

# REPORT ON

# CORPORATE GOVERNANCE OF STATE- OWNED ENTERPRISES IN RUSSIA\*

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**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

**TABLE OF CONTENTS**

REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES .....	1
INTRODUCTION .....	4
CHAPTER I SIZE AND ACTIVITIES OF STATE-OWNED COMPANIES IN RUSSIAN ECONOMY .....	6
Transformation of rights of ownership and management of State-owned companies in Russia .....	6
Big-Time Privatization .....	7
Public Sector Still Very Important in Russia .....	11
Structure of ownership of State-owned companies (PLCs) with a participatory interest of regional governments .....	17
State-owned Companies Remain Key Players in Some Important Sectors.....	21
Organization and Number of State-owned Companies .....	22
CHAPTER II FEDERAL GOVERNMENT'S OWNERSHIP RESPONSIBILITIES .....	26
Evolution and Current Model of Exercise of Owner's Responsibilities by Russian Federal Government .....	26
Dual and Multiple sector Models of Managing State-owned Companies in Russia .....	27
Other Specialized Entities Involved in Exercise of Responsibilities of Owner of State-owned Companies .....	30
CHAPTER III RELATIONSHIPS OF STATE-OWNED COMPANIES WITH OTHER SHAREHOLDERS .....	32
General Legislative Framework .....	32
Consolidation of Role of Minority Shareholders in Decision Making by Board of Directors .....	33
Preemptive Right of Purchase of Shares .....	34
Right of Access to Information .....	34
Indemnification .....	35
Minority Dominant Shareholder: Case of "Golden Share" .....	35
CHAPTER IV OTHER STAKEHOLDERS IN CORPORATE GOVERNANCE .....	36
Legal Space Regulating Procedures of Participation of Employees of Public Corporations in Corporate governance .....	36
Creditors' Rights in Reorganization and Insolvency/Bankruptcy Procedures .....	37
CHAPTER V TRANSPARENCY AND DISCLOSURE OF INFORMATION .....	38
Structure of Financial and Economic Reporting, Accounting Statements and Special Reports .....	38
Disclosure of Reporting Information per Corporate Legislation .....	39
Preliminary and Summary Reporting .....	40
Aggregated Accounts of Performance of State-owned Companies .....	45
External Audit .....	46
CHAPTER VI DIRECTORS OF STATE-OWNED ENTERPRISES .....	47
Size of Board of Directors in State-owned Companies .....	47
Membership of Board of Directors .....	47
Process of Election/Nomination to Board of Directors .....	48
Remuneration to Representatives on Boards of Directors .....	50
Board of Directors .....	51

## Russian Corporate Governance Roundtable Meeting

### REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN RUSSIA

Development of Mechanism of Board of Directors .....	53
Appointments to Executive Management Bodies of Company.....	54
Practical Experience of Operation of State-Owned Companies.....	54
CHAPTER VII PROGRESS AND FUTURE OF PRIVATIZATION IN RUSSIA .....	58
Principal Tasks for Administration of Federal Property and Status in 2004.....	58
Optimization of Public Sector .....	58
Managing State Property .....	60
Efficiency Evaluation Criteria for Administration of Federal Property .....	60
Plans to Improve Efficiency of Federal Property Management .....	61
Improvement of Procedures of Privatization of Federal and Municipal Property.....	63
Compiling List of Strategic Enterprises and Joint-Stock Companies .....	63
Investment Projects with Participation of Federal Government with Real Estate or Ownership Rights.....	64
Commercial Development of Cultural Heritage Assets of Federal Significance .....	64
Development of Public Data Base "Public Register of Federal Property" .....	65

**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

**INTRODUCTION**

1. This study is dedicated to regulatory control of corporate governance of State-owned enterprises and institutions. This report also presents a review of the progress of privatization processes and trends in the Russian economic development. A good deal of attention is focused on the statistics of the public sector, as well as case studies of practical implementation of the system of corporate governance in companies with a participatory interest of the Government. The questions at issue related to management of public corporations are interfaced with those examined in the OECD document: "Comparative Report on Privatization and Corporate Governance of State-Owned Assets" (2005). Relevant data have also been drawn from the OECD report entitled "New GDP Comparisons Based on Purchasing Power Parities for the Year 2002".

**1. *State-Owned Companies Are Still Important in Russian Economy.***

2. The role of State-owned companies in the Russian economy is still very important. About **30%** of the industrial output in 2004 was to a varying extent under a corporate control of representatives of the Federal Government and regional authorities. Yet, due to specific peculiarities of the system of statistical observation in Russia this indicator is overestimated. Federal and regional unitary enterprises, joint-stock companies with a 100% Federal and regional government ownership, as well as State institutions account for only **7.9%** of the volume of industrial output. No more than **40%** of fixed assets in the national economy are registered on the books of these companies and organizations, which *inter alia* provide public services. However, in the banking sector the aggregate assets of the two State-owned banks alone account for close to **37%** of the total assets of all the banks in Russia.

**2. *Globalization and Liberalization Push for Reforms in Public Sector***

3. The need for foreign investments into projects of upgrading of the Russian economy constituted an indispensable factor of market reforms, in particular, for privatization. It is precisely the lack of Government funding of oil and gas production industries that provided an impetus for an almost complete privatization of this extremely important sector. At the same time other less competitive sectors of the Russian economy do not compare well in terms of their investment attractiveness. In this context transparency of business in the mechanical engineering, power generation, food processing and some other industries should be considered very important for attracting foreign investments. It should be noted that Russia, a non-member of the WTO, demonstrates a growing domestic demand. It is mainly due to the current growth of income of the population and strengthening of the ruble exchange rate relative to other international currencies.

4. More stringent requirements to the quality of management whose standards are set by the leading international corporations push for reforming of the management system of most State-owned companies. Advanced methods of control of the cost of production are being introduced, as well as improvements to the system of logistics and to the environmental compatibility of production facilities. Most big Russian State-owned companies invite leading international auditing and consultancy firms to buy their services.

***Special Issues with Managing State-owned companies***

5. The most acute problem related to managing State-owned companies in Russia consists in the lack of coordination between representatives of the Government on matters of strategic development of big State-owned companies. In some of the companies the role of Government representatives is strictly technical. Moreover, the ongoing public administration reforms in Russia are throwing the system of management of State-owned companies out of balance. An increasingly frequent reshuffling of the representatives of the Government evolves on the boards of directors of joint-stock companies.

**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

6. More and more the management efficiency tends to be evaluated by technical merits, i.e. profit share payable on the share holding of the Government. On the contrary the efficiency of addressing strategic objectives of the companies is not duly taken into consideration.

***Improvements in Management of State-owned Companies are Potentially Very important.***

7. Mindful of the role of public sector in the economy both of Russia and many OECD countries, on the one hand there is a need for improved management of the public sector as a whole, and, on the other hand, – for consistent efforts to increase the efficiency of management of individual enterprises.

8. It is important to continuously improve the system of statistical observation over the State-owned companies, in particular in terms of development of uniform tools for sampling State-owned companies for subsequent observation. In certain enterprises the OECD corporate governance standards must be implemented, as well as the Corporate Code of Conduct existing in Russia, a document which is not binding, but very important in terms of ensuring transparency and efficiency of decision-making procedures in companies.

9. It is also very important to consistently follow on the previously made decisions on privatization and commercial development of idling State property.

**3. *Structure of Report***

10. Executive analysis of corporate governance of Federal assets consists of 7 chapters. The first chapter contains the history of transformation of State property and State-owned companies in Russia. Brief description of the privatization process is provided. The pattern of development of incomes and the structure of privatized State property are discussed specifically. A description of the scope of public sector is given for output and fixed assets. An important issue is highlighted with regard to peculiarities of statistical observations in Russia in respect of State-owned companies. Term definitions are given, as well as comparisons with public sector of OECD countries.

11. In the second part explanation is provided for the key mechanisms of the exercise of the ownership role by the Government. The dual and Multiple sector management models are described similar to the review for OECD countries.

12. The third and the fourth parts of this study are related to the participation of minority shareholders in managing State-owned companies, and the role of the Government as a minority shareholder is shown. The key tools to ensure protection of the rights of minority shareholders are described.

13. Chapters 5 and 6 are devoted to the most important issues of corporate governance, i.e. transparency and disclosure of information, as well as procedural matters of conduct of business by the board of directors and executive staff of companies. It is also noteworthy that the description is provided in terms of the dual and Multiple sector models of management of State-owned companies currently in effect in the Russian Federation.

14. The analysis of the privatization process, given in the first part of the study, is taken up in the final (seventh) chapter of the Report. This chapter lays out proposed key vectors for the development of the privatization process for the nearest future. The structure of property being privatized is identified. Assessment is given of the actual status of implementation of the Concept of administration of State property.

**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

**CHAPTER I  
SIZE AND ACTIVITIES OF STATE-OWNED COMPANIES IN RUSSIAN ECONOMY**

**Transformation of rights of ownership and management of State-owned companies in Russia**

15. Historically there were multiple forms of ownership in Russia, including ownership of production facilities. There were government-owned (State-owned) factories, enterprises owned by the church, and, of course, private companies, joint-stock companies and coops. After the October revolution in 1917 private ownership of the means of production, financial institutions and land was abolished. According to the Constitution of the RSFSR of 1918 land was transferred to land users (farming units) for management, and production facilities in all industries were transferred to 'labor collectives'. Forests, subsoil and aquatoria were proclaimed State property. Further on the said provisions were slightly modified, but in general private ownership of production facilities (means of production) was non-existent in the USSR for more than 70 years.

16. Pursuant to the Civil Code of the RSFSR of 11 June 1964 the following types of property were identified: State-owned property, kolkhoz & cooperative property, property of trade unions and other public organizations and personal property. In the Soviet law, as in the contemporary Russian law, the title of the owner was divided into the rights of possession, use and disposal of property. Property was put on the books of these organizations for operational management. which meant that it was impossible to dispose of real estate assets without consent of the government authority, except current assets (cash, inventories, work in progress), which were under the operational control of the management of organizations. Charging against property of organizations, except cash liabilities, was prohibited. The law had a concept of common property (with division of shares, i.e. shared property, and without division, i.e. joint). The Code also allowed individual labor activities using your own labor resources and those of close relatives, but not hired labor. Most of the GDP in the USSR was produced by State-owned companies.

17. Management of State-owned property was distributed amongst the Union Government authorities, government authorities of Union republics, autonomous republic, autonomous republics, autonomous regions and autonomous districts, as well as government authorities of administrative jurisdictions.

18. Transformation of the Soviet system of management of State-owned companies began in 1983 after the Law of USSR "On labor collectives and their improved role in managing enterprises, institutions and organizations" was passed. (Technically it is still in effect in respect of provisions that are not at variance with the Labor Code of the Russian Federation of 2001). In particular, the law delegated to the general meeting of the labor collective the adoption of resolutions on important social matters, such as: construction and improvement of housing units by the company, as well as various social facilities (by today these facilities have been almost entirely transferred from the companies onto the books of municipalities). Thus, the 'labor collectives' were involved in decision making on the distribution of a considerable portion of profits (resources) of their companies.

19. Later on the rights of 'labor collectives' in managing State-owned companies were expanded. The Law of the USSR of 1987 "On State-owned company (group)" (was in force up to 1991) delegated to the labor collective the right of election of the managing director and the right of participation in drafting medium-term operational plans of the company. A remnant of this form of management in the contemporary Russia can be found in the Law "On distinctive features of the legal status of employees of

**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

joint-stock companies (people's enterprises)" passed in 1998. In fact this law implemented the idea of exercise of the right of ownership of the 'labor collective' in respect of the company they work for. However, this form of ownership did not go any further in practical experience (see details in Chapter IV).

20. The key legislation which has determined the course of the economic reforms in Russia and laid the foundation for the privatization process comprised the Law of the USSR of 1988 "On cooperatives in the USSR" (which in fact became invalid after 1995) and the "Fundamentals of legislation of the USSR on leasing" (was in effect till 1996). The Law "On cooperatives" established equality between State-owned and cooperative property, a system of setting up cooperative business units (in fact, private businesses) with a transfer of some of the State-owned property to cooperatives, including cash and other assets. The Law on leasing established a tool for setting up a legal entity by employees of a company with the right to rent State property, as a legal entity. It was possible to rent not only part of the assets (e.g. a production line), but also the State-owned company as a whole. Such rented companies were very widely spread and were in operation up until the close of privatization processes.

21. The said laws and other regulatory documents, including ones on liberalization of pricing policies, pursued the following two objectives. The first objective: adoption of subsidy-free operation policy by companies (self-reliance and self-financing). The second objective: establishment and promotion of crystallization of the middle class of owners, who could potentially consider claiming ownership of State property. Yet, formation of the middle class of owners might take a while, if based on coops and rented enterprises.

22. An important input into the process of development of property relationships was provided by the "Regulation on joint-stock companies and limited liability companies" and the "Regulation on securities", approved by the Resolution of the Council of Ministers in 1990, which were in effect up until 1995 for public corporations, till 1996 for regulating securities trade transactions, and till 1998 for limited liability companies.

23. The Law of the RSFSR "On property in the RSFSR" of 1990 (was in effect to 1995) fixed the concept of property of a private citizen, in effect established the right of private ownership of means of production and any other property (enterprises, securities, land parcels and other property assets), allowed to make profits on investments within actually traded amounts. The next Law of the RSFSR "On enterprises and business activities" provided a clear definition of the fundamental types of organization structure of companies". Many of the provisions of the Law were in effect up until the adoption of Part 1 of the Civil Code of the Russian Federation in 1994. In particular, the Law made provision for transfer of State property to employees for operational management. It is noteworthy that the Law prohibited unreasonable denials to register enterprises by the Government authorities.

24. The above laws facilitated coming to grips with the process of privatization of State property and large-scale redistribution of State property by converting it into private property. The timing, scope and, what's more important, the efficiency of privatization processes were kept under control by the Government of Russia and regional government authorities.

***Big-Time Privatization***

25. The intensification of the privatization process got underway in the RSFSR in 1990-1991 and was evolved spontaneously. The legislation already in place by that time enabled the sectoral ministries of the USSR and RSFSR to reorganize themselves into holding companies controlling the assets of the companies supervised by these ministries (Gazprom, Roslegprom, Stankoinstrument and other). According to the State Statistical Committee by 30 April 1991 in Russia 1,798 associations, 164

**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

concerns, 92 consortiums, 1,186 joint-stock companies, 58 inter-sectoral State groups<sup>1</sup> were established. In many respects the spontaneous privatization impacted on the corporate structure in place in the fuel and energy sector, mechanical engineering and some other industries (see more details in Part II).

26. The "spontaneous" "grass roots" privatization was fueled by the resources provided by the coops set up at the State-owned companies, as well as from retained earnings of rented companies. In addition, the legislation at the time provided a broad authority to local governments to privatize municipal property by selling it at auctions. In such a way retail stores and catering outlets were privatized in many cities and towns<sup>2</sup>.

27. At that time the system of regulation of economic relations was changing very substantially. In the summer of 1991 70-80% of products of companies were sold through the system of government contract. The administrative system of distribution of capital investments was at work, as well as centralized procurement of production equipment both from domestic suppliers and from the international market.<sup>3</sup> However, the system of mandatory supplies per government contract was abolished that same year. It was allowed to offer government contract on a voluntary basis at market prices. The powers of the local authorities to distribute products, manufactured by State-owned companies on their territory, were curtailed. It was permitted to purchase only some of the finished products, except raw stock, materials and components. Thereby foundation was laid for developing market relations between companies, which carried a whole lot of negative phenomena, i.e. dramatic drop in production output, crisis of reciprocal credit losses and acute inflation in the economy.<sup>4</sup>

28. The Law "On privatization of State-owned and municipal property in the Russian Federation" of 1991 (was in effect to 1997), as well as the Privatization program were called upon to curb the privatization process and fit it into the framework of the State Program of Privatization. The list of companies for privatization was compiled. The companies of fuel and energy complex were excluded from that list. An important argument was about the process of division of property between the Federal Government and regional authorities.

29. The Law also established a monopoly government body to administer sale of State property under the name of "Russian Fund of Federal Property" (RFFI). RFFI on behalf of the owner, i.e. the Government of the Russian Federation, exercises its responsibilities of an owner in the companies with a participatory interest of the Government (State-owned companies) (see more details in Chapter II). Investment funds and holding companies were proposed for establishment to accumulate cash of private citizens and participate in privatization processes. However, no due supervision over operation of these funds was provided. Subsequently most of them having issued significant amounts of their own securities went bankrupt.

30. The Decree of the President of the Russian Federation "On acceleration of privatization of State-owned and municipal enterprises" of 1992 made provision for several mechanisms of privatization. A model of privatization was developed based on the "voucher" scheme and privatization for cash. The term "mass privatization" combined two independent but closely related processes: reorganization of medium and large State-owned enterprises into joint-stock companies, and, on the other hand, providing private citizens with investment instruments (vouchers) which entitled them to part of the privatized State property (voucher privatization)<sup>5</sup>. In addition there were allocated resources at the rented enterprises for buying out the rented property. Yet, the bulk of the privatization evolved according to the scheme which

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<sup>1</sup> Courtesy: Russian Economy in 1991 Trends and Prospects // Institute of Economic Problems of Transition Economies, 1992.

<sup>2</sup> Ibid

<sup>3</sup> Ibid

<sup>4</sup> Ibid

<sup>5</sup> Courtesy: Russian Economy in 1992 Trends and Prospects // Institute of Economic Problems of Transition Economies, 1993.



**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

provided significant benefits to the employees in terms of acquiring shares (closed subscription).<sup>6</sup> In subsequent years these shares were repurchased by the management of the companies or by investment (privatization check) funds practically for nothing and became in effect speculative items. Only by the end of the 90-s the so called "effective" owner, i.e. full-fledged owner of the companies, was established.

31. In 1993 privatization carried on and reached its apex. 5,164 largest enterprises were reorganized into joint-stock companies. However, over 75% of companies were reincorporated with the existing benefits of the employees which contributed to atomization of equity.<sup>7</sup> According to some analysts the Government lost at the very least the difference in the price of a large holding and the sum of prices of its smaller portions having paid thereby for the explosive growth of the number of stock market players (investment funds).<sup>8</sup>

32. In 1992-1996 privatization in many industrial sectors was completed. In natural monopoly sectors (oil and gas industry and electric power production) privatization evolved along the lines of establishing holding-type entities retaining controlling or blocking shareholdings for the Government for a long term. Certain restrictions were also imposed on privatization of companies in the defense sector.

33. Unfortunately such a massive and radical campaign of ownership transfer was accompanied by cases of breach of law and outbreaks of scandals. Mortgage auctions in 1995 were the most glaring example. The auction organizers demonstrated their explicit preferences with regard to specific bidders, and the relationships between some of the participants acting as competitors were more than conspicuously self-evident. Under this arrangement the shares were not sold but mortgaged at the bid with investment conditions (more often than not the conditions were to repay the debt to the budget and on some occasions to invest into assets development). The original maturity of mortgage was 1 year (later it was extended for each company and was supposed to expire end of 1998); thereafter the shareholding was sold or repurchased by the Government. The latter was highly unlikely, because no budget appropriations were allocated for repurchasing stock.<sup>9</sup>

34. In 1997 a new model of privatization was introduced whose most important distinction was that the companies were no longer distributed but actually sold. In 1997 domestic capital funds were built up in sufficient quantities to pay for companies substantial amounts and to enable valuation based not on their "book" value but with due account of their future profits, which significantly increased the level of income generated by privatization (see Figures 1 and 2). Instead of the 1 billion US dollars estimated in proceeds in 1997, almost 4.5 billion dollars were earned, including after the sale of 25% of "Svyazinvest".

35. For completeness of the picture describing the scope of the privatization processes relative to the size of the economy of Russia let us look at the privatization income against the level of the GDP (see Figure 1) for 1993-1004.

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<sup>6</sup> Ibid

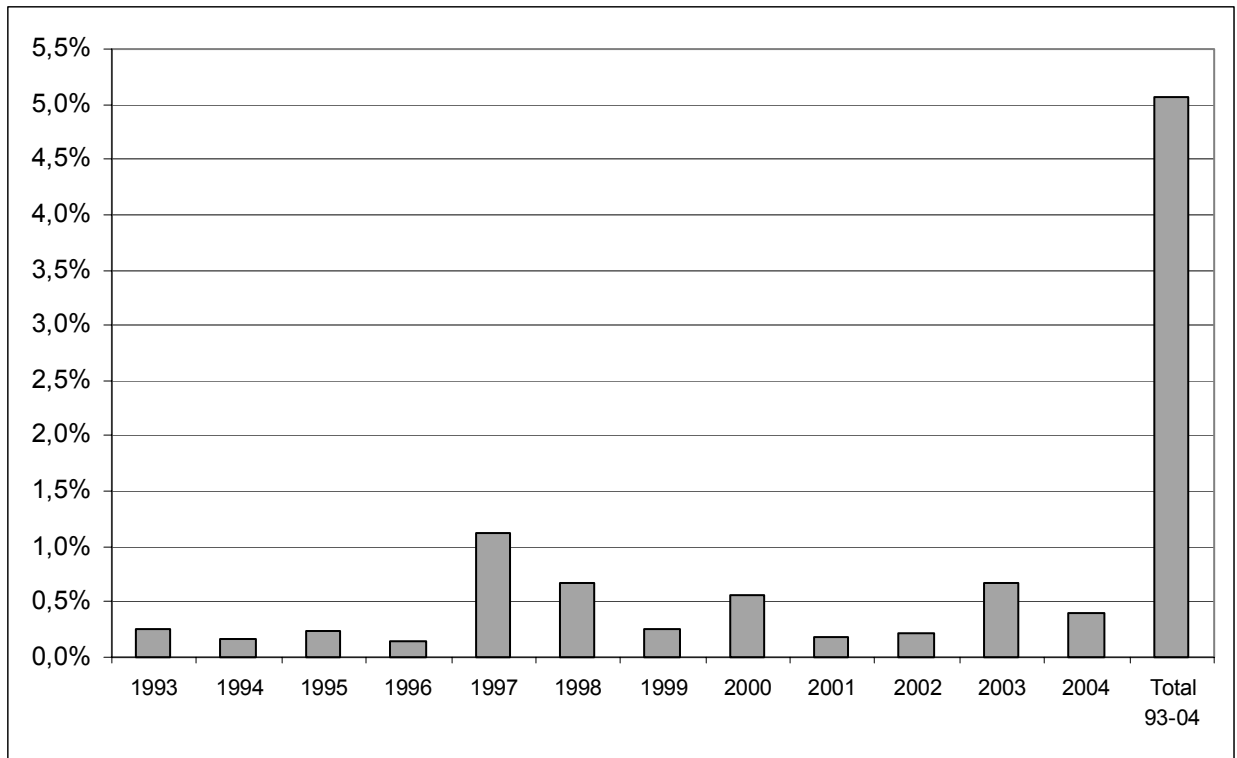
<sup>7</sup> Ibid

<sup>8</sup> Courtesy: Review of Economic Policy in Russia for 1997 / A. Astappovich et al.; Bureau of Economic Analysis. - Moscow 1998 – 427 pgs.

<sup>9</sup> Ibid

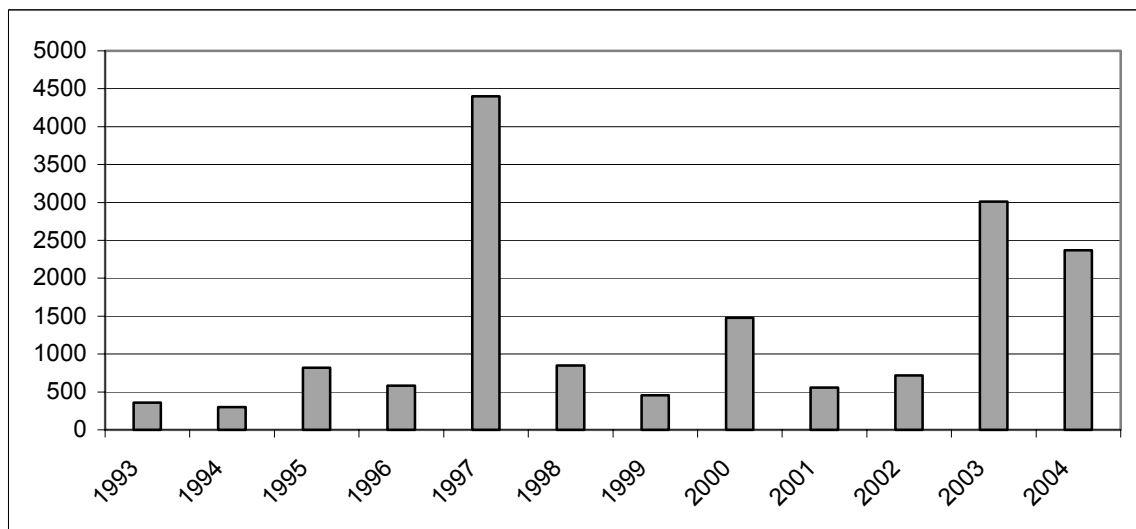
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Figure 1. Income from privatization compared with size of economy (1993-2004) (% of GDP)



Courtesy: Rosstat "Main Performance Indicators of the System of National Accounts, 2004, Review of Economic Policy in Russia for 1997 / A. Astappovich et al.; Bureau of Economic Analysis. - Moscow 1998 – 427 pgs.

Figure 2. Income from privatization of State property (1993-2004) (USD,000,000 )



Courtesy: Rosstat 2005, currency exchange rates according to the Central Bank of Russia.

36. As indicated above prior to 1997 privatization was not intended to generate income; in fact it pursued political objectives, including one of building a class of new owners. Having privatized most of

**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN RUSSIA**

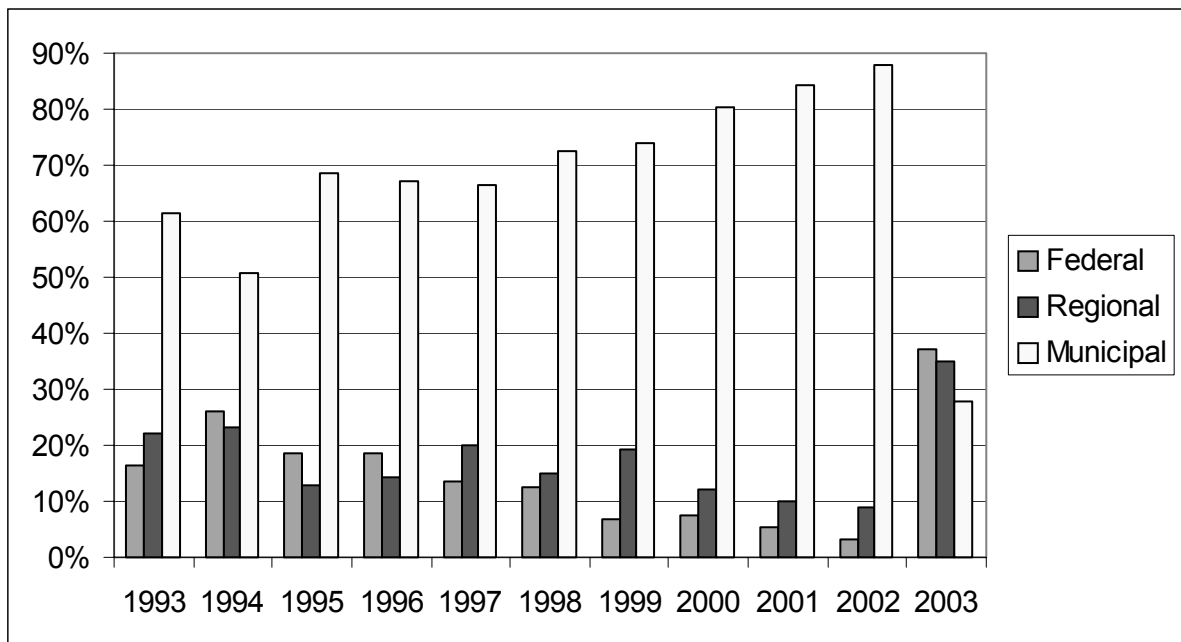
the industries at token prices, the Government of the Russian Federation subsequently ran out of steam to earn substantial income for lack of liquid assets and because of the low investment attractiveness of the companies, as well as for political and business risks. Thus the revenue of the Government generated by the privatization of the most important assets amounted to a little over 5% of the average GDP within 12 years from 1993 to 2004 (see diagram 1).

37. The OECD study of privatization of State-owned companies (2003) shows that the former socialist economies of the Eastern Europe (Czechoslovakia, Hungary, Poland) in 1990 - 2001 managed to earn over 18% of their GDP. Therefore, in terms of budget revenue the privatization in these countries was three times as efficient.

38. In 1998-1999 privatization income in equivalent terms, as shown in the diagram, dropped primarily because of the impact of the crisis and limited supply of assets by the Government. In dollar terms the privatization income in 1998 dropped more than 5-fold. Privatization income went up and became more sizable for the budget only after 2002; yet the growth rate registered in 2003-2004 is not so far on the record-breaking level of 1997.

39. It is noteworthy that privatization mostly focused on the municipal sector, i.e. on a large number of small and medium size enterprises (Figure 3). Because of their low value the budgets of municipalities and regional governments had practically no revenue from the privatization of their assets.

**Figure 3. Structure of privatized State and municipal property with ownership breakdown (1993-2003) (%)**



Courtesy: "Russian Statistical Yearbook, 2004"// Rosstat, Moscow, 2005

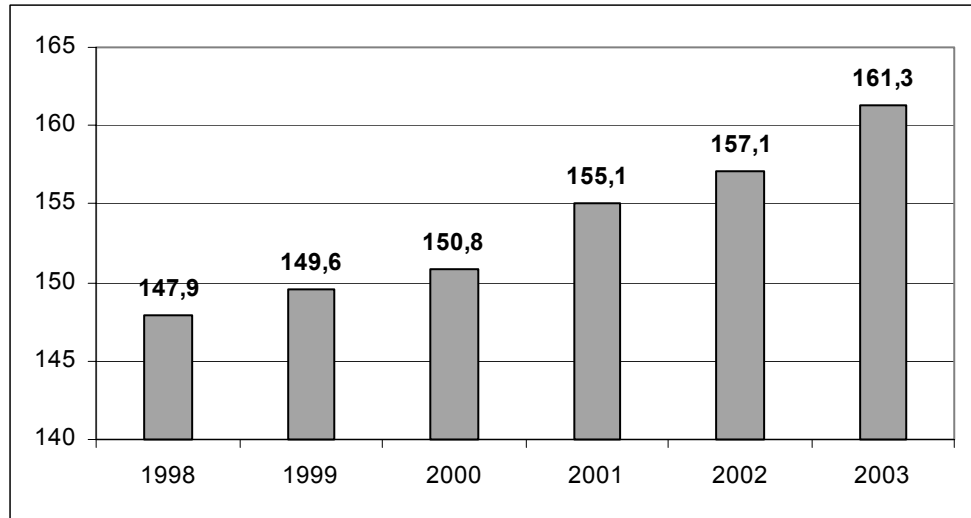
**Public Sector Still Very Important in Russia**

40. The number of State-owned companies in Russia is continuously growing (Figure 4). Their total number grew in 1998-2003 by 13 thousand entities (9%). Yet, the proportion of State-owned companies

REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN RUSSIA

in the total number of enterprises diminishes due to the outpacing rate of growth of the 'non-public' sector (Figure 5).

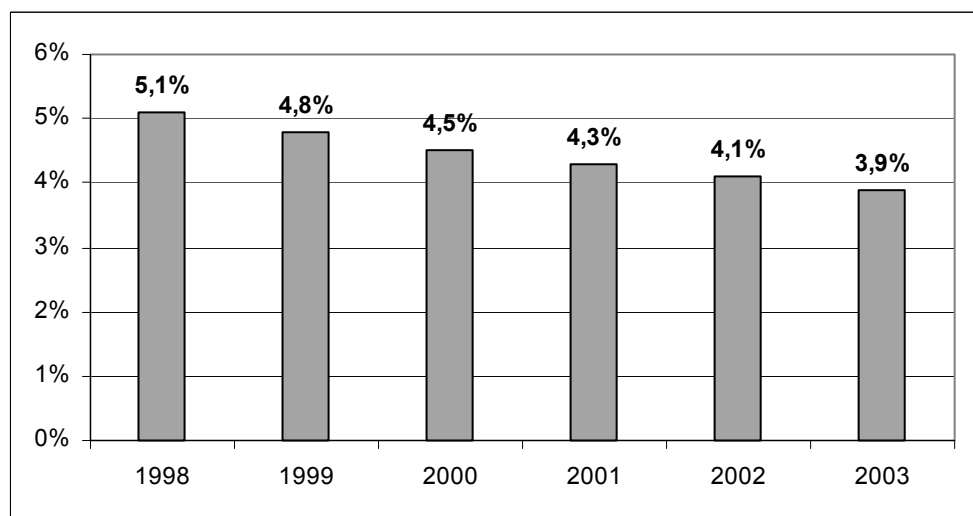
Figure 4. Total number of State-owned companies in Russia (1998-2003) (,000)



Courtesy: "Russian Statistical Yearbook, 2004"// Rosstat, Moscow, 2005

41. The Federal government share in the public sector of the economy remains the most significant in terms of its impact on the national economy, even considering the previously implemented privatization schemes. RAO "UES", Gazprom, PLC "Transneft", PLC "Transneftprodukt", PLC "Russian Rail Roads", the State unitary enterprise "Post of Russia", currently getting underway, are just a few of the Russian national-scope infrastructural companies involving business input from other sectors of the economy. In such and other companies the government owns or is likely to take over considerable numbers of voting shares in future to exert its influence on the economic policies of the country as a whole.

Figure 5. State-owned companies in total number of enterprises in Russia (1998-2003) (,000)



Courtesy: "Russian Statistical Yearbook, 2004"// Rosstat, Moscow, 2005

42. It appears impossible to assess in full the role State-owned companies in the national economy. Currently Rosstat is only planning on undertaking a sectoral statistical observation of the national

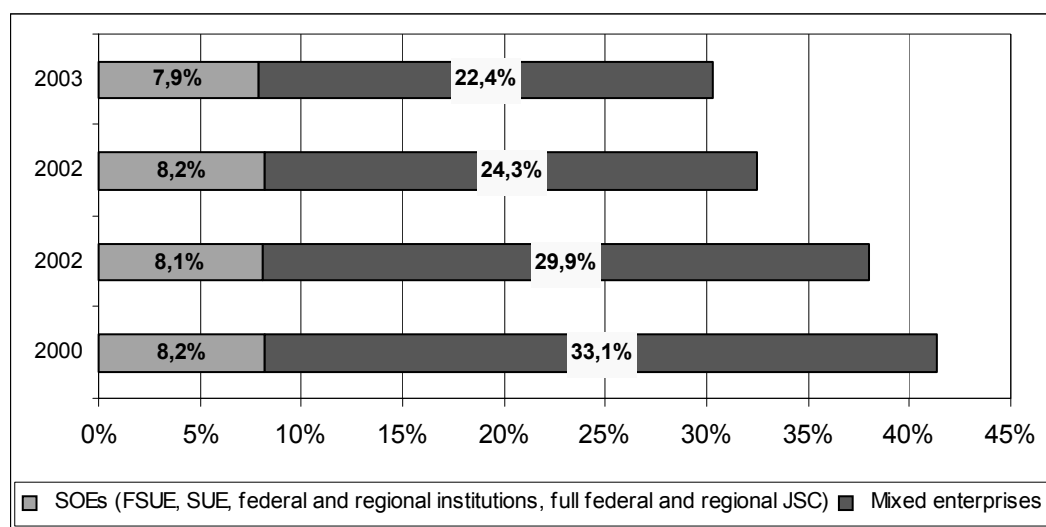
**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN RUSSIA**

economy. Therefore unbiased estimates of the share of State-owned companies in the economy are extremely complicated. Figure 6 shows the share of the average output of the State-owned companies industry-wide to diminish in recent years from 8.2% to 7.9%. However, the output data do not include large companies with a participatory interest of the Government below 100%.

43. A more complete description of the share of State-owned companies may be provided, if mixed-ownership companies are taken into consideration. Yet, not all the companies of this group have a participatory interest of the Federal Government or regional governments. Therefore, the closest estimate of the share of public sector enterprises in the industrial production in 2000 was equal to 8.2% - 41.3% (with mixed-ownership companies). In 2003 the share of public sector enterprises diminished from 7.9% to 30.3% (with mixed-ownership enterprises). The peculiarities of statistical observation in Russia are described in more detail in Note 1. Changes in the share of the industrial output of public sector enterprises for individual sectors of the economy are given in Figure 13.

44. The share of public sector enterprises in the GDP also drops from 15% in 2003 to 14% in 2004 (Table 1). The share of fixed assets of State-owned companies in the total value of all assets in the national economy, as well as relative to the GDP, is also steadily declining (Figures 7 and 8).

**Figure 6. Changes in share of industrial output of State-owned companies and mixed-ownership enterprises (2000-2003) (%)**



Courtesy: "Russian Statistical Yearbook, 2004"// Rosstat, Moscow, 2005

**Table 1. Output of products and services of State-owned companies / GDP (2003-2004)**

	2003	2004
Output of products and services (net of corporate transactions) in current prices (net of VAT and excise duty), RUB ,000,000.	1 948 566	2 284 842
GDP: RUB ,000,000	13 285 241	16 778 800
<b>Output of Products and Services / GDP</b>	<b>15%</b>	<b>14%</b>

Courtesy: "Russian Statistical Yearbook, 2004"// Rosstat, Moscow, 2005

REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA

Box 1 Terms used in the analysis of performance of State-owned companies

This report uses the following terms:

- *enterprises with state ownership (State-owned companies);*
- *mixed-ownership companies;*
- *State-owned fixed assets;*
- *Companies and organizations of public sector (public sector);*
- *Federal State-owned companies (PLC, LLC);*

The terms are similar but relate to different groups of companies and organizations. They are used for the following applications:

- a) Rosstat, as the most reliable and complete source of data on the national economy, in conducting statistical observations is guided by its own proprietary *techniques of rating* of enterprises and organizations as State-owned and mixed-ownership companies.
- b) To ensure comparability of the data contained in this report with those of the OECD report in respect of corporate governance matters, some of the figures show companies referred to as State-owned, although technically they are not rated as State-owned companies in terms of the system of State statistical observation. Therefore the term Federal State-owned companies (PLC, LLC) is used;
- c) In terms of control over the company the Government may own 25% + 1 share (blocking share) which will enable the Government to exert its influence on key matters of the company's business. Moreover, even a smaller government shareholding, or a "golden share", may be instrumental in managing the company. Hence in respect of financial settlements with State-owned companies (PLCs, LLCs) also include minority (government) share companies.

Figures 4, 5, 6, 7, 8, 9, as well as Tables 1 and 2 show data on State-owned companies which include:

- government institutions;
- State unitary enterprises, including Federal (SUE, FSUE)
- joint-stock companies with a 100% participatory interest of the government (Federal and regional authorities of the Russian Federation) (PLCs, LLCs and other).

Figure 6 also shows enterprises and organizations related to a mixed ownership structure, which include companies owned not only by private individuals, but also by the Federal Government or by regional governments or by both in varying proportions. Mixed-ownership category according to the State statistical observation model includes *inter alia* organizations without any participatory interest of the Federal or regional governments. E.g. this particular group may include enterprises with a participatory interest of public associations, although the number of such companies is insignificant. In size it amounts to an error which can be neglected in assessing the role of State-owned companies. On the other hand, this group does not include foreign & Federal capital companies (joint companies).

*Fixed assets owned by the Federal Government*, represent the value of fixed assets of different institutions, state unitary and government-owned enterprises, as well as wholly owned State companies (PLCs, LLCs etc.) (net of depreciation).

Public sector of the economy (public sector) includes:

- State unitary enterprises, including Federal;
- government institutions;
- business entities with over 50% interest (share) in the equity owned by the government (Federal and regional);
- business entities with over 50% interest (share) in the equity owned by other business entities

## Russian Corporate Governance Roundtable Meeting

### REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN RUSSIA

operating in the public sector of the economy.

Thus the group of "State-owned companies" counts fewer enterprises than the group of "public sector" by the number of companies with a participatory interest of 50%+1, but less than 100%.

The term *public sector of economy* (public sector) is not currently supported by any procedures as part of the State statistical observation model.

*Federal State-owned companies (PLC, LLC)*

- joint-stock companies (including closed-type corporations), limited liability companies with a participatory interest (shareholding) of the Federal Government, including (wholly owned companies, as well as special right of participation or "golden share").

Overall, it is necessary to put a rider on the assessments of the public sector in Russia. In performing international comparisons with OECD countries (Comparative Report on Privatization and Corporate Governance of State-Owned Assets (2005)), government institutions in some countries (e.g. Denmark) were not included in the sampling, and in a big country like Australia companies owned by regional governments were not included either. Nonetheless these companies are included into the sampling of State-owned companies for the state statistical observation model in Russia. On the other hand the sampling for Russia did not include minority (government) share companies. In this connection it appears necessary to consider developing a general statistical standard and a tool kit for monitoring the role of State-owned companies both in OECD countries, and in the form of guidelines for other non-member countries that will enable improved international comparative analysis.

*Courtesy:* Resolution of the Government of the Russian Federation of 4 January 1999 # 1 "On forecasting development of public sector of the Russian Federation", Russian National Classifier of forms of ownership, approved by the resolution of Goskomstat of Russia 20 April 1993 # 47.

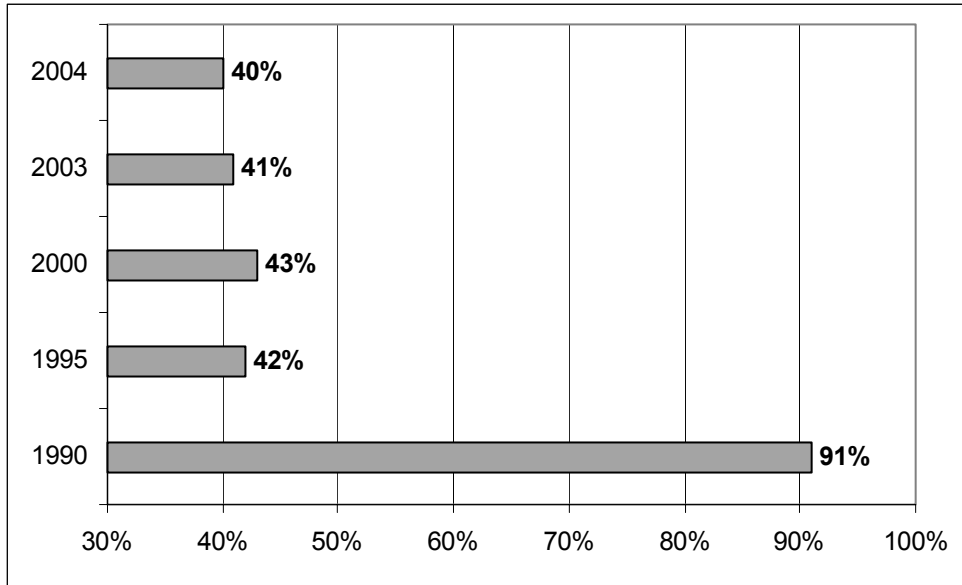
**Table 2. Fixed assets of State-owned companies per purchasing power parity of \$ (2002)**

Year	Total fixed assets	including per forms of ownership			
		State	interest	non-government	interest
2002	2 635	1 107	42%	1 528	58%

*Courtesy:* Rosstat 2005, OECD: "New GDP Comparisons Based on Purchasing Power Parities for the Year 2002", June 2004 p.3. PPP equal to RUB9,27 = USD1

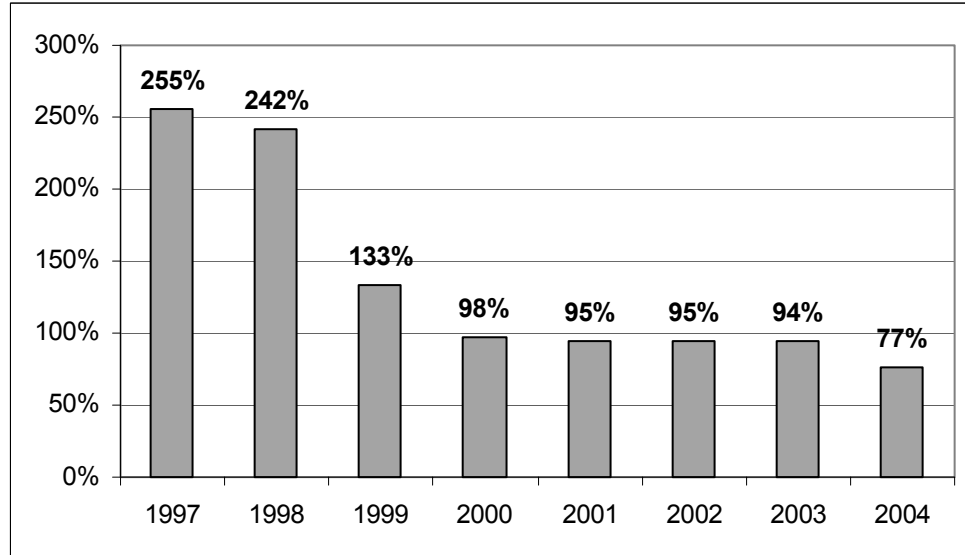
REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN RUSSIA

Figure 7. Changes in proportion of fixed assets of State-owned companies



Courtesy: "Russian Statistical Yearbook, 2004"// Rosstat, Moscow, 2005

Figure 8. Total value of fixed assets of companies and organizations of public sector / GDP of Russia

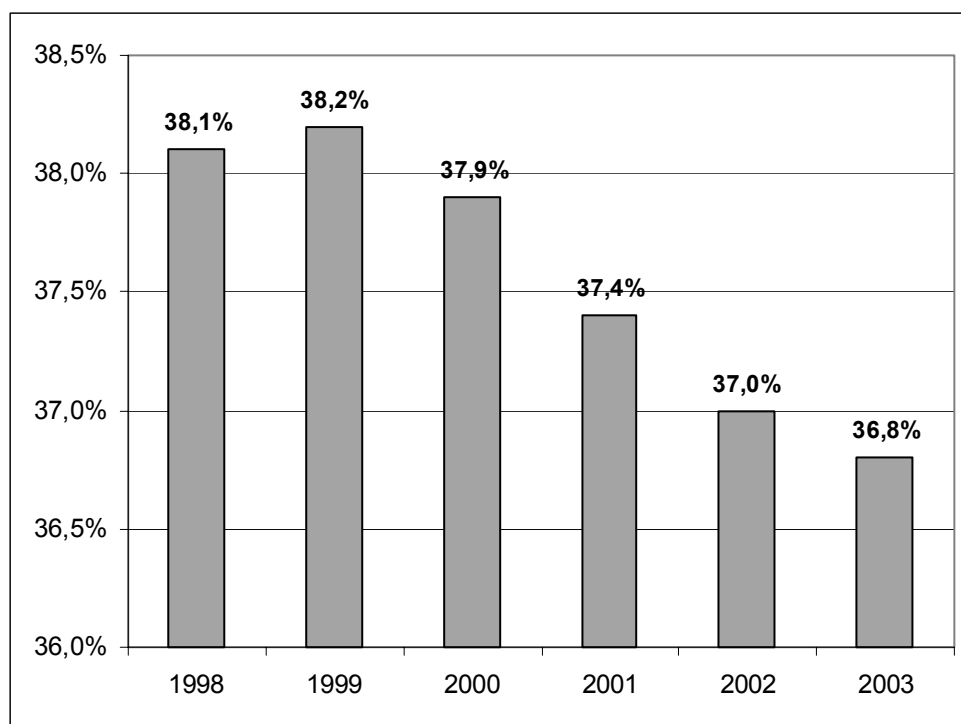


Courtesy: "Russian Statistical Yearbook, 2004"// Rosstat, Moscow, 2005



REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN RUSSIA

Figure 9. Share of employed by State-owned companies in total number of employed (%)



Courtesy: "Russian Statistical Yearbook, 2004"// Rosstat, Moscow, 2005

45. The development pattern of the key macro-economic performance indicators of State-owned companies shown in the above figures, demonstrates a steady downgrading of the role of State-owned companies in the Russian economy.

***Structure of ownership of State-owned companies (PLCs) with a participatory interest of regional governments.***

46. The overall trend in managing government shareholdings is as follows: on the one hand it is toward retaining a large share in strategically important enterprises, and on the other hand – sale of holdings in companies, participation in whose management is not part of the responsibilities of the Federal and regional governments of the Russian Federation. Figure 10 shows the pattern of changes in the structure of ownership of Federal State-owned companies (PLC): wholly-owned (100% interest in equity), majority shareholding (over 50% +1 share), and minority shareholding (less than 50% plus number of PLCs with a special right or "golden share")

47. The structure of ownership of Federal State-owned companies (PLC) for the period 2002-2004 has sustained certain modifications: If, e.g. in 2002-2003 the proportion of wholly owned government companies was equal to 2-2.3% of the total number of State-owned enterprises (PLC), in 2004 their share grew to 11% against the backdrop of the overall reduction in the number of State-owned companies by 3.5%.

48. The proportion of majority (government) share companies also dropped from 14.7% in 2002 to 12% in 2004. The minority (government) share companies constitute the majority of the State-owned companies. In 2002 - 2004 their number diminished from 83% to 77% because of the sale of small shareholdings by the government. In 2004 in 958 PLCs in addition to the government shareholding the rule of the special right of the Federal Government or "golden share" applies. Likewise the special right of the Federal Government of the RF is used in 284 public corporations where the Federal Government

## Russian Corporate Governance Roundtable Meeting

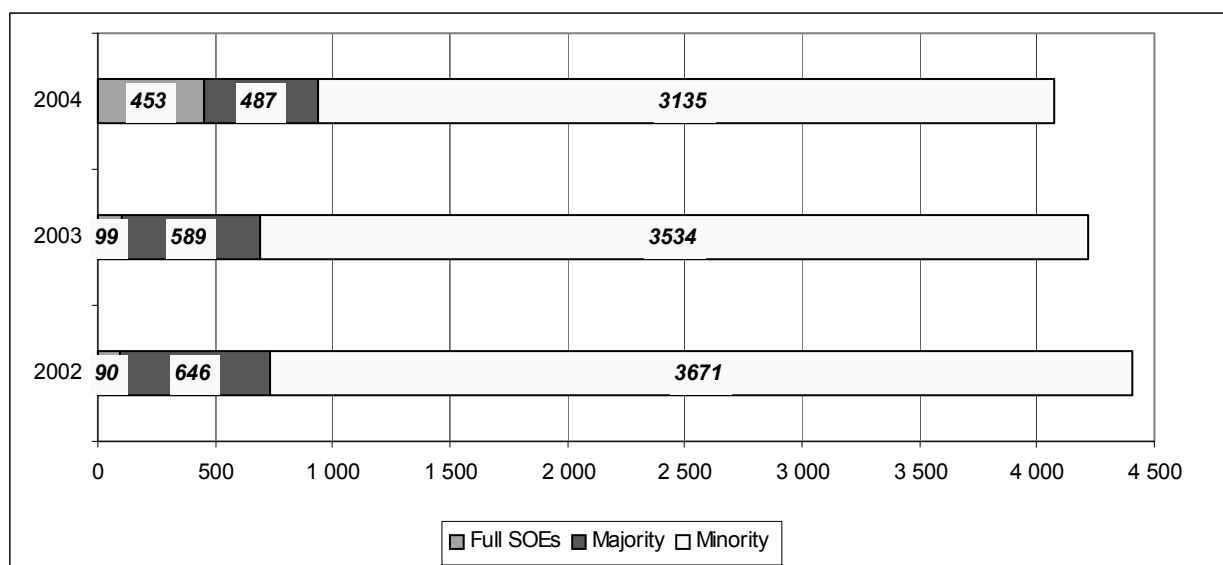
### REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN RUSSIA

has no shareholding. The above 284 companies are put on record together with all the minority share companies.

49. For comparison let's discuss the structure of ownership of State-owned companies with a participatory interest of regional governments. Their total number for 2004 constitutes 4,021 PLCs, of them 688 enterprises are wholly owned entities (17%), 1,590 are companies with a majority share of the Government (39.5%), and 1,743 are minority share companies (43.5%). Thus, regional authorities have a larger share and influence on State-owned companies, than the Federal Government.

50. It should be noted that the shareholdings of 102 PLCs of alcohol production industry were transferred for operational management to the Federal Unitary Enterprise "Rosspirtprom", which exercises its shareholder's rights on behalf of the Federal Government of the Russian Federation. The analysis of the implementation of corporate governance at State-owned companies demonstrated the inefficiency of management of the shares of alcohol industry PLCs.

**Figure 10. Changes in structure of ownership of federal State-owned companies (PLCs and LLCs)**



*Courtesy: Ministry of Economic Development of the Russian Federation, Rosimuschestvo, RFFI, 2005.*

REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN RUSSIA

Box 2 Records of Federal share holdings and shares of regional governments

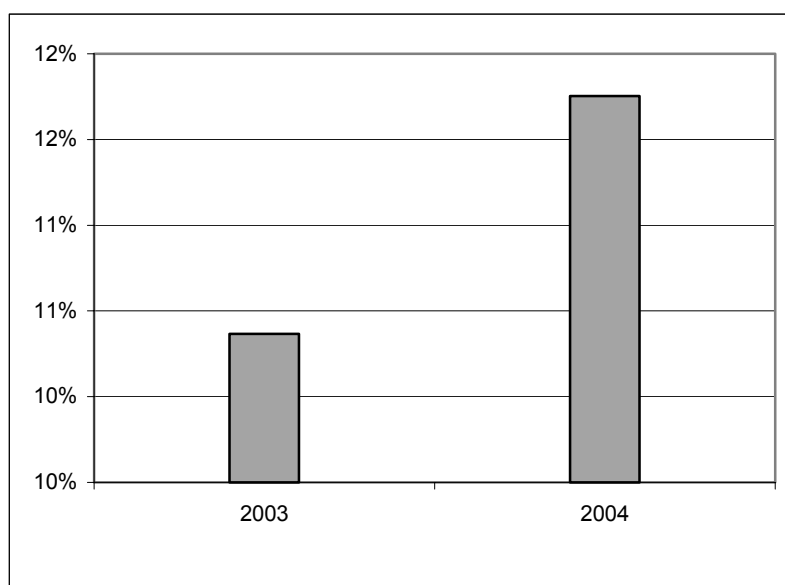
Privatization in Russia was evolving at a very fast pace. In the process considerable powers were delegated to the regional governments. The fast speed of the privatization processes, as well as the scope of the public sector hampered effective supervision and control. Currently work is underway to register the share holdings owned by the Federal Government and by the regional authorities.

According to the Federal Property Register (hereinafter Register), as of 1 January 2002 the book value of the share holdings and shares, including in 6 LLCs was equal to RUB7,528,433,000 (in 44 regional jurisdictions only), as of 1 January 2003 – RUB 11,134,431,000 (in 47 regional jurisdictions). During 2002 the book value of the said property increased by RUB3,605,998,000 (48%), including with more information made available on some regional jurisdictions. The Register contains no data on the value of the share holdings and participatory interest in limited liability companies as of 1 January 2003 for 40 (of 87) regional jurisdictions including St. Petersburg, Krasnodar and Primorskiy regions, Republic of Bashkortostan and Sakha (Yakutia), Nizhniy Novgorod, Samara, Tyumen, Chelyabinsk regions, Khanty-Mansy autonomous district.

Courtesy: Ministry of Economic Development of the Russian Federation, Rosimuschestvo, RFFI, 2005.

**Figure 11. Percentage of capitalization of State-owned companies (PLCs) in total capitalization of companies on market.**

51. In building diagram 6 data on capitalization of the following 6 biggest enterprises with a participatory interest of the Government listed at the stock exchange were used: Slavneft, Gazprom, RAO "UES of Russia" is PLC "Irkutskenergo", LUKOIL, "Aeroflot – Russian Airlines". It is noteworthy that by now the Federal shareholdings in Slavneft and LUKOIL have been privatized.



*Stock market capitalization and capitalization of companies given based on the data provided by the rating agency "Expert-RA", 2005.*

52. Ensuring growth of capitalization of the Russian stock market, as well as of joint-stock companies, including those with a participatory interest of the Government, constitutes an important factor which substantially impacts the dividend policy. According to the Ministry of Economic Development of the Russian Federation and the Federal Commission for Securities Market of Russia, beginning from 2001, capitalization of the Russian market has been growing at a very fast rate. Yet, if in

**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

2001 it increased by 88.6% (17.2% of GDP), in 2002 the rate of growth dropped dramatically, and the capitalization grew at 38.6% (it reached 33.7% of GDP). In the period 2003 - 2004 the aggregate capitalization of the market in its dollar equivalent grew only by 21%. The stock market capitalization in 2004 relative to the GDP diminished significantly. If in 2003 it was equal to 44.0%, in 2004 it was barely 41.5%.

**Box 3 Status of stock market in Russia**

If we look at the analysis of the structural changes in this segment, some negative indications should be noted. The most important one demonstrates a reduction in the number of issuers whose shares are traded on stock exchanges. It is due to the following reasons:

- no new issuers move into the stock market, and those whose shares were traded prior to the financial crisis of 1998, are no longer motivated to expand the market of their shares, because the market is still averse to investments through public offerings;

- according to expert assessments the costs of paperwork for the government registration of a securities issue amount to up to 5% of the total price of the issue;

- liquidity of the stock market is declining. The conventional RTS stock market currently has 172 issuers. However, shares of only 15 issuers can be legitimately qualified as liquid. Shares of 113 issuers (65% of their total number) either never traded in 2003 (41 issuers), or transactions occurred on an on-and-off basis (no more than 1-2 transactions a month).

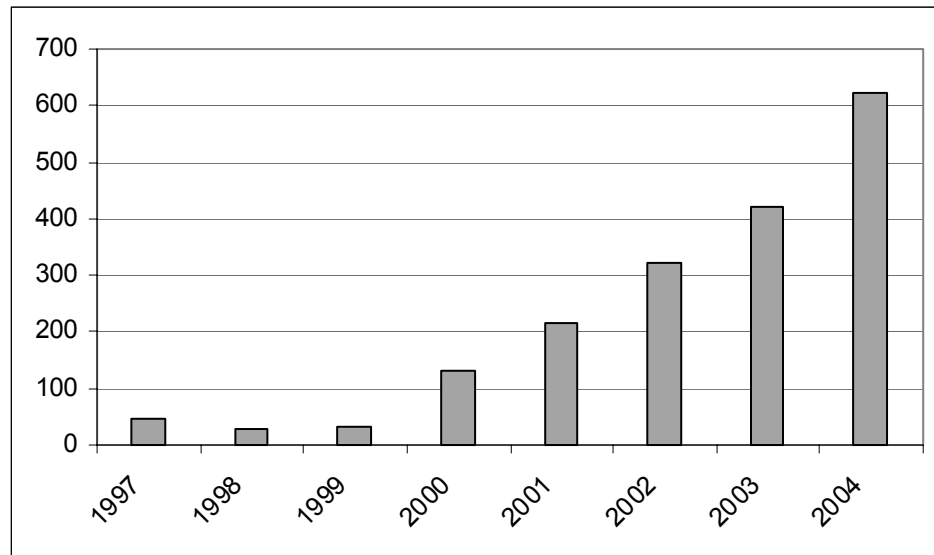
With the overall growth of trading activities, foreign market sales grow faster. As a result the comparison between the foreign and the Russian national stock markets skews in favor of the former. This condition to a large extent results from the fact that seeking investments on the international market for big business is more attractive than on the domestic market. The corporate issuers have a higher stake in the growth of liquidity precisely on the international markets. Some of them in moving into the domestic stock market primarily seek higher liquidity for their shares on the international market.

*Courtesy:* Ministry of Economic Development of the Russian Federation, Federal Commission for Securities Market, 2005

53. An important test of the quality of management of government assets is sustainable growth of dividends payable by State-owned companies (PLCs) on the government share holding. In 1997 - 2004 the dividends grew in size from USD45,000,000 to USD620,000,000. Besides, a steady trend evolved toward payment of 10% of profits of State-owned companies in dividends on the government share holding. Dividend payment schemes are addressed in more detail in the section dedicated to real policies of corporate governance.

REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN RUSSIA

Figure 12. Revenue from State-owned companies (PLCs) as dividends (1997-2004) (USD,000,000 )



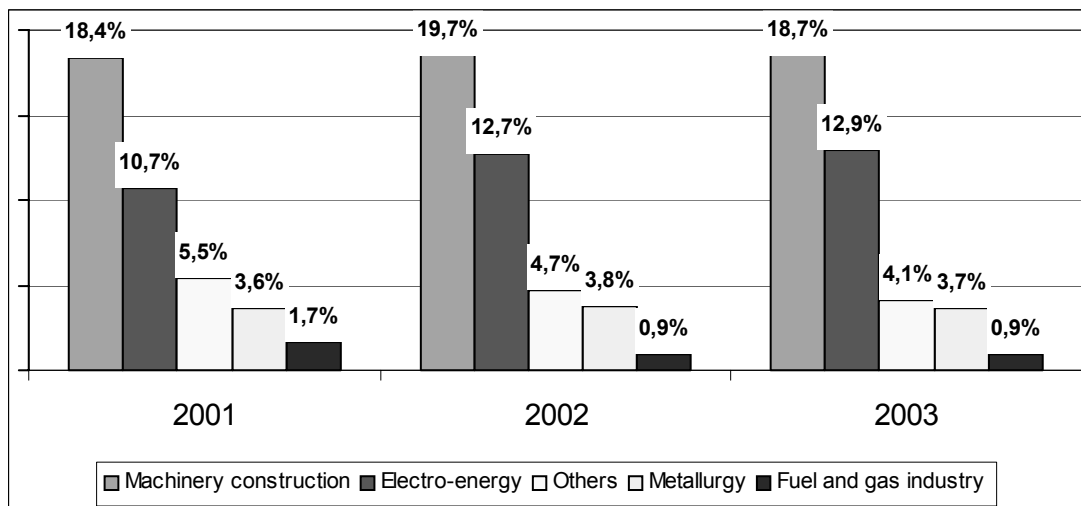
Courtesy: Ministry of Economic Development of the Russian Federation, Rosimuschestvo, RFFI, 2005.

*State-owned Companies Remain Key Players in Some Important Sectors*

54. With mixed-ownership companies taken into consideration about **30%** of the production output is under control of the Federal Government and regional authorities. Yet, complete control based on unitary ownership of enterprises and institutions, as well as with a 100% participatory interest of the Government in companies accounts for only **7.9%**. It should be indicated, however, that companies fully controlled by the Federal Government and regional authorities are distributed unevenly by sectors (Fig. 13).

55. The Government keeps under its full control a considerable portion of the production output in mechanical engineering, i.e. 18.7% in 2003. It is true primarily because of the high proportion of the defense sector companies in that industry (they are Federal unitary enterprises, government unitary enterprises and public limited companies with a 100% participatory interest of the Government.), as well as because of their poor investment attractiveness preventing their privatization.

Figure 13. Changes in proportion of industrial output of State-owned companies per sectors (2001-2003) (%)



**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

*Courtesy:* Ministry of Economic Development of the Russian Federation, Rosimuschestvo, RFFI, 2005.

56. The process of reforming the electric power engineering industry has not yet been completed; moreover, most of electricity is produced by nuclear power plants, wholly owned by the Federal Government. The input of RAO UES and its subsidiaries into the statistical data of the public sector is negligible. The Federal Government owns about 52% of shares of the PLC "UES of Russia", but the key producers in the industry of electrical power are subsidiaries of RAO UES which are owned by the parent company within 30% - 49%. It means that the proportion of State-owned companies in the electric power production sector is just a little over 12% and is represented primarily by power production companies with a 100% participatory interest of the Government.

57. The input of metallurgical State-owned companies (non-ferrous and ferrous metals) is insignificant, and such companies operate in the non-ferrous metals industry to produce metals under the government contract.

58. The proportion of State-owned companies in the fuel industry is less than 1%, because in practically all oil and gas production companies the share holding is less than 100%. E.g. the Federal Government owns about 40% of shares of Gazprom (RFFI owns 38.37%). Large State-owned companies, such as "Transneft" and "Transneftproduct" are not part of the industrial sector but rather transport companies, since they are responsible for transportation of oil and petroleum products by pipelines.

59. Overall, State-owned companies remain important players on many product markets, but are progressively losing their influence. The Government continues to step aside from management responsibilities and is moving over to elaboration of the "rules of the game" on these markets. Regulatory control is carried out by establishing tariffs for the oil and gas industry, for the pipeline transportation, some other markets, as well as import duties and quotas.

60. In addition, in the nearest future part of the gas supplies will be sold at commodity exchanges (up to 5% of total gas sales), thus making products of this industry subject to market pricing mechanisms. However, in some sub-industries, e.g. nuclear power generation, alcohol production, certain defense suppliers, the Government plays the key role of manager of State-owned companies.

61. The Government also plays an important role in other domains of our economy. In the biggest bank of Russia, "Sberbank" a 60.75% equity share is owned by the Central Bank. 95.5% of shares of "Vneshtorgbank" are owned by RFFI, and this State-owned bank owns substantial share holdings of many private banks of Russia. The aggregate assets of Sberbank of Russia and Vneshtorgbank are equal to 37% of the total assets of all the banks of Russia (the equity share of these banks in the total equity of the whole of the banking system of Russia is about 33%)<sup>10</sup>.

***Organization and Number of State-owned Companies***

62. In Note 1 addressing the terminology of this Report, State-owned companies are defined from the perspective of State statistics. The state statistics for their part are based on definitions of the forms of ownership as provided by the Civil law of the Russian Federation. It is also necessary to indicate that State property is in fact Federal property and property owned by the regional governments of the Russian Federation. Municipal property is not State property in terms of the law. Accordingly the government authorities of administration and control are limited in their participation in managing municipal property.

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<sup>10</sup> *Courtesy:* Issuers' reports for the 4<sup>th</sup> quarter 2004. Data provided by agency "Expert-RA"

REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA

Yet, as studies have demonstrated, the system of management of municipal enterprises is, in general, consistent with the rules of Federal and regional legislation.<sup>11</sup>

63. State-owned companies are part of the public sector of the economy. However, "State assets" is an even broader concept than public sector in Russia. Table 3 shows data on the number of companies in the public sector, as well as assets of Federal and municipal property. Management and privatization issues of so considerable a portion of the Russian economy are addressed in Chapter VIII of this study.

64. According to the Civil Code organizations are defined as *institutions*, if they are established by an owner for the exercise of management, social and cultural, as well as other responsibilities of non-commercial nature and funded by him in whole or in part (Civil Code of RF, page 120). *Institution* is liable for its obligations with cash funds under its control. If the said cash is insufficient, the property owner carries subsidiary liability for its obligations.

65. In practice almost always institutions are funded by the Government (from the Federal, regional or municipal budget) only in part. Institutions in the area of education may engage in business activities, if profit made on these activities is used for funding educational processes. Health care institutions, especially in the regions and in municipal jurisdictions also provide paid services to the populations. Such "indulgences" have been allowed for the institutions to offset the lack of budget funds. However, institutions of general government may not engage in business, including in the course of their business functions. Yet, part of the business responsibilities of general government institutions can be exercised through unitary enterprises.

66. Neither the economics, nor the organization of budget-funded institutions has yet been affected by the ongoing market reforms. In recent years only processes of adaptation to reduced budget funding have been witnessed. Hence, in this area there still exist a lot of opportunities, at least for enhancing the efficiency of utilization of government funds, and, not infrequently, for their direct saving.

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<sup>11</sup> *Courtesy:* A. Radygin, A. Gazetov et al. // Reforming unitary enterprises in the Russian economy: industrial and regional aspects - Moscow. IEPP, 2004 (prepared based on materials of the research project sponsored by USAID)

## Russian Corporate Governance Roundtable Meeting

### REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN RUSSIA

**Table 3. Types and number of organizations in public sector, municipal sector, as well as Federal and municipal property assets (2004)**

Federal property	units	Municipal property	units
Federal institutions	36 445	Municipal institutions	246 100
Federal unitary enterprises	8 524	Municipal unitary enterprises	n/a
Federal shareholdings in PLCs, participatory interests	4 075	Municipal shareholdings in PLCs, participatory interests	n/a
including more than 50%+1 share	1 419	including more than 50%+1 share	n/a
<b>Total assets:</b>	<b>49 044</b>	<b>Total assets:</b>	<b>246 100</b>

Regional property	units	in addition:	units
Regional institutions	24 888	subsidiaries with 50% +1 shares (interest) owned by the Federal and regional governments)	1 663
Government unitary enterprises	8 087		
Regional shareholdings in PLCs, participatory interests	4 021	Federal real estate assets	74 722
including 50%+1 share	1 362	Regional real estate assets	408 751
<b>Total assets:</b>	<b>36 996</b>	<b>Total Federal and municipal sector with subsidiaries and real estate assets.</b>	<b>817 276</b>

*Courtesy:* Ministry of Economic Development of the Russian Federation, Rosimuschestvo, RFFI, Rosstat, 2005.

67. *Unitary enterprises* based on the business management right are defined as such, if they are established pursuant to a resolution of a duly authorized government body (Federal, regional or municipal body). Property is transferred to such enterprises based on the right of business management, but remains government (municipal) property. Regulatory documents separate Federal unitary enterprises, government unitary enterprises, i.e. enterprises established by regional governments, and municipal unitary enterprises.

68. *Operational management unitary enterprises* (Federal, regional or municipal government enterprises) are recognized as such, if they are established pursuant to a resolution of an authorized body on the basis of property owned by the Federal, regional or municipal government, and if they are based on the right of day-to-day management.

69. The basic difference between unitary and government enterprises is as follows: The owner of a government enterprise, i.e. Federal or municipal government, carries subsidiary liability for the obligations of the enterprise. Accordingly, a government enterprise differs from an institution in that the enterprise may engage in business activities. For example, "Gosznak" (Mint) is a government enterprise which is a monopoly producer of paper money, coins, State award medals, insignia, etc.

70. It is noteworthy that unitary enterprises may not establish subsidiary unitary enterprises, but they may have equity shares in other companies, except for those engaged in banking business. Unitary enterprises may not be set up jointly with the Federal Government, regional governments or municipalities.

71. Yet, direct comparison of State unitary enterprises with private businesses based on their performance does not yield any straightforward conclusion as to any advantages over each other either way. There are many factors to be considered, including, on the one hand, the fact that the recently



REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA

privatized businesses have not yet been refurbished, have not mastered new management techniques, and consolidation of control functions has not yet been completed; and, on the other hand, State unitary enterprises are frequently awarded government contracts without any bidding procedures, as well as enjoy benefits in managing assets under their control (e.g. leasing, or sub-leasing State property transferred to them for economic management).

72. The last group of State-owned enterprises comprises public and closed joint-stock companies, and limited liability companies. These enterprises are not classified as State-owned companies by the State statistical observation model, and are rated as mixed ownership companies (Appendix 1). Yet, their role as sources of budget revenue tends to build up, as well as in terms of intensification of the economic growth and attraction of investments. For more detailed description of models of management of such companies please read in subsequent sections of this study.

73. In addition to the above basic groups of companies, there are some other special forms of ownership of organizations. For example, non-profit non-membership organizations founded by the Federal Government based on property contributions and established for carrying out social, management or other important public activities, are classified as *government corporations*.

74. Groups of legal entities, acting as parent companies or subsidiaries pooling in whole or in part their tangible and intangible assets (system of share holding) on the basis of an agreement on establishment of financial and industrial groups for the purpose of technological or economic integration for the implementation of investment and other projects and programs, are recognized as *financial and industrial groups*. Some financial and industrial groups have been established based on State property. In the 90-s financial and industrial groups were very popular as a link between banks and industrial assets. As a result, in Russia there are still very many small commercial banks (so called "pocket banks") which undermine the banking system. By virtue of their affiliation to industrial groups these banks have tough time consolidating their assets with the banks of other industrial groups.

75. In conclusion it should be noted that the most attractive portion of State property are some of the Federal real estate assets. These assets are not put up as contributions toward the equity of enterprises. They have been either leased out for rent, or for use or transferred based on any other legal right. Such assets are, for example, airfield runways and infrastructural facilities intended to ensure safety and life support. However, there are significant resources for their more efficient utilization (higher rent, contributing them as equity share of Federal unitary enterprises, PLCs), as well as privatization.

REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN RUSSIA

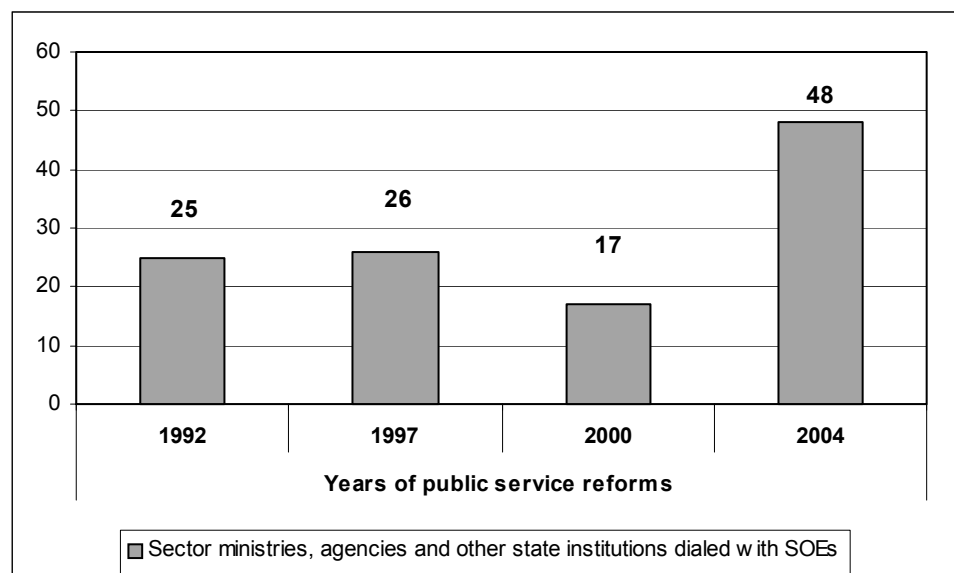
CHAPTER II  
FEDERAL GOVERNMENT'S OWNERSHIP RESPONSIBILITIES

76. Managing so unwieldy a structure as public sector requires a ramified and well adjusted mechanism of the exercise of the owner's responsibilities by the Federal Government. The progress is visible. Chapter I describes the growth of income generated in the process of management of Federal share holdings. Below we will focus in more detail on the performance and principal vectors of evolution of the State property management system.

**Evolution and Current Model of Exercise of Owner's Responsibilities by Russian Federal Government**

77. Large-scale administrative reforms were undertaken on a number of occasions (in 1992, 1997, 2000 and 2004). In the course of the reforms of 1992-2000 it was chiefly about consolidation of the ministries and redistribution of their administrative powers. In the course of the public service reform of 2004 a new system of State property management has been set up in the Russian Federation, which represents a so-called "triple-link" system applied in some countries. With the overall increase in the number of government entities (Figure 14), many ministries were reduced in size.

**Figure 14. Total number of sectoral ministries, services and agencies**



*Courtesy: Decrees of the President of Russia of 1992, 1997, 2000 and 2004.*

78. The first management tier is represented by Federal ministries. They are responsible for drafting public policies and State property management strategies, as well as developing rules and regulations ranging from drafting Federal bills all the way down to the industry manuals, if necessary. The so-called "sectoral" ministries are required to define the distinctive features of property management to ensure enforcement of the Federal terms of reference in their respective sectors. For this purpose the Government

**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

of the Russian Federation instructed them to develop individual "sectoral" concepts for property management.

79. Sectoral blocks comprise all the 15 existing Federal ministries which cover all areas of social and political interests of the Government in the relevant sectors of the national economy. The sectoral blocks are responsible for the provision of public services to the population in specific sectors, i.e. transport, communications, health care, medical services, culture, education, utility services, etc. Regardless of the share of participation of the government in the management of organizations in each sector, it is precisely the sectoral block that is responsible for ensuring uninterrupted provision and high quality of services to the business entities with due consideration of the requirement of advanced technologies. Moreover, there exist inter-sectoral blocks which define common policies and, to an extent, supervise performance of the sectoral blocks. These blocks include the following departments: financial (Ministry of Finance of Russia), economic (Ministry of Economic Development of Russia), legal (Ministry of Justice of Russia).

80. The ministries formally supervise other departments which report to them. The second and third tiers of management are represented by Federal Agencies and Federal Services which are formally independent.

81. The Federal Agencies are responsible for law enforcement in their respective sectors: they implement policies defined by appropriate Federal ministries and toward this end they administer State property.

82. Federal Services exercise control of compliance with the laws of the Russian Federation by the Federal Agencies.

83. In December the Government of the Russian Federation defined the lists of the Federal enterprises and institutions within the terms of reference of the sectoral blocks. In managing these organizations the property block should exercise its exclusive responsibilities for control of the property uses. Generating revenue from these companies and organizations is not one of top priorities.

84. In addition, a considerable number of joint-stock companies are supervised by the ministries and agencies, whose shares are owned by the Federal Government. There are approximately 1,500 such enterprises. For such organizations the sectoral priorities in their operation should prevail over commercial interests. (Figure 15). The dual management model is used in respect of such enterprises.<sup>12</sup>

85. Other organizations (they are in majority) should be entirely subordinated to the property block departments. Sectoral priorities are considered to be of secondary importance for such organizations; maximization of profits and capitalization of the company are in effect their key priorities. The number of such companies is currently equal to approximately 2,500 units (Figure 15). Such enterprises will be managed by Rosimuschestvo on the basis of the "centralized" management model. For several years these companies will be prepared for the sale of the Federal share holdings.

***Dual and Multiple sector Models of Managing State-owned Companies in Russia***

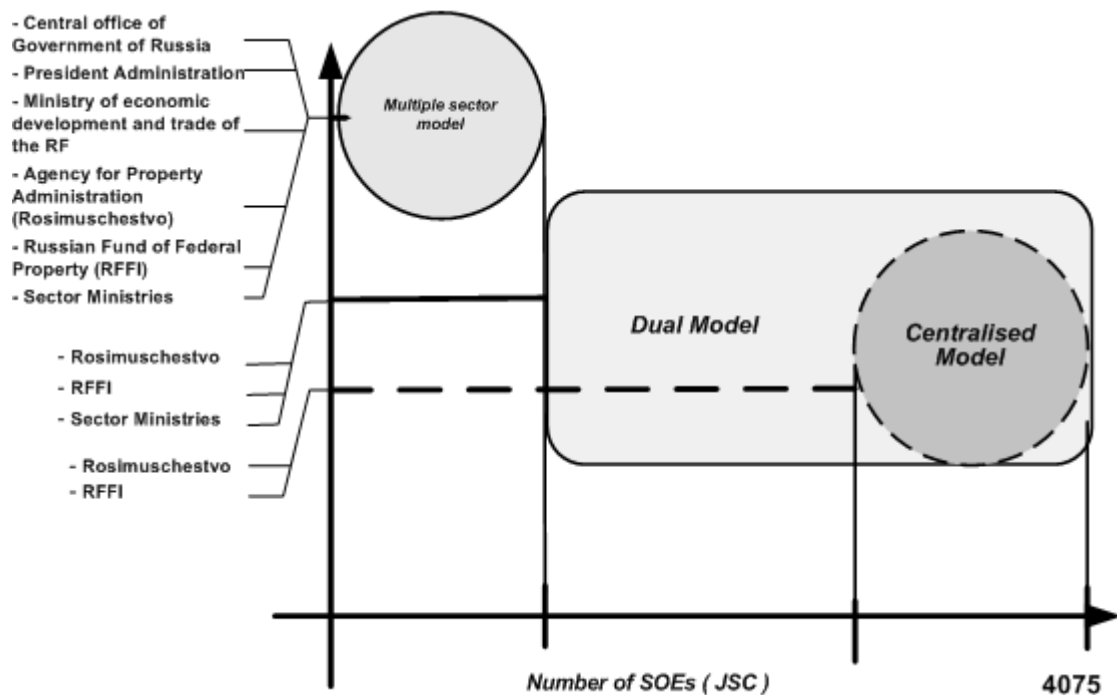
86. The dual management model is used in respect of most enterprises. It requires reporting by companies to two ministries (agencies). The first department is Rosimuschestvo, and the second one is related to the respective sectoral block (Figure 16).

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<sup>12</sup> *Note:* The terms "dual management model", "sector management model", "centralized management model", "triple management model" are defined in the OECD's "Comparative Report on Privatization and Corporate Governance of State-Owned Assets" (2005).

REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN RUSSIA

Figure 15. Models of Exercise of Owner's Responsibilities by Russian Government



87. The dual management model is characterized by the following distinctive features. The government entity responsible for the preparation and nomination of candidates at the annual meetings of shareholders is "Rosimuschestvo", which is duly authorized by the Government of the Russian Federation to act as a shareholder of Federal shares and exercise the rights of a shareholder.

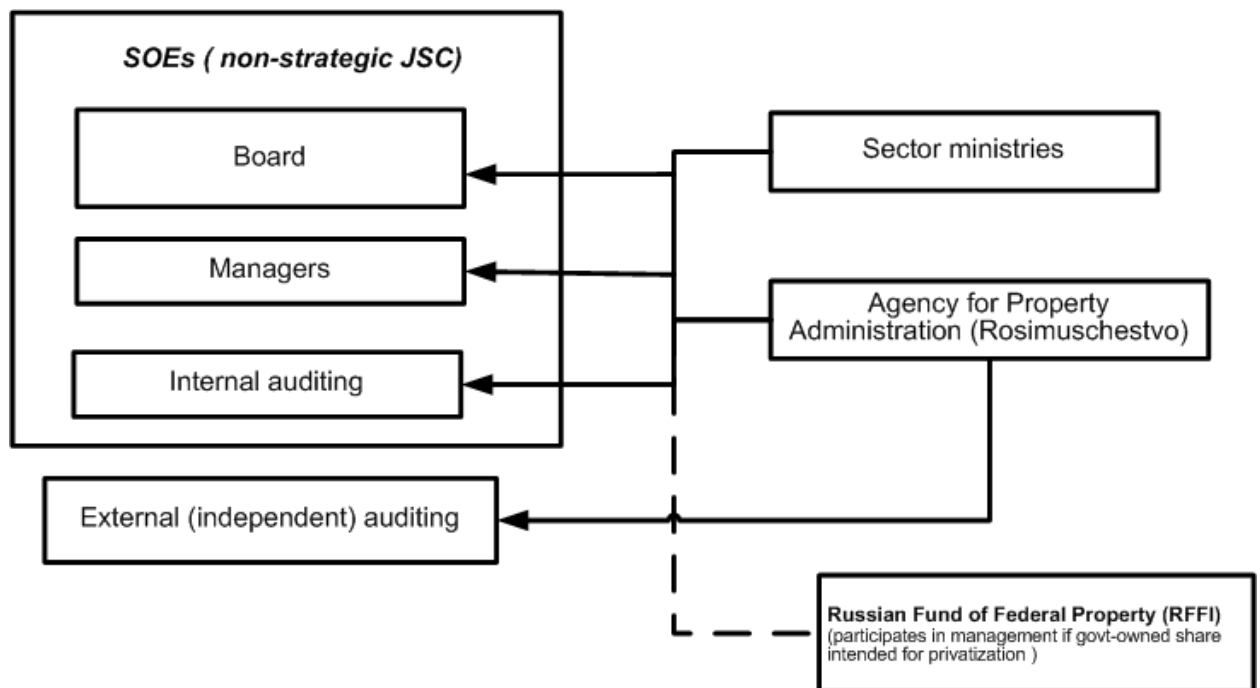
88. As a general rule, in preparing nominations to the board of directors "Rosimuschestvo" takes into account the sectoral distinctive characteristics of the company's business, and nominates to the board of directors the majority (for a Federal share holding) of representatives of the sectoral block (sectoral ministry or sectoral agency). Thereby the sectoral department participates in managing the company through its representatives.

89. Normally, representatives of "Rosimuschestvo" constitute majority on the board of directors (pro rata the Federal share holding + three directors) and in the auditing bodies of the company, i.e. in the audit committee. At the general meeting of shareholders the government (Federal Government of the Russian Federation) is represented by "Rosimuschestvo", as a shareholder, which has duly executed powers of attorney to act at the general meeting of shareholders according to the instructions (directives) given to the representative on the agenda. The directives are given to the representative by "Rosimuschestvo".

90. In most important companies which are on the borderline between the sectoral priorities of the Government and its political interests, this rule may be disregarded and top officials of the country may be nominated to the boards of directors. Thus the special "multiple sector" model is exercised involving many ministries and departments, including the supreme government authorities, i.e. the Office of the Government and the Administration of the President of the RF (Figure 17).

REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN RUSSIA

Figure 16. Dual model of organization structure of ownership of small State-owned companies (non-strategic PLCs) in Russia



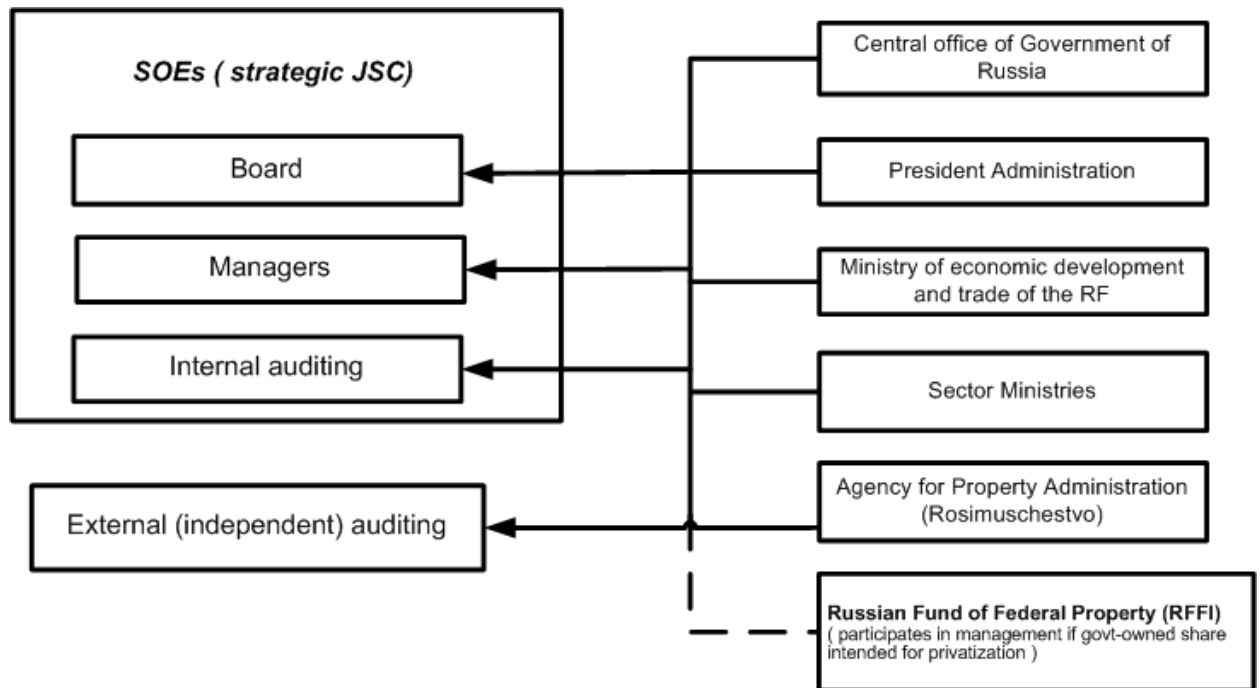
91. An approximate number of such companies is equal to 102 units.<sup>13</sup> The list was approved by the Resolution of the Government of the Russian Federation, but this Resolution is no longer in effect. However, the number of these companies may be changed. There is no new list of companies with a participatory interest of the Administration of the President or of the Office of the Government. Actually the old list is considered to be valid. In addition, there exist executive orders of the Government of the Russian Federation on nomination of representatives of the Government as directors of public companies. These executive orders in fact determine the list of strategic companies for participation of top government authorities in their management.<sup>14</sup> Decree of President of the RF expanded list of strategic SOEs up to 539 units.

<sup>13</sup> *Courtesy:* List of public limited companies in respect of which nomination of candidates to the board of directors and audit committee, as well as to the executive management team of the public company, if such decisions are delegated by the Articles to the general meeting of shareholders, the nomination of representatives of the Government of the RF for voting at the general meetings with voting shares owned by the Federal Government, replacement of directors (members of the supervisory board), representing the interests of the Government of the RF, is the responsibility of the Government of the Russian Federation, as approved by the Resolution of the Government of the Russian Federation of 7 March 2000, # 195.

<sup>14</sup> *Courtesy:* E.g. the Executive Order of the Government of the Russian Federation of 29 January 2004 # 127-r and of 30 January 2004 # 127-r approves the list of representatives of top government authorities for nomination to **43** and **21** important joint-stock companies. The executive order of the Government of the Russian Federation of 23 January 2003 # 91-r, with approved list of representatives for **48** joint-stock companies. The executive order of the Government of the Russian Federation of 30 January 2001 # 114-r with approved list of nominated representatives to **91** important joint-stock companies.

REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN RUSSIA

Figure 17. Multiple sector model of organization structure of ownership of large State-owned companies (strategic PLCs)



92. The procedure for issuing directives in certain cases (e.g. for strategically important companies listed in the special register) may require a preliminary review by the Ministry for Economic Development of Russia and the Government of the Russian Federation.

93. It should be indicated that the status of the Government of the Russian Federation as a shareholder in joint-stock companies listed in a special register, approved by the Government of the Russian Federation, is defined by a Resolution of the Government of the Russian Federation, by the Chairman of the Government of the Russian Federation or, by delegation, by the Deputy Chairman of the Government of the Russian Federation.

94. The Federal unitary enterprises, government unitary enterprises and institutions are managed by means of the dual management model.

**Other Specialized Entities Involved in Exercise of Responsibilities of Owner of State-owned Companies**

*Russian Fund of Federal Property*

95. One of the most important State-owned company management stakeholders is the Russian Fund of Federal Property (RFFI). As mentioned above, this agency was established at the very outset of the privatization campaign. Its key functions are organization of the process of privatization, sale of Federal property, exercise of the rights of the owner in administering this property. For the exercise of these responsibilities RFFI is vested with ownership rights in respect of Federal property, including Federal share holdings. The ownership rights to any specific property assets are approved by the Government of the Russian Federation according to the current privatization plans. Upon approval of the ownership of the government share holding, RFFI in fact exercises its sole authority in managing this share holding on behalf of the Federal Government and in preparing it for sale. RFFI is also authorized to enter into transactions on behalf of the Federal Government on land parcels, as well as unowned property (e.g. items seized by the customs).

**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

96. Insofar as the exercise of the shareholder's responsibilities by the Federal Government is concerned, RFFI up until the sale of its shares retains the status of a shareholder and may exercise in compliance with the current legislation ownership rights on behalf of the Federal Government at the general meetings of shareholders (see Figures 15 and 16). As of the beginning of 2002 RFFI owned shares of 2,333 companies, including equity shares of over 50% - 299 holdings, 25% - 50% - 543 holdings, 10% - 25% - 692 holdings, 5% - 10% - 301 holdings, and less than 5% - 498 holdings. These data may serve as a benchmark for forecasting further privatization of Federal share holdings.

*Holding Companies*

97. Holding companies with a participatory interest of the Government were established pursuant to the Decree of the President of the Russian Federation of 1992. It should be noted that there is no definition of the concept of 'holding' in the Civil Code. The Decree prohibited setting up holding companies with total share of the output of the companies-members of the holding, exceeding 35% of the market. State-owned holding companies in the sector of retailing of manufacturing and technology products, agricultural production, catering business, as well as transport (except rail, pipeline and international haulage) were not allowed. In setting up financial holding companies responsible for management functions only, the Federal shareholdings transferred into the custody of the holding could be equal to no more than 20%. However, pursuant to the Decree of the President of the Russian Federation the following companies were exempt from the general rule: "UES of Russia", "TVEL" (production of fuel for nuclear power plants), "AKB Ilyushin" (aviation development and manufacturing), as well as coal mining companies.

98. In 1992 pursuant to the Decree of the President of the Russian Federation and the Resolution of the Council of Ministers "Gazprom" was established as a joint-stock company. The equity of this company was put together with transferred property of State-owned gas supply companies and 51% of shares of gas production service companies, as well as shares of some other companies. The government retained ownership of no less than 40% shares of the established company for the next 3 years. Subsequently State-owned companies incorporated by "Gazprom" were reorganized into joint-stock companies and became its subsidiaries. The employees of these subsidiaries were granted an opportunity to purchase at a reduced price about 15% of "Gazprom" shares, another 20% were sold for privatization vouchers. Later the participatory interest in the equity of "Gazprom" was limited to 9%.

99. 2003 saw the establishment of one of the largest Russian State-owned companies "Russian Railroads". The equity of the company is equal to RUB1,535,7 billion. The equity was formed of property assets of Federal unitary enterprises and institutions of the Ministry of Transport of Russia.

100. Overall, it should be noted that holding companies in the domain of power production and transport ensure technological security of the sector. Yet, practically all large companies are in need of reform, and most of them are either in the process of reforming their business ("UES of Russia"), or are planning on starting such reforms. These reforms are mainly designed to ensure access to transport utility and infrastructure of independent producers (carriers). However, it is also important to ensure protection of the rights of the shareholders in the process of restructuring of these companies, in particular, in respect of enabling pro rata exchange of shares of the holding company for shares of production (transport) enterprises spun off it.

**CHAPTER III  
RELATIONSHIPS OF STATE-OWNED COMPANIES WITH OTHER SHAREHOLDERS**

101. In Chapter I of this Report data are given as of 2004 on the structure of ownership of Federal companies (PLCs) and state-owned enterprises with a participatory interest of regional governments. In 89% of Federal joint-stock companies and in 83% of regional companies other shareholders are involved, i.e. non-government minority shareholders. In 77% of the Federal joint-stock companies and in 43% of the regional companies the Government itself is a minority shareholder. Therefore, protection of the rights of minority shareholders is an objective to pursue both for private investors, and for the Government.

**Box 4 "Greenmail" as flip side of rights of minority shareholders**

Cases of "greenmail" are commonly known (though very rare) in companies with a participatory interest of the Government. Moreover, some companies are known to engage in corporate attacks based on the rights of minority shareholders on a systematic "commercial" scale. In such cases the Government, as a general rule, unable to put the situation under control and "overpower" the opponents by procedural mechanisms, falls back on its administrative resources and exerts pressure on the minority shareholders to curtail their attempts to take over or immobilize the company. Nonetheless such examples are extremely rare in State-owned companies. However, for other companies "greenmail" is a constant threat of genuine disaster. Minority shareholders initiate action in courts in locations far away from the place of registration and business of the company, and the courts on various grounds rule in favor of the minority shareholders. They, for their part, taking advantage of the 'right' ruling of the court, seize control of the company by force.

With a view toward reducing abuses of corporate legislation, the Ministry of Economic Development of the Russian Federation circulated among ministries and departments its proposed draft amendments to the Arbitration Procedure Code, seeking to establish procedures whereby disputes on management and participatory interest would be examined only by Arbitration courts in places of business registration of the company. Only these courts would be expected to impose injunctions on the companies. And corporate disputes regardless of who acts as the plaintiff, a legal entity or a physical person, would fall under the sole jurisdiction of the Arbitration courts.

**General Legislative Framework**

102. Relationships between State-owned companies and non-government shareholders are regulated by the Civil Code, the laws "On joint-stock companies", "On securities market" "On protection of rights and legitimate interests of investors on securities market"; a number of important procedural provisions are contained in the resolutions of the Government of the Russian Federation of 3 December 2004 # 738 "On management of shares of public corporations owned by the Federal government and exercise of the special right of participation of the Federal government in management of public corporations ("golden share")" and # 739 "On powers of Federal administrative authorities in exercising their ownership rights with respect to property of State unitary enterprises".

103. The legislation of the Russian Federation does not provide any preferences in respect of the position of minority shareholders, if the majority shareholder is the Government of the Russian Federation. In such cases the regulator relies on the principle of equality of entities in civil transactions as established by the Constitution of the Russian Federation. The legislation of the Russian Federation



**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

contains general provisions designed to protect the rights of minority shareholders. The Supreme Arbitration Court has made rulings, which provide explanatory comments on the procedure of application by the courts of remedies to protect the rights of minority shareholders.<sup>15</sup>

**Consolidation of Role of Minority Shareholders in Decision Making by Board of Directors**

104. The rights of minority shareholders of State-owned companies are protected by a number of procedural provisions of the Federal Law "On securities market" and "On protection of rights and legitimate interests of investors on securities market". The law establishes the right of appeal against legality of securities issues on the grounds of alleged unfair practices, a procedure for disclosure of information to investors by Rosimuschestvo, a procedure for issuing a legal opinion on cases of protection of rights of investors, as well as preferential treatment of shareholders in the event of reorganization (Articles 18 and 19 of the Law) and other remedies to protect the rights of shareholders.

105. As regards membership of minority shareholders in the board of directors, it should be noted that the cumulative voting procedure enables the minority shareholders to concentrate their votes on a certain candidate and make sure their candidate is elected to the board of directors. However, the Russian legislation provides no special regulatory requirements in respect of mandatory allocation of a seat for a minority shareholder on the board of directors. Nonetheless, practical experience shows that the most efficient way to ensure representation of minority shareholders on the board of directors is setting up alliances.

106. As regards the exercise of the rights by minority shareholders, it should be noted, based on practical experiences, that very rarely would a majority shareholder (e.g. the government) waive any of its rights in favor of minority shareholders. If necessary, minority shareholders seek to consolidate their votes to ensure election of their representatives to the board of directors of joint-stock companies. As is the case with any other corporate proceedings, the government, in its capacity of a majority shareholder, takes advantage of isolation of minority shareholders in the voting procedure and thereby ensures the best possible representation for itself on the boards of directors and audit committees.

107. Yet, corporate legislation contains provisions which enable, and in certain cases, require representation of independent directors on the board of directors. The position of an independent director has been established in order to improve the performance efficiency of the board of directors, to enhance transparency of its decision-making process and to ensure protection of the rights of minority shareholders. The Law on joint-stock companies in case of an affiliated status of some of the directors in performing certain transactions makes provision for mandatory participation of an independent director in decision making on the said transaction (Article 77 of the Law "On joint-stock companies").

108. As a minority shareholder the Government had often faced problems with representation of its interests in the board of directors of joint-stock companies, having no opportunity to ensure election of at least one representative. The 2004 amendments to the Federal Law "On joint-stock companies"<sup>16</sup>, which establish that elections to the board of directors are carried out by cumulative voting, contribute to increasing the number representatives of the Government on the board of directors of a joint-stock company, in which the government has minority voting shares. Furthermore, the said rule also gives a chance, even with the size of the government's holding of 25% - 50%, to take steps to ensure election of a representative of the Government in addition to the statutory number of representatives pro rata its share (see below for more detailed description).

109. In theory a representative of the Government may vote to incorporate into the Articles the provisions that would grant to minority shareholders extra rights in addition to those already provided by

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<sup>15</sup> Note: Resolution of the plenary session of the Supreme Arbitration Court of 18 November 2003 # 19 "On issues of application of the Federal Law "On joint-stock companies"."

<sup>16</sup> Federal Law of 24 February 2004 # 5-F3 "On amendments to the Federal Law "On joint-stock companies".

**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

the corporate legislation, only if the representative is expressly directed to do so by the Government of the Russian Federation.

**Preemptive Right of Purchase of Shares**

110. In addition to the abovementioned remedies for the protection of the rights of minority shareholders, the Federal Law "On joint-stock companies" provides:

- Preemptive right of purchase of corporate shares (Articles 7, 40 and 41 of the Law);
- Right to claim buyout of shares in the event of change in control of the company (Article 80 of the Law) and some other provisions;
- Right to purchase shares at a lower price as compared with that offered for third parties (Articles 36 and 38 of the Law);
- Right to claim buyout of shares in the event of a large-scale transaction (Article 75 and 76 of the Law);
- Preferential treatment of shareholders in the event of reorganization (Articles 18 and 19 of the Law);

**Right of Access to Information**

111. The legislation of the Russian Federation makes provision for special rules regulating disclosure of information on individual transactions. However, the above rules are very general and are not designed solely for protection of the rights of minority shareholders.

112. An important requirement to information of the shareholders is disclosure of information on related party transactions. The directors and other persons described in the Law must disclose information about such a transaction to the company. In addition, the said transactions must be approved by the board of directors or the general meeting of shareholders. If the above requirements are not met, the transactions may be rendered null and void by a claim filed by the company or a shareholder.

113. Article 93 of the Law on joint-stock companies requires disclosure of information about affiliations.

114. There exist legal requirements to disclose information to the shareholders about any potential intention to buy out shares of the company and send a notice in writing to the shareholders about the upcoming sale of shares (Article 7 of the Law). For example, Article 80 establishes a procedure for disclosing information to the shareholders about any intention to buy 30% or more of the corporate stock. The said article also contains a requirement to buy out shares of the shareholders, who do not agree with the change in control of the company. Article 32 of the Law "On joint-stock companies" establishes a procedure for disclosing information on any pecuniary interest in transactions.

115. Joint-stock companies are required to publish corporate reports, as well as information on large-scale transactions and other fundamental economic and financial information. For more detailed description of the above aspects please read the section on accounting procedures of joint-stock companies.

116. In real life public listed companies take advantage of different procedures to demonstrate to portfolio investors the interest of the companies, and the Government as its major shareholder, in their input: more detailed disclosure of information in line with international standards, and transparent corporate governance procedures.

**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

**Indemnification**

117. It should be noted that the rights of minority shareholders can be protected by setting up various public organizations protecting their rights, as well as by means of the Federal indemnity fund, which was created pursuant to Article 19 of the Federal Law "On protection of rights and legitimate interests of investors on securities market" as part of the State Program of protection of rights of investors<sup>3</sup> in respect of payment of reimbursements to investors – physical persons.

**Minority Dominant Shareholder: Case of "Golden Share"**

118. In the case of "golden share" representatives of the Federal Government, or regional authorities, nominated to the board of directors (supervisory board) of a public corporation, participate in the general meeting of shareholders with a veto right in adopting resolutions on:

- Amendments and supplements to the Articles of the public corporation or approval of the Articles of the public corporation as amended;
- Reorganization of the public corporation;
- Liquidation of the public corporation, appointment of a liquidation panel, approval of the interim and final liquidation balance sheets;
- Changes in the equity of the public corporation;
- Large-scale transactions and related party transactions proposed to be performed by the public corporation as described in Chapters 10 and 11 of the Federal Law "On joint-stock companies".

119. An important distinctive feature of the special right "golden share" as addressed in the Russian legislation, consists in that this right can be terminated by resolution of the Government of the Russian Federation or by a regional government. Seats of representatives of the Federal Government or regional government on the board of directors are not counted for the election of the board of directors (supervisory board) and audit committee, which ensures a broader representation of the Government in the governing bodies of the joint-stock company.

REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA

CHAPTER IV  
OTHER STAKEHOLDERS IN CORPORATE GOVERNANCE

120. There is no legislative framework to support participation of employees of State-owned companies in management decision making. Employees are normally represented as minority shareholders. The exception constitutes executives and top managers who have taken advantage of the opportunity to acquire additional share holdings in the beginning of the privatization process. As major shareholders they participate in management decision making, and in general meetings of shareholders along with the other owners.

121. Strictly speaking employee-employer relations are regulated by the Labor Code, whereas the relations between the shareholder, the company and the board of directors are within the purview of the civil law. Thus, the legislation of the Russian Federation separates the responsibilities arising out of labor relations from those governed by the civil code based on their legal nature. Hence, the legislation on joint-stock companies should not contain any rules of law regulating labor relations, whereas the Civil Code, which covers the Law "On joint-stock companies", should not contain any rules of labor law.

122. Based on the above, it is necessary to indicate that "symbiosis" of labor and shareholder relations discussed below, constitutes an exception from the general rule and is, *sui generis*, unique for the Russian legislation.

**Legal Space Regulating Procedures of Participation of Employees of Public Corporations in Corporate governance**

123. As regards the right of representation of employees on the board of directors or transfer of shares into their ownership, it is necessary to make the following observations. Matters relating to the establishment of joint-stock companies with a majority share holding owned by the employees of the company are regulated by the Federal Law of 19 August 1998 "On distinctive features of the legal status of employees of joint-stock companies (people's enterprises)".

124. A people's enterprise may be established by reorganization of any business entity, except State unitary enterprises, municipal unitary enterprises and public corporations whose employees own less than 49% of the corporate equity.

125. The number of employees, who are not shareholders of the people's enterprise, in one financial year, must not exceed 10% of the payroll employees of the people's enterprise.

126. The Law on people's enterprises also establishes a mechanism of protection of the right of minority shareholders to representation on the supervisory board. Para 7 of Article 12 of the Law on people's enterprises establishes that in a people's enterprise with a payroll of employees over one thousand persons and if over 2% of them are not shareholders of the company, one representative of non-shareholders, elected by the general meeting of non-shareholders, must have a seat on the supervisory board.

127. As mentioned in Chapter I of this study "people's enterprises" have not gained any substantial ground in Russia.

REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA

**Creditors' Rights in Reorganization and Insolvency/Bankruptcy Procedures**

128. One mechanism to support transparent and *bona fide* relations with creditors consists in mandatory disclosure of information, as required by Article 92 of the Law "On joint-stock companies". One other element to support fair and transparent relations with creditors is the responsibility for notification of the creditors about the upcoming reorganization of the company (Article 15 of the Law "On joint-stock companies"). The company is required to notify in writing the creditors of the company and publish information about the adopted decision in a specialized publication containing data on State registration of legal entities. Compliance with the above requirements is enforceable under the Law "On joint-stock companies", since State registration is conditional on submission of proof of notification of the creditors.

129. The bankruptcy law establishes a set of procedures to ensure protection of the rights of creditors in the event of insolvency/bankruptcy of organizations (with certain special conditions pertaining to lending institutions). However, there are some distinctive features specific for strategically important enterprises.

130. The Law on bankruptcy lists strategically important enterprises and organizations in a special category (Federal unitary enterprises, joint-stock companies and other forms of ownership – in total 1,100 organizations), one of the qualification criteria being shares owned by the Federal Government and Federal ownership of property of companies.<sup>17</sup> With all other indications unchanged, the term of overdue arrears has been extended from three to six months. To initiate a bankruptcy case for strategically important companies and organizations all claims charged against such debtors must amount in total to no less than RUB 500,000, and not RUB100,000 as provided in the general rule (para 2 Article 6 of the Law).

131. As required by law the Government takes additional steps to prevent bankruptcy of enterprises, and to ensure monitoring of their financial condition. The Government undertakes to offer State guarantees to restructure the liabilities of the said companies to their creditors, as well as to provide financial assistance (subsidies or loans) as part of the pre-trial reorganization. The main reason for adopting this mode of regulatory intervention was non-performance or undue performance under the obligations of the government to pay for delivery under the government contract, which, in its turn, contributed to building up the debt liability of these companies to their suppliers.

132. Yet, not all of the strategically important organizations are joint-stock companies, and even if some of them are, they may not have a large majority shareholding owned by the Government. In this context it may not be legitimate to maintain that such rules constitute a distinctive feature of bankruptcy procedures designed for joint-stock companies with a large share holding owned by the Government. Very many joint-stock companies with a majority share owned by the Government remain outside the purview of this regulatory rule.

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<sup>17</sup> Courtesy: List of strategic enterprises and organizations approved by the Decree of the President of the Russian Federation of 4 August 2004 # 1009, and the Executive Order of the Government of the Russian Federation of 9 January 2004.

REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA

CHAPTER V  
TRANSPARENCY AND DISCLOSURE OF INFORMATION

133. Transparency and reputation of companies constitute a pledge of their investment attractiveness and expand borrowing opportunities. Corporate legislation addresses disclosure of information on joint-stock companies to a large extent. Yet, it should be noted that far from all State-owned companies, joint-stock companies or Federal unitary enterprises can go public because of their specific business characteristics.

*Structure of Financial and Economic Reporting, Accounting Statements and Special Reports*

134. Reporting documents of State-owned companies include all groups of accounts of companies operating on the territory of the Russian Federation, as well as special forms of reporting designed specifically for unitary enterprises.

135. Federal unitary enterprises and regional unitary enterprises submit the following mandatory reports of the State national accounts.

136. Reports approved by the Federal Government:

- Financial and tax reporting;
- General statistical financial and economic reports;
- Sectoral statistical financial and economic reports;
- Reports of recipients of budget funds.

137. Reports approved by the Federal Government for Federal unitary enterprises and by regional governments for regional unitary enterprises are as follows:

- Reports of Managing Director of Federal unitary enterprise or regional unitary enterprise;
- Reports describing property transferred to Federal unitary enterprises or regional unitary enterprises;
- Sectoral reports of sectoral administrative body of Federal Government or regional government.

138. Schematic structure of the above reporting is given in Table 4.<sup>18</sup>

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<sup>18</sup> *Courtesy: A. Radygin, A. Gazetov et al. // Reforming unitary enterprises in the Russian economy: industrial and regional aspects - Moscow. IEPP, 2004 (prepared based on materials of the research project sponsored by USAID)*

## Russian Corporate Governance Roundtable Meeting

### REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN RUSSIA

**Table 4. Contents of reporting of State-owned companies (Federal unitary enterprises, regional unitary enterprises, joint-stock companies)**

Financial and Parties in business activities	Reporting groups					
	Financials and tax	General statistics	Recipient of budget funds	Manager of FUE / Govt Rep in JSC	Property	Sectoral
Activities	X	X	-	X	-	X
Profits/Losses	X	-	X	X	-	-
Income/Expense	X	-	X	X	-	-
Cost of production	X	X	X	X	-	X
Debt	X	X	X	-	-	-
Property/Investments	X	X	X	X	X	X

139. It should be noted that in general the above statistical data can provide almost all characteristics to describe performance of the company; yet, currently there are no standardized techniques to regulate this analysis.

#### *Disclosure of Reporting Information per Corporate Legislation*

140. The following information is subject to mandatory disclosure:

- Annual report of the company, annual accounts (the Procedure for publication of accounting statements by public corporations is approved by Executive Order of the Ministry of Finance of 28 November 1996 # 101);
- Prospectus for issue of corporate shares;
- Account of general meetings of shareholders;
- Number of registered shareholders;
- Net assets to equity ratio;
- Information about affiliated entities/persons.

141. The reliability and accuracy of data contained in the annual report of the company must be verified and confirmed by the audit committee (Auditor) of the company. In addition, prior to the publication of the said documents the company must invite an auditor with no vested interests in the company or its shareholders for review and approval of the annual financial accounts (Article 92 of the Law "On joint-stock companies" and the Federal Law of 7 August 2001 # 119-F3 "On auditing activities").

142. The Law "On joint-stock companies" also requires mandatory disclosure of the following information<sup>2</sup> by companies, including closed joint-stock companies, in cases of public offering of corporate bonds or other securities:

- Data on reorganization of the issuer, its subsidiaries and affiliated companies;

**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

- Data on developments that may have resulted in an increase or reduction of the value of assets of the issuer by more than 10%;
- Data on developments that resulted in an increase of net profit or net losses of the issuer by more than 10%;
- Data on individual transactions performed by the issuer, whose size or the value of assets transacted constitutes 10% or more of the total value of assets of the issuer on the date of the transaction;
- Data on acquisition by the company of a 20% share in another company, as well as on every 5% share of the same company over and above the 20% already acquired<sup>19</sup>.
- Data on securities issued by the issuer;
- Data on accrued and/or paid out dividends on the issuer's securities;
- Data on listing in the issuer's register of a person owning over 25% of its securities of any individual class;
- Data on maturity schedules the issuer is required to comply with;
- Data on resolutions of the general meetings;
- Data on approval of the authorized agency of the issuer to issue securities.

143. Article 11 of the Law "On joint-stock companies" establishes disclosure requirements for information about affiliated persons, involved in a transaction, as well as about their pecuniary interest in the said transaction. The consequences of non-compliance with these regulations may be very dramatic, including rendering the transaction null and void.

144. Moreover, data on the Registrar of securities and on the Register maintenance procedure of the joint-stock company are subject to publication.

***Preliminary and Summary Reporting***

145. Reporting of a company can be classified into information about the plans of development and accounts of actually achieved results. Target indicators of development of State-owned companies prescribed by the Government are normally not achieved (as distinct from the centrally planned economy in the Soviet times). The divergences between the plan and the actual output are mainly a function of the quality of performance of the economic and financial services of the company.

146. In real life pressure is exerted on the State-owned companies primarily to ensure they account to the asset owner in due procedure. In the late 90-s the Government was not informed about the performance of many State-owned companies.

147. The Federal authorities are required to supervise utilization of the property controlled by the company, to analyze the efficiency of management performance by engaging specialized organizations, when appropriate, as well as to determine proposed sizes of dividends on shares of joint-stock companies

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<sup>19</sup> Note: Resolution of Federal Commission for Securities Market of Russia of 14/05/1996 # 10 "On procedure of publication of data on acquisition of over 20% of voting shares in another company"



**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

for voting by the representatives of the Federal Government on the board of directors of the said companies.<sup>20</sup>

148. The guidelines for the organization and performance of economic assessment of performance efficiency of Federal unitary enterprises and public corporations with a participatory interest of the Federal Government have been approved. The above guidelines require more stringent control on the part of the Government over transactions involving property, as well as over generation of profits accruing to the property owner (for Federal unitary enterprises and regional unitary enterprises), or dividends (for public corporations)<sup>21</sup>. It is common knowledge that most of the regional governments of the Russian Federation have adopted similar policies for management of shares in their ownership, but no centralized review of such documents has yet been undertaken.

149. A procedure for the examination of target indicators and data actually reported is given in Figures 18 and 19. The established procedures are based on the dual and Multiple sector management models for State-owned companies (see Chapter II hereof).

150. A few comments on accounting of government institutions. Institutions and organizations file their accounting statements with their superior budget fund managing authority. The principal Federal budget fund managers submit consolidated accounting statements to the Main Department of the Federal Treasury and to the relevant departments of the Ministry of Finance of the Russian Federation.

151. The annual and quarterly accounting statements of institutions and organizations include commentary on performance of the income and expense estimates, which describes the key factors that affect the performance of the income and expense estimates for the budget funds and funds received from off-budget sources, as well as indicates the amounts of budget funds left over, data on inventory stock and the status of the settlement items on the balance sheet.

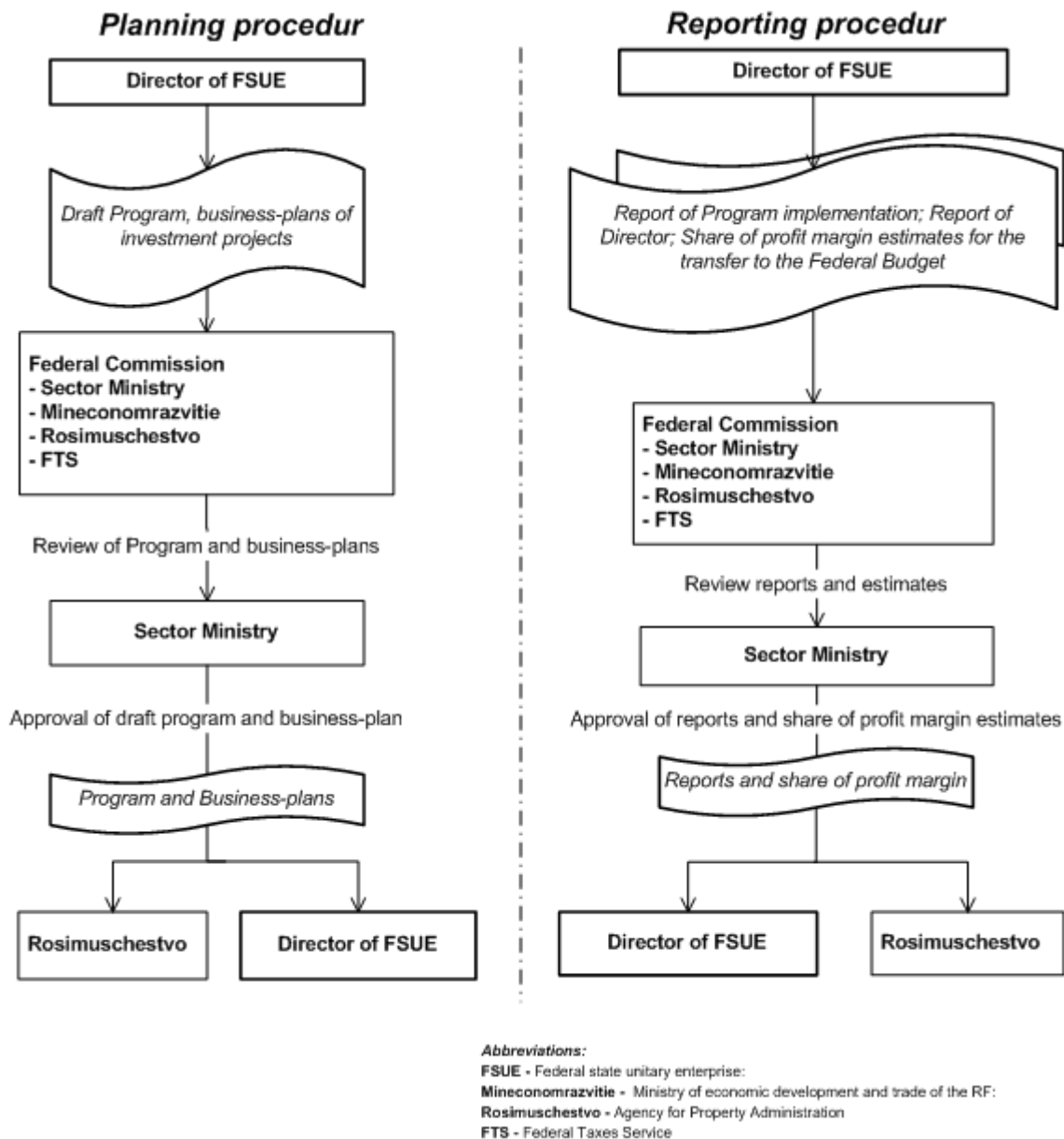
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<sup>20</sup> *Note:* Resolution of the Government of the Russian Federation of 3 February 2000 # 104 "On introduction of additional controls over the Federal unitary enterprises and management of Federal shares in public corporations"

<sup>21</sup> *Note:* Executive Order of the Ministry of Property Administration of Russia of 10 July 2000 # 183-r

REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN RUSSIA

Figure 18. Procedure for planning and review of performance of Federal unitary enterprise



Major Issues of Accounting

152. The regulations of financial and statistical reporting for public sector enterprises are not expressly different from those in private sector. The problems, State-owned enterprises face in this domain, are similar to those, other Russian major public companies have to deal with, and are as follows:

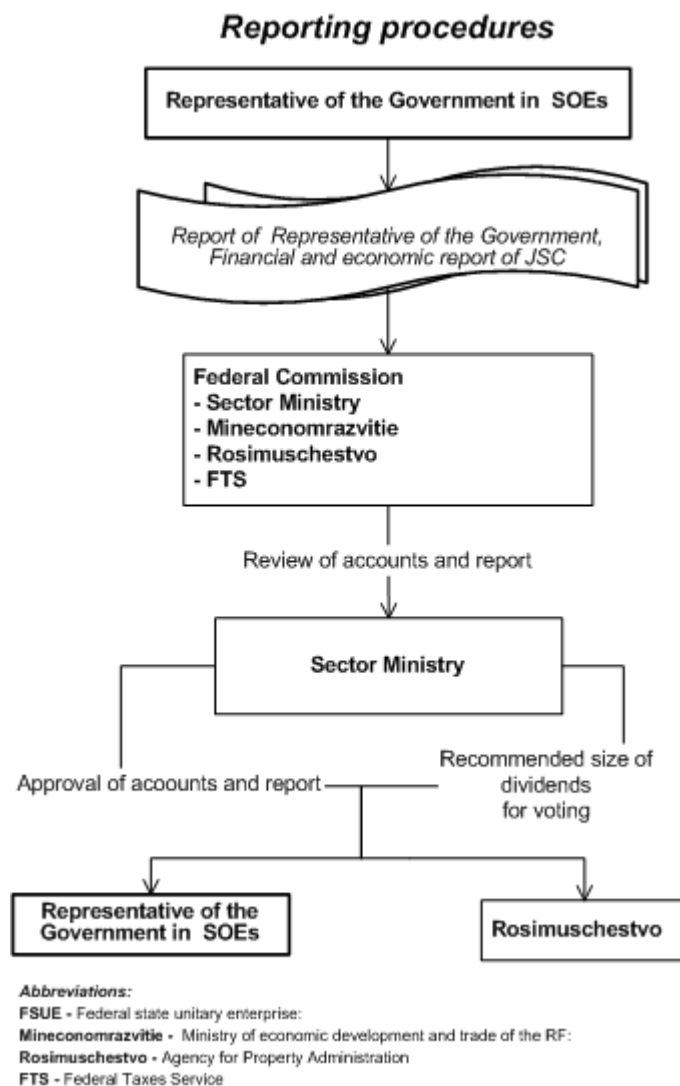
- Inadequate system of financial accounting standards;
- Strong pressure of tax implications on the indicators of financial statements;
- Strictly technical approach to disclosure of additional information;
- Inadequate control and responsibility for submission of reports;

REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN RUSSIA

- Inadequate hardware and procedures for collection, storage and processing of data coming from State-owned enterprises.

153. One of the top priorities is adoption of the International Financial Reporting Standards for compiling financial statements, which will facilitate ensuring transparency and comparability of performance indicators of public sector enterprises.

Figure 19. Procedure for evaluation of performance of Government representative on board of directors of public corporation



154. To provide access to adequate and real-time information on the performance of State-owned enterprises with the Government exercising its ownership functions, it appears extremely important to implement a management accounting system in public sector enterprises both for developing indicators for strategic planning, and for real-time control of performance of State-owned enterprises.

155. Another very important driver of improving controls over performance of State-owned companies is a system of industry-specific performance indicators. These indicators should show the efficiency of implementation of the goals and objectives specified in the Articles of Federal and regional unitary

**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

enterprises, as well as public corporations.<sup>22</sup> These industry-specific performance indicators enable directors to quickly access the necessary performance information in a multitude of various forms of statistical observations and accounting data and get an unbiased picture for making strategic decisions for their further business activities.

*Disclosure of Financial Information*

156. Accounting documents must be accessible and available for review by the shareholders (shareholder) with an aggregate shareholding of at least 25% of voting shares of the company. In case special right of participation ("golden share") is exercised by the Federal Government, regional governments of the Russian Federation or municipalities, their representatives must be entitled to uninhibited access to all documents of the company.

157. The annual report of a joint-stock company with a participatory interest of the Government is subject to approval by the executive management body of the company no later than 30 days prior to the annual general meeting of shareholders.

158. Quarterly and annual accounts are submitted by joint-stock companies according to schedules established by the accounting legislation, i.e. within 30 and 90 days from the end of the accounting period.

159. Joint-stock companies, whose shares are owned by the Federal Government, disclose additional non-financial information in compliance with the legislation on securities market. Disclosure of information by the issuer of securities is carried out in the form of Prospectus, quarterly reports of the issuer and statements about fundamental changes affecting the financial and economic operations of the issuer.

160. Information must be disclosed by joint-stock companies with a participatory interest of the Government in accordance with the legislation on securities market and joint-stock companies, and is normally posted on corporate websites of the companies.

*Management and Corporate Governance Reporting*

161. Reports of managing directors of Federal (regional) unitary enterprises or of government representatives in public corporations (Figures 18, 19) should contain the following information:

- Data on profits (losses);
- Data on accounts payable/receivable;
- Indicators of liquidity and financial stability;
- Data on value of net assets;
- Data on real estate of company unused for business purposes;
- Data on indications of likelihood of bankruptcy.

The representative of the Government in the governing bodies of a public corporation needs additional non-financial information on:

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<sup>22</sup> *Note:* For more detailed description of the need for estimation and monitoring based on industry-specific performance indicators see the Report of TACIS European Expert Service, Project RF-40 "Improving Efficiency of Management of State and Municipal Unitary Enterprises", Moscow, 2001, GBRW. EA-Ratings - Standard&Poors.

REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA

- Participation in general meetings of shareholders (annual and extraordinary or special);
- Participation of representative in meetings of the board of directors (supervisory board) ;
- Control exercised by representative to supervise payment of dividends by public corporation.

162. State-owned enterprises submit their reports and accounts, as required by law, to their duly authorized government agencies in hard copy.

*Aggregated Accounts of Performance of State-owned Companies*

163. The Budget Code of the Russian Federation contains specific requirements to compiling consolidated financial plans of public sector companies. These requirements are based *inter alia* on the need to project estimated profits from the performance of State-owned companies, revenue from privatization transactions, sale of interest in companies and other proceeds. Nonetheless, there are common tasks of forecasting future social and economic development objectives of the Russian Federation, including the need for estimating production outputs for staple industrial products, investments, employment and other public sector performance indicators.

164. The only consolidated documents describing the performance of public sector companies are plans (programs) of privatization, as well as information provided by Rosimuschestvo and RFFI for drafting resolutions of the Government on nomination of representatives to the boards of directors, consolidated information on estimated profits, outcome of bidding by auditing companies, etc. The current quality of these data prevents full compliance with the requirements of the Russian legislation.

165. Moreover, the responsibility for performing statistical observations also rests with Rosstat. More detailed information on the process of adoption of the new methodology of statistical observations to enable monitoring of the process of development and the current status of the public sector is given in Box 5.

Box 5. On improvement of statistical observation of public sector companies

Rosstat has embarked on implementation of the statistical **Classifier of Institutional Units (CIU)**, which subdivides the Russian economy into groups of business entities.

**CIU** is designed for classification and coding of institutional (local) units by their respective sectors, which enables development of macro-economic indicators for the institutional sectors and assessment of *inter-sectoral* flows in the economy.

The basis of the concept of "local unit" in Russia was provided by the requirements of EUROSTAT given in its **Guidelines on Registers** and used in international statistics, as well as the definition of self-contained divisions in accordance with the requirements of the Tax Code of the Russian Federation (p. 11) and used by tax authorities.

Implementation of the Classifier already started earlier in 2005. Based on the CIU the national accounts of the system of State statistical observation will be calculated and published for institutional sectors of the economy based on performance indicators in 2006, including for public sector enterprises.

*Other Methods of Disclosure*

166. One of the most important sources of information on the performance of companies is a corporate website. However, overall information on the performance of public sector companies is accessible on the websites of certain Government departments.

**Russian Corporate Governance Roundtable Meeting**

**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN RUSSIA**

**Table 5. Examples of website content on government property administration**

<b>Description</b>	<b>Website address</b>	<b>Content</b>	<b>Quality</b>	<b>Translation into other languages</b>
Russian Fund of Federal Property	www.fpf.ru	Annual reports, plans, information on bidding requirements for state property privatization, regulatory documents on state property administration, contact information.*	Informative, user-friendly interface	N/A
Federal Agency for Property Administration ("Rosimuschestvo")	http://www.rosim.ru	News of state-owned enterprises, annual reports, plans, regulatory legislation, contact information.	Informative, user-friendly interface	N/A
Ministry of Economic Development	http://www.economy.gov.ru/wps/portal/	Performance reports; reviews, prepared by subordinate government authorities; news, including about state-owned enterprises. Log-in system.	Very informative	Choice of languages from an extensive list in logging in. Public information is not translated into other languages.
Ministry of Energy	http://www.mte.gov.ru/	Website under construction	-	N/A
Ministry of Industry, Science and Technologies	http://www.mpnt.gov.ru/	Website under construction	-	N/A

\* - Websites of above ministries

***External Audit***

167. Engaging auditing firms by State-owned companies (public corporations and LLCs) requires consent of the directors, i.e. the Government. Contracting auditing organizations by Federal or regional unitary enterprises is also a mandatory requirement, and should be based on competitive bidding. Evaluation panels must include representatives of "Rosimuschestvo" and relevant sectoral ministries. Another important criterion to go by in inviting audit firms is availability of security clearance to information on state-owned companies operating in the defense and national security sector.

**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

**CHAPTER VI  
DIRECTORS OF STATE-OWNED ENTERPRISES**

*Size of Board of Directors in State-owned Companies*

168. The Government of the Russian Federation, regional governments or municipalities may be represented on the boards of directors of joint-stock companies, whose shares are owned by the Federal Government or municipalities, by alternate government or municipal officials, or by private persons under a contract with the Government<sup>23</sup>.

169. In 2000 the total number of representatives of the Government of the Russian Federation was equal to 3,217 persons. Out of that number 1,178 were Federal Government officials, 1,677 – regional government officials. Compared to 1997 the total number of such representatives increased by over 50%. The growth in the number of representatives of the Government was triggered by the new draft of the law on privatization, which requires the numerical representation of the Government to be pro rata its share in the equity plus three more persons.

**Table 6. Structure of community of government representatives as of 2000**

Description of Representative	Number of persons
Government officials	2855
Persons contracted to represent interests of Government of Russian Federation on boards of directors	362
<b>TOTAL:</b>	<b>3217</b>

*Courtesy:* Ministry of Economic Development of the Russian Federation, Rosimuschestvo, RFFI, 2005.

170. It is noteworthy that today still about 90% of the total number of representatives of the interests of the Government of the Russian Federation constitute government employees. In the regions and municipalities the above number is even higher.

*Membership of Board of Directors*

171. In joint-stock companies, in respect of which the Government of the Russian Federation and regional government authorities exercise their special right of participatory interest in management ("golden share")<sup>24</sup>, the Government is represented on the boards of directors by government employees, because according to the Federal Law "On privatization of State-owned and municipal property"<sup>25</sup> only government employees may be appointed as representatives of the Government of the Russian Federation or regional governments. The government representatives are selected from candidates nominated by

<sup>23</sup> See sub-para 3 of para 1 Article 39 of the Federal Law "On privatization of State-owned and municipal property".

<sup>24</sup> Currently in 283 companies out of 563 public corporations where the special right ("golden share") is provided, there are no Federal shares, and only the special right is exercised.

<sup>25</sup> See sub-para 1 para 2 Article 38 of the Federal Law "On privatization of State and municipal property".

**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

appropriate shareholders, i.e. the Government of the Russian Federation, regional governments or municipalities.

172. For joint-stock companies, whose shares are owned by the Government of the Russian Federation, regional governments or municipalities, the regulatory requirements to the status of the representative are not so stringent. Persons, not actually government employees, may be contracted to sit on the board of directors.

*Government Representatives*

173. The said representative is an official representing the position of the Government as a shareholder on an issue currently under consideration in the company, based on the directives and by virtue of the powers of attorney of a Government agency ("Rosimuschestvo").

174. Private individuals representing the interests of the Government of the Russian Federation in the governing bodies of joint-stock companies, provide services on the basis of civil contracts for a remuneration. An important requirement of such contracts is as follows: representatives of the Government in the governing bodies of joint-stock companies are required to obtain written approval of the authorized government agency for voting on agenda items of the board of directors in cases defined by law<sup>26</sup>.

175. A model agreement is available for representation of Federal interests in the governing bodies of joint-stock companies (business partnerships), some of whose shares (interest or contributions) are owned by the Federal Government, and a procedure for execution and registration of such agreements. The above contracts are executed by a special commission on contracts for representation of interests of the Government of the Russian Federation in governing bodies of public corporations, whose shares are owned by the Federal Government<sup>27</sup>.

176. The following numbers of contracts have been entered into in due procedure: in 2001 – 103, in 2002 - 23 contracts with 11 representatives, in 2003 - 19 contracts with 10 representatives of the interests of the Russian Federal Government, in 2004 – 210 contracts with 67 representatives of the interests of the Government.

*Process of Election/Nomination to Board of Directors*

177. The Government of the Russian Federation holding a share in the joint-stock company of no less than 2% is entitled to nominate its candidates to the management body and to the position of the sole executive officer of the company. The nomination of candidates (in the form of proposals to the joint-stock company) is the responsibility of "Rosimuschestvo" (dual management model – Figure 17).

178. There is also a special procedure regulating decision making for strategically important companies (Multiple sector model – Figure 18). These enterprises must be listed in a special register approved by the Government of Russia.<sup>28 29</sup>

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<sup>26</sup> Agenda items on which voting by the representatives requires instructions from the authorized government agency, are given in para 17 of the Regulations "On management of Federal shares in public corporations and exercise of the special right of participation of the Government of the Russian Federation in management of public corporations ("golden share")".

<sup>27</sup> The statute of the Commission was approved by the Ministry of Property Administration of the Russian Federation by its executive order of 19/06/2000 # 93-r.

<sup>28</sup> At present it is the executive order of the Government of the Russian Federation of 23 January 2003 # 91-r, with approved registers containing 48 joint-stock companies.

<sup>29</sup> Currently it is the Decree of the President of the Russian Federation of 4 August 2004 # 1009.



## Russian Corporate Governance Roundtable Meeting

### REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN RUSSIA

179. For these joint-stock companies the position of the Government of the Russian Federation on the nomination of candidates to the board of directors is determined by the Office of the Government of the Russian Federation, and not by "Rosimuschestvo"<sup>30</sup>.

180. As a general rule, in accordance with Article 66 of the Law "On joint-stock companies" directors are elected at the general meeting of shareholders by cumulative vote. The number of votes is multiplied by the number of directors. However, a company with the number of shareholders with voting shares exceeding 1,000 should have no less than 7 persons on the board of directors, and a company with 10,000 voting shares – at least 9 directors.

181. Election to the board of directors of such companies is carried out according to the general rule with only one exception. The number of nominees to the board of directors of State-owned companies does not include those nominated by the Government of the Russian Federation or by the regional government. For nominating candidates to the board of directors of joint-stock companies, whose shares are owned by the Federal Government, the following rule applies: The number of candidates, nominated by the Government of the Russian Federation for incorporation into the list for election to the board of directors, must contain 3 more persons on top of the number corresponding to the share of the Government of the Russian Federation in the equity of the joint-stock company<sup>31</sup>

182. This requirement is designed to ensure election to the board of directors of the number of representatives corresponding to the share of the Government of the Russian Federation in the equity of the joint-stock company. Thus the following model applies: pro rata number of shares + 3 seats (Table 7).

**Table 7. Government representatives on boards of directors of State-owned companies (dual and Multiple sector models)**

Number of Govt representatives	Multiple sector model	Dual model
<i>Pro rata shares + 3 seats</i>	Russia (over 1,000 shareholders – at least 7-directors, over 10,000 – at least 9 directors)	

*Courtesy:* Ministry of Economic Development of the Russian Federation, Rosimuschestvo, RFFI, 2005.

#### *Peculiarities of Electing Directors*

183. One distinctive feature of the legal status of joint-stock companies with the special right of "golden share" consists in the fact that representatives of the Government of the Russian Federation, regional governments nominated in due procedure to the board of directors are included into the membership of the board of directors, and the seats of the representatives of the Government of the Russian Federation or regional governments are not counted in the election of the board of directors. Thereby the government ensures its membership on the board of directors regardless of the size of its share holding.

<sup>30</sup> The Government of the Russian Federation annually issues executive orders to approve lists of candidates for the nomination to the board of directors for each of the joint-stock companies listed in the special register. The current executive orders of the Government of the Russian Federation are dated 29 January 2004 # 126-r and 30 January # 127-r.

<sup>31</sup> Sub-para 5 para 9 of the Regulations on management of Federal shares in joint-stock companies and exercise of the special right of the Government of the Russian Federation to participate in management of public corporations ("golden share"), approved by the Resolution of the Government of the Russian Federation of 3 December 2004 # 738.

**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

***Remuneration to Representatives on Boards of Directors***

184. Remunerations for the directors are addressed in para 2 of Article 64 of the Federal Law "On joint-stock companies", which establishes a procedure, whereby it is determined by the general meeting of shareholders that the directors during their term of office on the board of directors may be entitled to remuneration or reimbursement of expenses sustained in the line of their duty. The size of such remuneration or reimbursements is determined by the general meeting of shareholders.

185. Practical experience of payment of remuneration to directors is extremely limited. In the overwhelming majority of cases joint-stock companies have adopted the arrangement for reimbursing the directors' expenses made in the course of discharge of their duties. Yet, remunerations are paid in negligible amounts, if at all.

186. It is especially true with respect to non-executive directors, i.e. directors who are not on the management team of the company. The reason is most shareholders see little value in non-executive directors and believe that their job should be paid by those who cast their votes for them. Such an attitude makes independent directors "dependent" on individual groups of people and undermines their ability to take unbiased balanced decisions in the best interests of the company as a whole. At the same time some majority shareholders, interested in the growth of capitalization of their companies, and to achieve these objectives make sure independent directors are elected to the board of directors, begin take steps to introduce a system of payment for their work.

187. The size of the remuneration should be determined based on the evaluation of the performance of the board of directors as a whole and of the output of each director, including the Chairperson. The Corporate Code of Conduct contains the following guidelines on payment of remuneration to the directors:

- It is recommended to pay remuneration in equal amounts to all directors.
- It is recommended to pay uniform remuneration to all directors, regardless of his/her status, i.e. executive, non-executive or independent director.
- Criteria for the determination of the size of remuneration of directors must be elaborated by the committee on human resources and remuneration of the board of directors for the final review and approval by the board of directors. Since the above criteria affect in a significant way the performance of the board of directors, it is recommended to incorporate them into the in-house regulations on the performance of the board of directors. Thereby a transparent mechanism of control accessible to the shareholders will be put in place for the supervision of performance of the directors and determination of their remuneration.
- It is recommended to reflect in the annual report of the company the results of performance of the board of directors, as well as data on the total amount paid out to the directors as remuneration and/or reimbursement of expenses.

188. As regards remuneration of directors, who are representatives of the Government, the following should be taken into consideration. Pursuant to the Federal Law of 31 July 1995 # 119-F3 "On fundamentals of public service in the Russian Federation", government employees are not allowed to engage in any activities for remuneration other than teaching, academic and creative activities.

189. Thus, representatives of the Government on the board of directors in their capacity as government employees are not entitled to any remuneration in the company for their work on the board of directors. As a result of the approval of remuneration to be paid to the directors, it does not accrue to the

**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

government employees and is not paid out; the amounts allocated for the purpose, are retained by the company.

190. The above restrictions do not apply to private individuals hired under contract to represent interests of the Government of the Russian Federation in the governing bodies of joint-stock companies.

191. According to the legislation on pension plans, all legal entities and entrepreneurs engaged in business activities are required to allocate their regular social contributions to the Pension Fund of the Russian Federation. The procedure for provision of pension plans is established by the Federal Law of 15 December 2001 # 166-F3 "On provision of pension plans in the Russian Federation".

***Board of Directors***

*Procedures and Regulations of Board of Directors*

192. The activities of representatives of the Government of the Russian Federation and representatives of the interests of the Government are defined by the Regulations on management of Federal shares in public corporations and exercise of the special right of participation of the Government of the Russian Federation<sup>32</sup>.

193. In conformity with the said Regulations, on certain key issues relating to the operations of the joint-stock company, which are normally dealt with by the board of directors<sup>33</sup>, voting is performed on the basis of directives. The above issues are as follows:

- Identification of top-priority business projects;
- Calling of general meetings of shareholders;
- Approval of the agenda;
- Increase of the company's equity;
- Establishment of management bodies and termination of their office;
- Approval of business transactions;
- Payment of dividends;
- Election (re-election) of the Chairperson of the board of directors, for the representatives of interests of the Government of the Russian Federation and representatives of the Government of the Russian Federation on the board of directors.

194. The above directives to the said representatives are issued (approved) by an authorized Federal government agency. "Rosimuschestvo" is the agency duly authorized by the Government of the Russian Federation (dual model).

195. For joint-stock companies listed in the special register, approved by the Government of the Russian Federation, the directives issued to the representatives of interests of the Government of the Russian Federation and representatives of the Government of the Russian Federation on the board of

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<sup>32</sup> Note: The Regulations approved by the Resolution of the Government of the RF of 3 July 1998 # 738

<sup>33</sup> As per para 17 of the Regulations on management, such issues are listed in para 1 of Article 65 of the Law "On joint-stock companies" (items 1, 2, 3, 5, 6, 7, 9, 11, 15).

REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA

directors of the said joint-stock companies, are approved by the Government of the Russian Federation (Multiple sector model). "Rosimuschestvo" is required to review and approve the positions on all of these items (see Note 6).

196. There are no specific requirements in the legislation with regard to any minimum number of meetings of the board of directors to be called in one year. However, according to the Regulations on conduct of meetings of the board of directors in strategically important enterprises the meetings are called **at least once every three months**.

Box 6 Example of conduct of business on board of directors in companies with a participatory interest of the Government

Public corporation "Transneft" (hereinafter "Transneft") is engaged in transportation of oil by cross-country oil pipelines, as well as their construction and operation. This enterprise is, in fact, a monopoly service provider in the sector of cost-effective pumping of oil by pipelines. Its assets are structured as follows: 75% owned by the Government of the RF, which is equivalent to 100% of voting shares. 25% of the equity are preferred shares. The company is listed in the register of strategically important enterprises and is managed on the basis of the Multiple sector model.

The fight for the dividends payable for the company performance in 2004 began as far back as in April 2004, i.e. right after the first quarter, during which the financial statements of the company are published.

The top management of the company, appointed by the Government of the Russian Federation, announced the following performance results: net profit had grown against 2002 by 17.8% up to RUB15,845,000,000 (USD556,000,000), and the revenue amounted to RUB118,152,000,000 (USD4,145,700,000) (according to IFRS profit in 2003 amounted to RUB30,560,000,000 and the revenue, to RUB114,160,000,000). The difference between the net profit and the revenue numbers according to the Russian accounting standards is very large.

According to its Articles the monopoly must allocate 10% of its non-consolidated net profit for payment of dividends on preferred shares. It means, that the payments in dividends to the owners of preferred shares for 2003 should amount to RUB1,584,000,000. This amount is unprecedented, since based on the performance results in 2002 the owners of preferred shares received RUB1,344,000,000, and for 2001 - RUB1,400,000,000.

On common stock (75%) "Transneft" was going to pay out for 2003 about RUB1,300,000,000. It means that for 75% of the equity the amount allocated for payment of dividends was 22% less than in the case of payment for 25% of the equity.

Comments of government representatives on this situation were divergent. The representative of the "core" ministry (Ministry of Energy) spoke in support of the proposed level of dividends based on the assumption that any further increase in the size of the dividends may negatively impact on the investment policy of the company. The Federal Service on Tariffs cautioned that an increase in the dividends would lead to higher oil transportation charge rates.

Nonetheless, the final size of the dividends is determined by the Government of the Russian Federation in the form of a directive, approved by the Ministry of Economic Development and Ministry of Property Administration. These two departments favored increased dividends. The Ministry of Economic Development backed doubling of the dividends, approximately up to RUB2,377,000,000, and the Ministry of Property Administration - up to RUB1,600,000,000.

In the final analysis pursuant to the directive signed by the Prime Minister 27 August 2004 the general meeting of shareholders was called and the sole shareholder owning 100% of voting shares, represented by

**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

the Federal Agency for Property Administration, decided in favor of the dividends for 2003 to be paid out by the company as follows:

on preferred shares - RUB1,584,000,000 (USD55,600,000)

on common shares – RUB 2,377,000,000 (USD83,400,000)

Thus the position of the Ministry of Economic Development was enforced.

It should also be noted that at the general meeting called 27 August some related party transactions were approved, as well as amendments to the Articles and to the regulations on the board of directors of the company. These amendments were submitted by the Board of directors of the company.

Yet, next September the term of office of the Chief Executive Officer (Semen Vainshtok) was expiring. However, the decision to extend his term was not adopted at that meeting. The Government withheld its approval of extension of the office of the Chief Executive Officer up until a positive decision on the payment of dividends. In short, the fight for the dividends was fierce enough. The extension of the term of office of the Chief Executive Officer was granted, if only a bit later.

*Courtesy: Annex to Chronicle of Federal Service on Financial Markets // N 036 pgs 45,46, date: 20/10/2004 Chronicle // # 091, p. B3, date: 31/05/2004 Chronicle // # 085, p. B3, date: 21/05/2004 Chronicle // # 107, p. B1, date: 23/06/2004*

197. The folder with working documents delivered to a director must contain information which should assist him to prepare for the meeting and keep him updated on the course of events ongoing in the company. For joint-stock companies with a participatory interest of the Government the quality of information supplied for the meeting is of primary importance, because it should be adequate for the assessment of the status of the issue and for the preparation of a balanced voting instruction for the representative of the Government at the meeting of the board of directors. Therefore, in large-scale and important joint-stock companies with a participatory interest of the Government a policy of consolidation of requirements to the information kit is pursued in the internal regulations of the companies.

198. In order to ensure timely preparation of the directives the board of directors, as initiated by the representatives of the Government, adopts a work plan of the board for the year, including an outline of the schedule of meetings and a list of agenda items. The work plan must make provision for a number of meetings sufficient to enable discussion of the key problems faced by the company.

199. According to the Federal Law on joint-stock companies (Articles 48 and 65) establishment of the management body of a joint-stock company and termination of its office may be within the terms of reference either of the general meeting of shareholders or of the board of directors.

***Development of Mechanism of Board of Directors***

200. For State-owned companies of the Russian Federation provision is made for independent directors on the board. Independent directors on the board, although formally independent, are, nonetheless, required to vote on issues of major importance per directives received from the representative of the Government of the Russian Federation, as a shareholder.

**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

***Appointments to Executive Management Bodies of Company***

201. The Government of the Russian Federation holding a share in the joint-stock company of no less than 2% is entitled to nominate its candidates to the management body and to the position of the sole executive officer of the company.

202. Determination of a position of the Government of the Russian Federation on the persons nominated for incorporation into the list of candidates for election to the management team (officers) and/or to the position of chief executive officer (managing director) is performed in compliance with the Regulations on management of Federal shares in public corporations and exercise of the special right for participation of the Government of the Russian Federation in management of public corporations ("golden share"), as approved by the Resolution of the Government of the Russian Federation of 3 December 2004 # 738.

203. Pursuant to the above Regulations, the nomination of candidates (in the form of proposals to the joint-stock company) is the responsibility of "Rosimuschestvo".

204. The principal mechanism of the participatory interest of the Government in management of joint-stock companies, whose shares are owned by the Federal Government or a municipality, as well as in respect of which the Government of the Russian Federation and regional government authorities exercise their special right ("golden share"), consists in having representatives of the Government of the Russian Federation seated in the governing bodies (primarily on the board of directors) of joint-stock companies. Through the mechanism of its representatives the Government gains an opportunity to influence the decision making process at the meetings of the boards of directors of joint-stock companies, the business development policy targeting attraction of investments taking advantage of stock market opportunities.

205. Representatives of the Government present the position of the Government in the governing bodies of joint-stock companies, and inform the Government of the decisions made by the governing bodies of the company, which in turn allows to judge, to what extent the representatives have managed to protect the interests of the Government, and thus to evaluate the performance of the representative.

***Practical Experience of Operation of State-Owned Companies***

206. In recent years the profile of the Government is gaining weight, but not in the sense that it intervenes more in the economic affairs. Rather the rules of law contained in the legislation are increasingly applied in practical work. It means that as a general rule the performance discipline in ensuring adoption of strategic decisions of the Government of the Russian Federation is beginning to materialize.

207. However, not all the administrative processes in the Government are already in good shape. It is true including in respect of some procedures involving government representatives. Some State-owned companies are managed efficiently enough (see Note 7). Yet, in some of the companies with a participatory interest of the Government there is no consensus on the implementation of their long-term strategies (Note 8).

208. The prevailing trend in corporate governance patterns is absolute and relative growth of payment of dividends. Representatives of the Government demonstrate their vigorous drive on this issue. In most companies profits payable to shareholders are growing with an active assistance of government representatives not only in absolute but also in relative terms.

REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA

Box 7 Example of successful management of State-owned company

The State-owned company PLC "Transnefteprodukt" demonstrates one of the most successful examples of implementation of corporate governance and corporate governance principles. This company, which unites cross-country petroleum pipelines into a network, is among the top five largest international light petroleum product transportation companies. It is the only company in Russia which transports diesel fuel, gasoline and kerosene for 16 oil refineries to various regions across the territories of 38 regional governments of the Russian Federation by a system of main petroleum pipelines. The equity of PLC "Transnefteprodukt" is equal to RUB1,263,000,000 (USD44,300,000).

The net profit of PLC "Transnefteprodukt" according to the Russian accounting standards in 2003 amounted to RUB3,333,000,000 (USD116,000,000), which is 67% less than in 2002. Yet, only RUB100,000,000 (USD3,500,000) was allocated for payment in dividends (3% of the net profit). However, the low dividends are justified by a large-scale project of strategic importance implemented by the company on its own without public investments. This project consists in construction of the first phase of a petroleum product pipeline 1,056 km long, and an oil storage facility in the port of Primorsk with a total storage tank capacity of 240,000 m<sup>3</sup> designed for storage and shipment of light petroleum products. In November 2003 as part of the project of technical assistance in the area of "environmental management" a grant in the amount of EUR200,000 was extended to PLC "Transnefteprodukt" by EBRD for ensuring environmental safety of the project.

However, the Ministry of Taxes and Charges threw "a fly" into that "ointment". In the beginning of 2004 against one of the subsidiaries of the company tax liability claims were filed based on a transaction involving export supplies of marginal stock of petroleum products from main petroleum pipelines. Such marginal supplies of petroleum build up on a regular basis, and the taxation requirements are not clear with regard to their sales.

*Courtesy: Chronicle // N 091, p. B3, date: 31/05/2004*

209. The proportion of the net profits, allocated for payment as dividends, gravitates toward 10% of net profit of the companies. More often than not dividends are determined by guesswork. Traditionally, the governing bodies of joint-stock companies downsize them, whereas the government representatives tend to insist on higher dividends. However, neither of them put forward any sufficient evidence in support of their dividends policy. As a general rule the companies suggest part of the profits should be used for funding investment projects, and the government advises to go to their subsidiaries to seek investment resources.

210. Sizes of profits, when calculated according to the Russian accounting standards and the International Financial Reporting System, may differ substantially. Furthermore, profit is calculated based on the performance data of the parent company, which may be its "cost center", whereas the "profit centers" are concentrated in subsidiaries. Therefore, both the government and the shareholders of parent companies by implication receive considerably less than is due in dividends.

211. Government representatives in some companies demonstrate lack of consensus on matters of development strategies for their State-owned companies. Yet, in working around these issues in the office of the Chairman of the Government of the Russian Federation common grounds are frequently found.

**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

**Box 8 Examples of unsuccessful management of State-owned companies and sole decisions by the Government**

The Government owns a 51.17% share in PLC "Aeroflot - Russian Airlines" (hereinafter "Aeroflot"), the National Reserve Corporation (NRC) – about 30%<sup>34</sup>, and about 10% of the shares is controlled by the company management.

Based on its performance in 2003 "Aeroflot" was listed among the top 25 international companies with the best financial results. According to the international magazine "Air Transport World" "Aeroflot" ranks 13<sup>th</sup> in the nomination "Net profit" and 20<sup>th</sup> on "Operating profit". As regards its net profit, in 2003 it was equal to USD126,600,000 with a revenue of USD1,716,000,000 .

The net profit of "Aeroflot" exceeded the level of the previous year by 78%. Overall, in 2004 according to the Russian accounting standards the net profit was RUB5,171,500,000 (about USD181,500,000).

The "sectoral" ministry (Ministry of Transport) from time to time demands resignation of the company management in connection with the plans of the airline to start building the "Sheremetyevo-3" terminal, which, according to the government representatives, "Aeroflot" will be unable to handle. In this context, in 2005 "Aeroflot" borrowed USD150,000 from a syndicated lender<sup>35</sup> (for 3 years at LIBOR + 2.25%), of which amount USD50,000,000 will be used for refinancing of the current debt liabilities, and the balance USD100,000,000 will be spent on building the "Sheremetyevo – 3" terminal. The total price of the terminal building project is estimated at USD430,000,000.

The current differences evolved into two general meetings of shareholders, which followed each other in close sequence. The first meeting, held 2 June 2004, resulted in the resignation of the Chairman of the Board - CEO of "Aeroflot" Alexander Zurabov, who had held this key position since 2000. At the following extraordinary meeting on the 24th of July 2004 called in response to the initiative of NRC, the position of the government was consolidated by adding another government representative on the board of directors after removing an officer of the former management team from the board. Finally, the board of directors was left with one executive officer, 7 representatives of the government and 3 representatives of NRC.

Based on the above it was decided against selling the government share holding in 2004. The issue on building the "Sheremetyevo-3" terminal is still unsettled. The net result for this State-owned company is it has neither a clear-cut development strategy nor straightforward priorities.

It appears reasonable to assume that this situation has emerged due to an unconsolidated policy of the Government. Its representatives cannot reach a consensus on the follow-on development objectives of the company and, in particular, on implementation of a very exciting project of building a new passenger terminal.

The precedent of a sole-authority approach to management of joint-stock companies with a 100% government ownership also appears interesting. One of the most important of such joint-stock companies is PLC "Russian Rail Roads" (hereinafter RZhD). Its current equity is equal to RUB1,535,700,000,000 (USD53,884,000,000).

An annual general meeting of shareholders was replaced by an ordinary executive order of the

<sup>34</sup> Note: NRC, controlled by Alexander Lebedev, a the State Duma delegate, owns the Cyprus-based Grabor Trading (Overseas) Limited, which, in its turn, owns 16.34% of "Aeroflot", and Transinvest Control S.A. (Luxemburg) owns 9.76% of the State-owned company.

<sup>35</sup> Note: Syndicate: ABN AMRO, Calyon, West LB and Societe Generale



REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA

Government of Russia. This executive order established a new membership of the board of directors of the company and the Chairman of the Board. Based on the recommendation of the board of directors the dividends to be paid out for the performance in 2003 were determined in the amount of 10% of the net profit, i.e. RUB590,000,000 (USD20,700,000). Moreover, the Chairman of the Board (President) recommended to allocate only RUB500,000,000 (8.6% of the net profit). The "round" number 10%, as proposed by the board of directors, was adopted without any discussion or economic assessment (business plan).

In general, investment analysts indicate that arbitrary approach, demonstrated by the Government, generates uncertainties in the operations of companies. The representative of the Government spoke in favor of rejecting the idea of a bond issue of "RZhD" in response to a proposal to raise RUB10,000,000,000 - 12,000,000,000. But the work in this domain never stopped.

"RZhD" nonetheless demonstrates positive innovations on the Russian market in the field of corporate governance. For example, one PR personality, the "founding father" of a renowned publicity agency in Moscow, was recently appointed to the board of directors of "RZhD" as an advisor to the President. His responsibilities will be work with investors and launching publicity campaigns.

*Courtesy: Komsomolskaya Pravda // # 142-r, p. 3, date: 02/08/2004 "Aeroflot will repay \$37 mln in loans from its own resources" // INTERFAX 03/03/2005; "Kommersant" // # 134-p, p. 5, date: 26/07/2004; "Shareholders' meeting of RZhD replaced by executive order of the Government to approve dividends" // INTERFAX 20/06/2004; Chronicle // # 235, p. B1V, date: 22/12/2004*

212. There exist cases of evidence of arbitrary decision making in wholly owned government companies. The proposal of the Ministry of Economic Development of the Russian Federation to include independent directors into the boards of directors of State-owned companies has not found sufficient support. Many candidates to the position of independent directors refuse to vote as directed by the government-owner. At present there are very few independent directors from private companies on the boards of directors of State-owned enterprises. Among them: "YUKOS", "Norilskiy Nickel", the Steel Group "Mechel", "Vimm-Bill-Dann", "NOVATEK".

213. According to some analysts participation of the Government in management of companies plays a positive role in ensuring sustainable development and "immunity" from excessive claims on the part of fiscal and other "security" authorities. However, in cases of express violations of law there is no remedy against tax claims even for State-owned companies.

**CHAPTER VII  
PROGRESS AND FUTURE OF PRIVATIZATION IN RUSSIA**

***Principal Tasks for Administration of Federal Property and Status in 2004***

214. The available international and domestic experience of administering Federal property is addressed in a condensed format in the Concept of administration of State property and privatization in the Russian Federation<sup>36</sup>.

215. The Concept states that most of the assets scheduled for privatization are not liquid and that the public sector of the economy is still too large. It also provides a classification of the State property and proposed specific administration and management mechanisms for each class of property. Furthermore, the Concept makes it clear that the previously adopted principle, according to which the only method to enable proper management of State property was to change ownership, should be revised. The Concept determines that the list of the Government's potential priorities in the area of State property includes property management tasks. It is established that for specific property assets, not subject to disposition, efficient management constitutes top priority.

216. The Concept establishes principles and priorities for public policy in management of shares owned by the Government, including those regulating responsibilities of representatives of the Government on the boards of directors of public corporations whose shares are owned by the Government. By and large, as of today the Concept has been implemented except for one very important item. Many companies failing in their social responsibilities, as well as in ensuring defense and security capability of the country are Federal and regional unitary enterprises.

217. Despite consistent reduction in the size of State property, public and municipal sectors of the economy remain excessively unwieldy and unmanageable. The most important tasks for State property administrators for today are as follows:

- Progressive reduction of excessive property assets in the public sector, which fail to support the government in performing under its responsibilities, to ensure increased revenues from utilization of property no longer needed for such responsibilities and subject to privatization;
- Adoption of a new model of management of the remaining State property on the basis of strict consistency of the State property with the Government responsibilities and ensuring efficient management of said property with optimized management expenses on the part of the Government.

***Optimization of Public Sector***

218. For addressing the tasks of administering State property five groups of companies and organizations have been identified:

- Organizations subject to retain their Federal property status;

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<sup>36</sup> Note: Approved by the Resolution of the Government of the RF 09/09/99 # 1024

## Russian Corporate Governance Roundtable Meeting

### REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN RUSSIA

- Federal unitary enterprises, whose property is transferred into ownership of regional and municipal governments of the Russian Federation;
- Organizations subject to privatization or liquidation;
- Enterprises and institutions subject to further examination.

#### Box 9 Groups of State property

The first group comprises organizations subject to retain their Federal property status. This group incorporates State-owned organizations operating in the defense and security sector of the Russian Federation, in performing Federal government responsibilities, in preservation of the national and cultural heritage of the Russian Federation. In total 10,538B organizations are subject to retain their Federal status (41% of all those examined by the Commission, of which 1,019 are Federal unitary enterprises and 9,519 - institutions). The above group also included unitary enterprises subject to corporatization with a 100% Federal ownership.

The second group includes Federal unitary enterprises, whose property is transferred into ownership of regional and municipal governments of the Russian Federation, and Federal institutions subject to be transferred to regional executive authorities of the Russian Federation. This group comprises 3,970 organizations (16% of the total number of those examined by the Commission, of which 202 are unitary enterprises, and 3,768 - institutions).

The third group consists of organizations subject to privatization or liquidation as non-conforming to the criteria of retention of the Federal status. 6,119 organizations are subject to privatization or liquidation in due process (24% of all those examined by the Commission, of which 3,384 are unitary enterprises and 2,735 - institutions).

The fourth group comprises enterprises and institutions subject to further examination after adoption of regulatory and legislative requirements on social benefits to Government civil servants. Among them there are individual State-owned organizations in the sectors of health care, sanatorium-and-spa and transport facilities providing services to Federal Government authorities. 70 organizations require further examination upon adoption of the appropriate regulatory requirements and legislation (0.3% of all those examined by the Commission, of which 37 are unitary enterprises and 33 - institutions).

Moreover, a special group was allocated to include organizations whose status needs review and revision, or in respect of which reorganization or liquidation procedures should be initiated and executed and changes should be added into the Federal property register; in total there are 4,776 such organizations (19% of the total number of those examined by the Commission, of which 1,856 are unitary enterprises, and 2,920 – institutions).

**Table 8. Sale of government share holdings and Federal unitary enterprises**

	2001	2002	2003	2004	2005**
Number of privatized shareholdings	125	112	630	565	989
Number of privatized FUEs	5	102	562*	517	547

*Note:* \* net of FUEs, whose property was put up as equity contributions of RZhD

\*\* target indicators

*Courtesy:* Ministry of Economic Development, Rosimuschestvo (2005)

**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

219. The lack of demand for the privatized shareholdings can be accounted for primarily by the fact that controlling shares of most of the joint-stock companies subject to privatization are owned by one person or a group of affiliated persons, which reduces the interest of "outside" investors in acquiring shares.

220. In 2004 the so called "second echelon" privatization methods were used, i.e. sale by public offering and sale without price quotation. Such methods, secondary in relation to auctions and specialized auctions, offer reduction of the price in the process of sales and are designed to ensure sale of low-liquidity assets of Federal property.

221. The total number of auction sales amounted to 283. In addition, 18 shareholdings were sold at a specialized auction. The analysis of the sale of shareholdings showed that in all instances privatization transaction prices exceeded the bid prices. Most of assets (50%) when traded on the auction were sold at prices exceeding the initial prices by more than 5%. And in 48 cases (17%) the excess was more than double the price (Table 9).

**Table 9. Pricing profiles in selling government shareholdings**

Sale of shares (interest) at open and closed auctions	Number of sales	% of total
Selling price equal to bid price	10	4%
Selling price exceeds bid price by less than 5%	130	46%
Selling price exceeds bid price by more than 5%, but less than 20%	43	15%
Selling price exceeds bid price by more than 20%, but less than double the bid price	52	18%
Selling price is more than double the bid price	48	17%
<b>TOTAL</b>	<b>283</b>	<b>100%</b>

*Courtesy:* Ministry of Economic Development of the Russian Federation, Rosimuschestvo, RFFI, 2005.

***Managing State Property***

222. With all due priority attributed to the optimization of the excessive property in public sector, it is nonetheless important to ensure efficient administration of the property which will retain its Federal status. However, the existing management techniques are not adequate in terms of efficient addressing the tasks faced by the Government in public sector.

***Efficiency Evaluation Criteria for Administration of Federal Property***

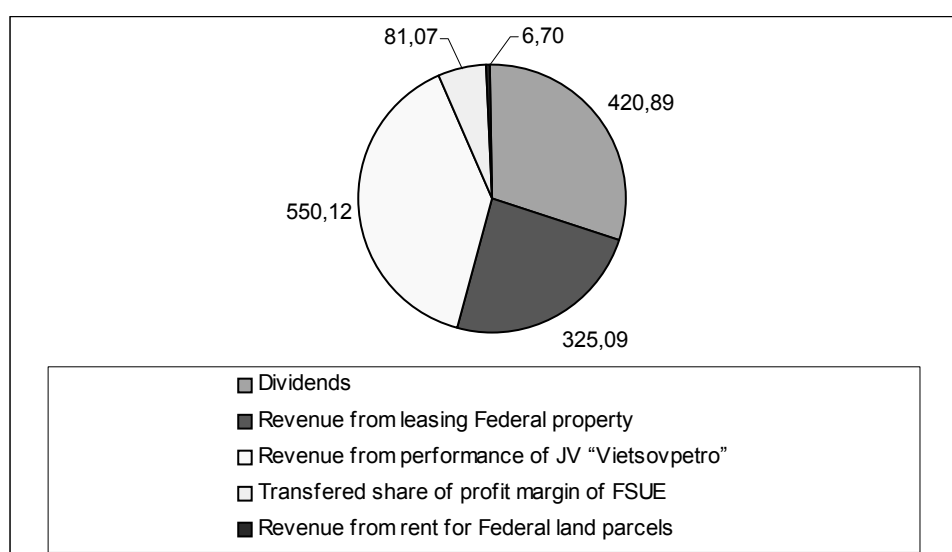
223. Efficiency of managing Federal property is evaluated based on the pattern of generation of revenue from utilization of Federal property and in terms of compliance with the established target revenue indicators. However, positive revenue flow should not be considered to be the only criterion to evaluate the efficiency of Federal property, since in addition to efficient property management to generate revenue, the Government of the Russian Federation, as a public institutional establishment, should discharge its social (public) responsibilities.

224. In assessing the efficiency it appears appropriate to identify criteria for profit-driven (revenue generation) and non-profit (public responsibilities) property management.

REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN RUSSIA

- The efficiency of profit-driven property management is assessed in terms of income generated by the property, which implies both budget revenues, and appreciation of the property.
- The efficiency of non-profit management (e.g. discharge of public service responsibilities) is determined by the output of products and services commissioned by the Government in compliance with specific social and other standards (regulatory requirements) and within the pre-determined limits of the costs of production.

Figure 20. Structure of revenue generated by State property (2003) (\$,000,000)



225. In certain cases the criteria of property management efficiency may be combined. Profit driven efficiency may be evaluated by criteria established for specific management modes, whereas other applications may require criteria associated with the discharge of public responsibilities. At the same time separate records and supervision should be in place for both, i.e. for revenue generation and for costs associated with public responsibilities. In general social and other public responsibilities are funded from the revenue generated by profit-driven property management, which results in reduced income levels.

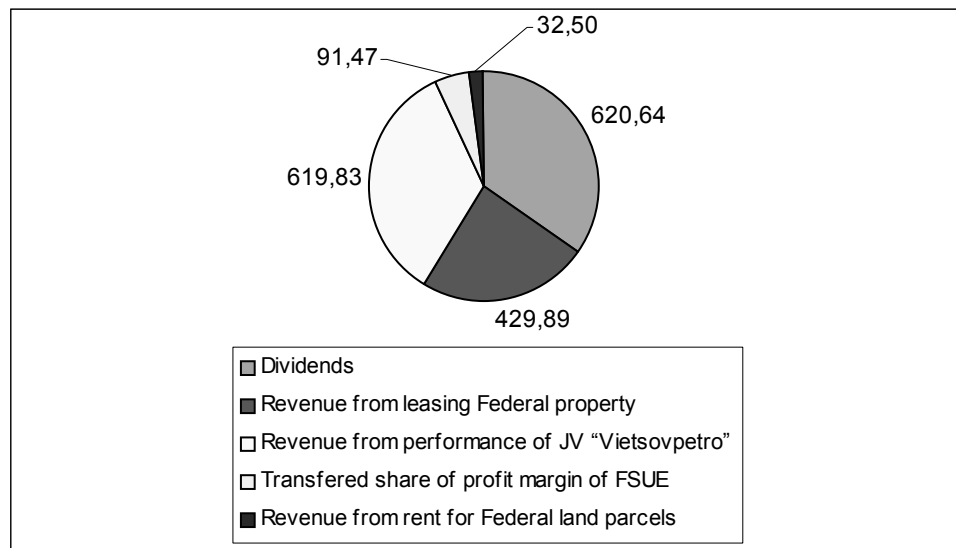
**Plans to Improve Efficiency of Federal Property Management**

226. The Ministry of Economic Development of Russia has come up with a plan of improvement of the efficiency of management of Federal property for the medium term of 2005 – 2008 targeting the following top priority problems:

- Removal of excessive property from the public and municipal sectors of the economy, if it fails to support discharge of responsibilities by the Federal Government, regional governments and local self-government within their terms of reference;

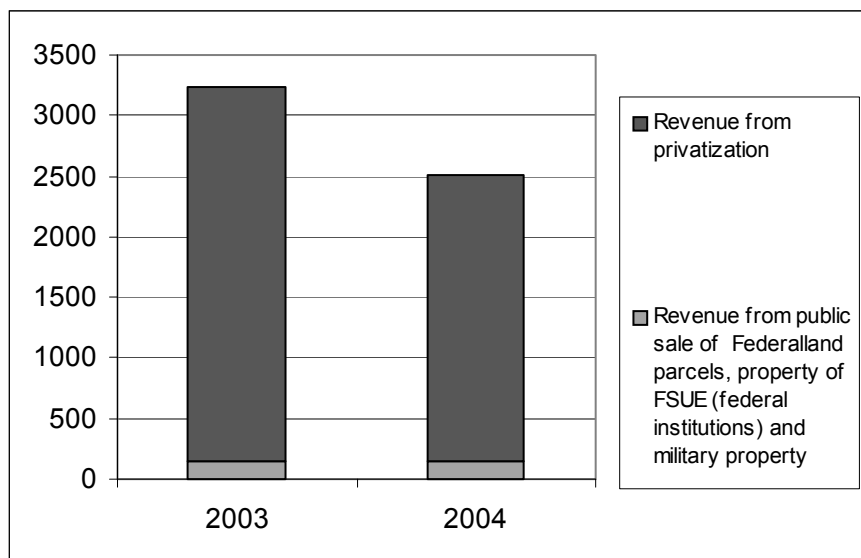
REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN RUSSIA

Figure 21. Structure of income from management of State property (2004) (USD,000,000 )



- Improvement of the efficiency of management of State and municipal property required for the discharge of the responsibilities of the Government of the Russian Federation, regional governments and local self-government within their terms of reference;

Figure 22. Income flows from sale of State property (2003-2004) (USD,000,000 )



- Improvement of performance efficiency of the system of sale of State and municipal property;
- Identification of strategic vectors of transformation of public sector (to be initiated on the basis of sectoral concepts providing supportive grounds for the objectives and tasks of participation of the Government of the Russian Federation in administering Federal property, as well as benchmarks for the development of specific sectors of the economy for a medium and long term).

**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

227. For a medium term the Federal property management objectives will require a whole package of actions to ensure improved manageability in the public sector at a level of efficiency to match that in the competitive sector of the economy. The proposed conceptual change in the legislative regulatory controls will call for improvement of the existing and development of new mechanisms of privatization and management.

***Improvement of Procedures of Privatization of Federal and Municipal Property***

228. The plans currently under development include the following:

- *Streamlining the procedure of privatization of Federal and municipal unitary enterprises by removing for some of them the process of corporization, which is currently a mandatory requirement.*
- *Simplification of the sale of single shares of public corporations by setting up price-down auctions, including in one trading session in the presence of the auctioneer and all bidders for the property on sale in the form of a conventional Dutch auction (barker), or by closed bidding.*
- *Introduction of competitive plans of screening of sellers for Federal property with a view toward eliminating the monopoly of RFFI.*
- *Introduction into the Articles of RFFI of a new concept of relationship between the Federal property administration authorities and State property sellers.*
- *Termination of the concept of regulatory price in the process of privatization with view toward elimination of duplication of the responsibilities of independent appraisers.*
- *Adoption of a totally new concept of transparency of information on privatization.* It is hereby proposed to establish a system of official publications of details of decisions on the conditions of privatization, as well as notifications about the sale of property with references to the addresses, including email, where one can access full texts of the relevant documents and additional information.
- *Legislative adoption of a model of medium-term planning of privatization process.* It appears reasonable that a planning cycle for privatization should be three years with an annual review and revision.
- *Streamlining the procedure of establishing public corporations after privatization.*
- *Removal of the restriction on trading in land parcels from the law on privatization.* The above ban emerged in the text of the law historically, because the bill was submitted to the State Duma of the Federal Assembly of the Russian Federation before the Land Code of the Russian Federation, and therefore contained a minimum package of rules of land law.

***Compiling List of Strategic Enterprises and Joint-Stock Companies***

229. The status of a strategic organization does not automatically imply mandatory Federal financial support in the form of budget loans, tax benefits or government contract. More often than not such organizations are required to engage in business activities on the market and compete with private organizations which have better opportunities for attracting investments. In some cases potential investors consider a large shareholding of the Government in the equity of a company as financial risk.

**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

230. In order to achieve optimization of the number of strategic organizations the Ministry of Economic Development is currently engaged in revising the Register. In doing so the Ministry proceeds from the understanding that organizations, whose business activities evolve in the market sector of the economy, and are not engaged in ensuring defense or national security objectives, protection of morals, health care and legitimate interests of Russian citizens, should be removed from the Register of strategic organizations and should be privatized. Thus the Register should only contain organizations really indispensable to ensure the interests of the Government, including in the defense sector.

231. The reduction in the number of strategic organizations with follow-up privatization proposed by the Ministry of Economic Development, will provide the necessary conditions for completion of the systemic transformations initiated by the Government of the Russian Federation in some sectors of the economy, for improvement of the investment and business climate, will positively impact on developing a competitive environment, will enhance the transparency and efficiency of management, expand the volume of investments required for some production facilities, which, in the final analysis, will contribute to the economic growth.

***Investment Projects with Participation of Federal Government with Real Estate or Ownership Rights***

232. The main objective of the Government's participation in investment projects consists in attracting off-budget investments for construction of new assets of Federal property. Most investments are concentrated in housing and commercial construction projects which generate more or less predictable cash flows. At the same time such projects are not expected to be considered top priority for Federal institutions and enterprises. The only exception may be special-purpose housing construction programs.

233. Investment projects will be implemented only with property of subordinate organizations of the Government whose capital investments should be the responsibility of sectoral departments.

234. The situation, as it emerges currently, is such that the Federal organizations own significant assets of real estate, including vacant land parcels which are not needed for implementation of their main objectives. Yet, there exists an unsatisfied demand of businesses for those assets, they need for implementation of the above projects, and which are incompatible with the discharge of the responsibilities of the Federal authorities.

235. The Federal Government in cooperation with Rosimuschestvo will undertake stocktaking procedures in respect of their subordinate organizations and institutions to determine real requirements of each of the organizations for real estate assets considering the amount of public services provided by them. Excess property is subject to vacation with subsequent redistribution among Federal organizations or commercial development.

236. The most efficient and transparent method of commercial development of real estate assets may be sale of the assets or rights of ownership thereof, i.e. a one-off transaction, because for sale of something there is a need to keep track of only one parameter, which is compatibility of the transaction price with market conditions. Therefore, the most adequate form of commercial development of real estate assets is provided by the mechanisms of privatization or sale of leasing rights to land parcels. It should be noted, however, that privatization centers only on projects attractive for investments. Therefore, significant portions of the Federal property will be sold at cut-rate prices.

***Commercial Development of Cultural Heritage Assets of Federal Significance***

237. The former restrictions imposed on privatization of State property and its commercial development, in general, not only prevent relieving the Government from the responsibility for managing non-core assets, but also contribute to further degradation of the said property. The most glaring example is the current status of cultural heritage assets of the peoples of the Russian Federation.



**REPORT ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES IN  
RUSSIA**

238. A moratorium has been enacted on privatization of cultural heritage landmarks<sup>37</sup>. The above restriction, in effect, removes all the cultural heritage assets from the civil market. At present the problems of the proposed termination of the moratorium are being examined by the Constitutional Court of the Russian Federation.

239. After the ruling on the above issues, and following the resumption of arbitration proceedings seeking protection of the Federal ownership of cultural heritage assets in Moscow, efforts will be resuscitated to obtain termination of the moratorium on privatization of cultural heritage assets.

240. Privatization of cultural heritage assets, accompanied by fundamental and mandatory encumbrances in the form of preservation commitments, required by law, constitute the only solution to enable effective degradation safeguards for a multitude of historical and cultural landmarks against.

***Development of Public Data Base "Public Register of Federal Property"***

241. One of the important constraints holding up the process of improvement of the efficiency of management of Federal property consists in the lack of adequate information support for its commercial development. Sources of information on management decisions in respect of Federal property assets are extremely scattered and can hardly be considered generally accessible because of the limited circulation or coverage zone.

242. Up till now no centralized data base has been developed to enable general public to have on-line access to updated information on executed or proposed management decisions in respect of Federal property assets. The responsibility for provision of information to the said "Public Register" should be imposed on the Federal Government authorities, government organizations and other parties entitled to management decision-making powers in respect of Federal property assets, whereas maintenance of a consolidated data base, i.e. "Public Register", should be within the terms of reference of the Federal Property Administration Agency.

243. The relevant draft Resolution of the Government of the Russian Federation ("On public information system "Public Register of Federal Property"") has been prepared by the Ministry of Economic Development of Russia.

244. Improvement of information support for the process of managing Federal property will enhance interest of potential buyers (tenants or investors) in such property, will facilitate identification and commercial development of idling or inefficiently managed Federal assets, will increase control over due management and integrity of the said Federal property.

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<sup>37</sup> Note: enacted by the Federal Law of 25/06/2002 # 73-FÇ "On cultural heritage assets (historical and cultural landmarks) of peoples of the Russian Federation" (para 2 Article 63).