate raiders counted on support from regional authorities and a general crisis of law enforcement.

Some of the best known corporate conflicts include the stand-off between SIDANKO and TNK, Transneft, Lomonosovo Porcelain Factory, Vyborg CBK (armed takeover), Achinsk Alumina Plant (armed takeover), Kuznetsk Metallurgy Combine, Kachkanar Mining and Refining Combine (armed takeover), Nizhnesandinsk Metallurgy Combine (armed takeover), coal pits in the Krasnoyarsk Territory and Kuzbass, aluminium plants, Moskhimfarmpreparat (a unitary enterprise, an attempt of armed takeover), Orsko-Khalilovsk Metallurgy Combine (essentially for the first time in Russia's corporate history alternative extra share issues took place).

It is essential to point out a new trend that emerged in 2000-2002, a transition from relatively amorphous associations of the conglomerate type towards more homogeneous integrated structures with clear-cut organisational and legal boundaries. This process has been particularly manifest in the oil and metallurgy industries, but there have been similar examples in the chemical, food and other industries. Similar trends have been registered in civil aviation construction and several sectors of the military-industrial complex. Criteria for setting up such structures – compared to the previous financial-industrial groups – have changed too: they include the technological and financial-economic advisability of taking over new assets (enterprises), a considerably higher level of corporate control over affiliate companies (up to 75 percent or higher), organisational and legal transformation (including mergers, consolidation within and between holdings, the switch to a single share. Evidently this process means that there is still a large room for further corporate conflicts.

Among basic tendencies that are typical of the corporate sector development in 2002-2003 it is noteworthy to single out both the continuing process of share capital concentration, amalgamation of enterprises and reorganisation of already existing business-groups and a whole series of new tendencies related to intracorporate programmes of a number of the largest companies (groups). It is essential that an analysis of reorganisation changes in 2002-2003 allows us to reveal different strategic motives – depending on the groups' "maturity". The development of corporate governance standards within a company is directly connected with its

reorganisation and long-term strategy. Peculiarities of the latter are also defined by potential views of group's owners on the features of its international expansion in the nearest years.

In oil, coal and metal branches in 2002 the intensive process of redistribution of property was to a great extent finalised (due to the fact that the last government share holdings got privatised and spheres of influence between the largest industrial groups got distributed). A further development in the redistribution processes in these sectors is primarily defined by transactions connected with reorganisations of large holdings, optimisation of their assets (withdrawal of non-profile assets), or alliances among groups.

At the same time a certain stabilisation in the sphere of property interests (in a certain sense - a post-crisis fixation of property interests' spheres) creates prerequisites for a new phase of hostile absorptions. Both the deficit of "available" takeover objects and gradual exhaustion of available financial resources give ground to suppose that the takeover style in the nearest years will to a considerable extent be "administrative", using debt schemes, actions at law about insignificance of previous transactions, etc. On the other side in a number of branches that possess a considerable growth potential and/or relatively scattered assets intensive concentration (takeover) processes and glaring corporate contradictions persist, the latter being typical of unstable institutional structures.

A concentration process of relatively scattered assets in the meat industry started in 2002, which was initiated to a considerable degree by agricultural sub-holdings belonging to large oil and metallurgy groups. On the whole the tendency of interest growth on the part of largest Russian groups to the agricultural sector has been characteristic for the past 3 years, which is connected both with the effective demand outlooks in this branch and the possibilities to legalise capitals.

A parallel process of getting rid of non-profile assets and diversification allows us to speak about moving of financial resources between branches that started in the past two years and is being serviced by the absorption market. Meanwhile, two basic features are typical of the recipient branches: lack of strategic (controlling) owners and an acceptable (higher than the average) level of profitability. The acuteness of corporate conflicts persistent in the majority of branches also testifies to the effect that hostile takeovers (including those containing specific Russian features – usage of the "administrative resource"31) keep being the predominant method of share capital concentration. For the nearest years (taking into consideration the plans to privatise state-owned enterprises and turn them into joint-stock companies) one can also forecast corporate conflicts connected with shift of control at these enterprises prior to and in the course of privatisation transactions.

Finally, one can point to certain rather contradictory changes in the market's approach to corporate governance issues on the whole.

Given that the corporate governance practices of the late '90s clearly have a negative image, between 2000 to 2001 an efficient corporate governance has arisen as one of the most

[31] The "administrative resource" notion (materially motivated decisions of courts, federal and regional authorities, etc), which is so wide-spread at present and being rather evident in its essence, is at the same time difficult to be interpreted and even more difficult to be legally proved (which was spoken of with confidence in one of his interviews by the president of "Alpha-Bank" and leader of one of the most aggressive Russian groups in the sphere of corporate absorptions M. Friedman). The president of "Sibneft" Y. Shwidler stated for example that each of oil companies in the course of its development got its share of the administrative resource and it is namely this fact that defines the real competitions at the oil market (Kommersant-Vlast, 2003. January 20-26, p. 25). It is noteworthy that according to the original version of the same source, the standardisation and the mass character of using the procedure of the "administrative resource" in 2002 led to a reduction of its price and simultaneously caused a situation when rivalling parties use same methods (balanced support actors) and are most often uncapable of bringing their cases till final victory of one of the parties. In such a situation expenditures that correspond to the corporate conflict become comparable to the real price of the assets and civilised negotiations become more economical.

fashionable matters in Russia and formed the agenda for dozens, if not hundreds, of conferences and workshops. The largest corporations that in just 2-3 years before that had found themselves in the lists of the most malicious violators of shareholders' rights, are keen to adopt 'corporate governance codes', create 'shareholder-interest-watchdog' departments, introduce 'independent' directors to their boards, and ensure 'transparency'. Russia's FCSM issued its own 'corporate governance (behavior). In 2001-2002 several private organizations offered their competitive 'corporate governance ratings' on the market, while bureaucrats have mastered the term and gradually transform it into a new fetish. On the crest of this situation there appeared a visible trend to emasculation of the sense and concept for corporate governance and its transformation into a new slogan for a new campaign[32].

The "repairwork" started in many large corporations relating to the improvement of corporate governance('codes of corporate governance', 'independent directors', 'departments of shareholder relations', ensuring 'transparency' etc.) will hardly be able to delude anybody. Obviously, this renovation is predominantly a redecoration that does not affect the system of relations established in the Russian corporate sector in the 1990-s. This has been caused, above all, by lack of serious conditions for fundamental improvements in this field (especially within the context of equal treatment of all shareholders and of shareholder rights) – lack of serious conditions in the structure of ownership and control, in the field of financial sources and business organisation charts, in the outside environment (taxes, politically engaged selective enforcement etc.)33.

In this connection, it would hardly be wise to take seriously declarations made in 2001 - 2003 by a number of large Russian companies on the problems that the business faces due to the lack of civilised ethical business norms. Such declarations partly expressed in the so-called Charter of Corporate and Business Ethics of the Russian Union of Industrialists and Entrepreneurs adopted on 25 October, 2002. The advocates of 'generally accepted moral rules and ethical norms' that put their signatures on the Charter include participants of the notorious 'loans for shares' deals of the mid-1990-s and initiators of many corporate conflicts and scandals of the late 1990-s - early 2000-s. The Slavneft deal in December, 2002, does not inspire any optimism in this connection, either.

At present there exists one more factor that supports the above statement. In reality, initial interest in corporate governance appeared only upon the mass privatisation of 1992 - 1994, although a number of economists had recognised the importance of its long-term nature for Russian companies earlier. The Law "On Joint-Stock Companies" (No. 208-FZ of 26 December, 1995) became a legal landmark, but one can contend that the discussion on corporate governance (or, to be more precise, on the discrimination of outsider rights) shifted into the sphere of practical application against the background and as a result of the stock boom in 1996 - 1997. The most notorious conflicts of that period (Noyabrskneftegas, YUKOS, Yugansknefegas, Samaraneftegas, Sidanco, Nosta, Varyeganeftegas, Chernogorneft, the Vyksun Metallurgical Plant, Magnitogorsk Metallurgical Enterprise, Baltic Shipping Company, Leningrad Metallurgical Plant, Akron, numerous telecommunication and power industry companies etc.) became a joint signal testifying to the problem's mass and chronic nature. The discussion was to a large extent initialised by foreign investors not yet accustomed to the Russian corporate standards. The financial crisis of 1998 brought about another wave and created new tools of property redistribution, which made the discussion only more intense. This occurred primarily owing to and in the course of strengthening of the

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

[33] For details see: *Radygin A.* Corporate Governance in Russia: Limitations and Prospects // Voprossy Ekonomiki, 2002, Issue # 1, Pages 101 - 124; *Radygin A., Sidorov I.* Russian Corporate Economics: One Hundred Years of Solitude? // Voprossy Ekonomiki, 2000, Issue # 5, PAGES 45 - 61.

curred primarily owing to and in the course of strengthening of the management's property positions and to appearance of new shareholders that bought out blocks of shares in the post-crisis period at a low price.

While in the mid-1990-s the calls for reforming corporate governance norms were generated rather by Western portfolio investors, at present the factor of 'pressure from the West' is losing dwindling. Apparently, at present one may speak of adaptation of the Western business community to the specifics of corporate relationship organisation in Russia: above all, conducting business through a groups of formally unconnected companies reporting to one owner or a number of partners, and the corresponding structure of financial flows34. Thus, one could assume that many Western partners have found creation of a formal image of the company (group) with elements of civilised corporate governance standards sufficient and taken the fundamental system of business organisation (including non-dividend sources of income and transfer pricing) as a matter of course.

Undoubtedly, there are a number of objectively positive trends in the development of corporate governance standards applied by Russian issuers. According to the Institute for Corporate Right and Governance (ICRG), corporate transparency has been increasing in the course of 2002-2003 (information is disclosed in greater detail and quicker, in particular, in issuers' quarterly reports and on the web-sites), the contents of the companies' constituent and internal documents have considerably improved. These shifts are reflected, in particular, in the ICRG corporate governance ratings. E.g., during the 12 month–period (Quarter II, 2001, to Quarter II, 2003) out of 23 companies that account for 90 percent of capitalisation of the Russian stock market, corporate governance improved in 18, deteriorated in four and remained unchanged in one. Certainly, the companies in question are the largest Russian companies, therefore it is so far impossible to speak of large-scale changes in the corporate sector in relation to the corresponding standards.

Although legal novelties in the field of corporate law proper (protection of shareholder rights) had, to a considerable extent, achieved their limit from the point of view of the existing economic conditions, the prospects for the improvement of the existing norms are quite good. This regards both the fundamental law "On Joint-Stock Companies" and the more specialised fields, such as reorganisation, acquisitions, groups of companies, affiliates, insider deals, information disclosure, reporting, bankruptcy and others. It is also apparent that it will be impossible to develop the methods used to protect shareholder rights any further without adequate general measures in the field of enforcement and changes in the law of procedure.

4. Conclusions

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

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

[34] E.g., I. Rozinski gave this assessment of the present situation at the conference of the Higher School of Economics "Modernising the Russian Economy: Results and Prospects" (Section 2, "Institutional and Structural Reforms"), 3-4 April, 2002.

- the federative structure of the state and an active role played by regional governments operating as independent agents in corporate relationships (more specifically, the agents that operate in the framework of the conflict of interests as owners, while exercising their administrative powers – as regulators, and as economic agents, too;

- an inefficient and/or selective (politicized) government enforcement (with a relatively developed law in the area of protection of shareholders' rights, though).

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

- the latent state of separation of ownership from management (convergence of controlling shareholders and managers) will be there in the medium term;

- a very low probability of expansion over the upcoming years of an outside shareholder financing as the other key economic prerequisite for an efficient corporate governance;

- the current uncertain state of the national financial system does not allow even to presumably estimate gravitation of the Russian corporate governance system to any classical examples (primarily any other than self-financing, sources and, accordingly, types of control);

- the concentration of joint-stock capital is an evident process in the frame of which there takes place both consolidation of control and implementation, by economic means, of a 'self-sufficient' corporate governance model (proposed in the mid-'90s for the transitional economies in the enforcement context);

- given the economic conditions, legal innovations in the corporate law (protection of shareholder rights) area to a significant extent have reached their limits;

- without adequate general measures in the enforcement area, methods of protection of shareholders' rights may not be developed;

- in the absence of a developed system of competitive product markets, markets for capital and labor, and bankruptcy, the methods of monitoring of management will remain inefficient.

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

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

Considering a more optimistic interpretation, one can speak about reaching in 2000s some 'model' balance between the level of concentration (adjusted for affiliated relationship and alliances) and a certain set of means of protection of small shareholders. A certain stabilization of the system suggests some optimism.

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

the dominance of small shareholders' interests (or a strong emphasis in the law on an absolute protection of them) is, perhaps, possible. However, in practice, there are no conditions for it. Nonetheless, the role played by small shareholders is critical to ensure companies' 'transparency'. Overall, in perspective one undoubtedly should head for some mixed model. The latter should take into consideration the aforementioned economic principles and trends and suggest the balance of interests of all shareholders and – in a broader sense – co-participants. At this point, the respective basis could be formed by model principles developed by OECD.

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

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

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