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**CORPORATE GOVERNANCE ISSUES IN  
RUSSIAN “QUASI-PUBLIC” NON-LISTED  
COMPANIES**

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## CORPORATE GOVERNANCE ISSUES IN RUSSIAN “QUASI-PUBLIC” NON-LISTED COMPANIES

### **NON-LISTED COMPANIES IN RUSSIA:**

Open-End Joint Stock Companies (OJSC) – about 14,000.

Closed-End Joint Stock Companies (CJSC) – about 30,000.

Limited Liability Companies (LLC) - about 800,000.



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## CORPORATE GOVERNANCE ISSUES IN RUSSIAN “QUASI-PUBLIC” NON-LISTED COMPANIES

### OPEN-END JOINT STOCK COMPANIES (OJSC)

Total number - about 14,000

1992- 2005: 18 IPOs

#### MICEX listing

##### *equities:*

Grade A1 - 27 companies

Grade A2 - 6 companies

Grade B - 17 companies

##### *bonds::*

Grade A1 - 73 companies

Grade A2 - 15 companies

Grade B - 39 companies

#### RTS listing

##### *equities:*

Grade A1 - 7 companies

Grade A2 - 18 companies

Grade B - 35 companies

##### *bonds:*

Grade A1 - 0 companies

Grade A2 - 1 companies

Grade B - 1 companies

### RTS Board (non-listed, irregularly traded, OTC market):

568 companies



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## **CORPORATE GOVERNANCE ISSUES IN RUSSIAN “QUASI-PUBLIC” NON-LISTED COMPANIES**

### **OPEN-END JOINT STOCK COMPANIES (OJSC)**

**Total - about 14,000**

**Privatization of 1992-1993:**

**Millions of shareholders – shares for privatization vouchers, not for money.**

**Secondary stock market – with sales of primary shareholders, not through company’s IPOs.**

**RTS Board: almost all stocks are traded by speculative investment entities without consent of issuer companies.**

**Controlling shareholders do not see privatization-made minority shareholders as entitled to company wealth.**



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## CORPORATE GOVERNANCE ISSUES IN RUSSIAN “QUASI-PUBLIC” NON-LISTED COMPANIES

***The main result of the Chubais privatization: a very large number of quasi-public companies (public in legal form, with a significant number of minority shareholders but private by their financing scheme and orientation of controlling shareholders)***



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## CORPORATE GOVERNANCE ISSUES IN RUSSIAN “QUASI-PUBLIC” NON-LISTED COMPANIES

### PREDOMINANT TYPES OF RUSSIAN “QUASI-PUBLIC” NON-LISTED COMPANIES

*Type 1*  
*Holding-type companies*

Holding-type companies



Subsidiaries

**Parent company (OJSC, CJSC or LLC)**  
**A single shareholder or a small group (4-10) of closely linked  
shareholders – 100% stocks**



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## CORPORATE GOVERNANCE ISSUES IN RUSSIAN “QUASI-PUBLIC” NON-LISTED COMPANIES

### *Subsidiaries (OJSC, CJSC)*

- Parent company – 60-70 to 80-95% of stocks.
- Minority shareholders (portfolio short-term investment companies and individuals) – 40 to 5%.

**Annual turnover: \$200 mln to \$3 bln**

**The bigger the turnover is, the larger is the parent company’s holding in subsidiaries.**

***The general trend over 1998-2005: concentration of holdings by the parent companies in subsidiaries (to the level of 80-90%).***  
**Yet, in a few cases all minority shareholders were offered buyouts.**



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## CORPORATE GOVERNANCE ISSUES IN RUSSIAN “QUASI-PUBLIC” NON-LISTED COMPANIES

### PREDOMINANT TYPES OF RUSSIAN “QUASI-PUBLIC” NON-LISTED COMPANIES

#### *Independent companies (mostly OJSC)*

- A single shareholder or a small group (4-10) of closely linked shareholders – 60 - 90% stocks.
- Minority shareholders (portfolio short-term investment companies and individuals) – 40 to 5%.

**Annual turnover: \$150 mln to \$500 mln**

**The bigger the turnover, the larger is the share of a single shareholder or a small group of closely linked shareholders.**

***The general trend over 1998-2005: concentration of ownership (to the level of 80-90%). Yet, in a few cases all minority shareholders were offered buyouts.***



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## CORPORATE GOVERNANCE ISSUES IN RUSSIAN “QUASI-PUBLIC” NON-LISTED COMPANIES

### *OJSC “Belon”*

**Parent company of a holding group, a major  
Russian coal trader and producer.  
2004 sales - \$380 ml.**

#### *Ownership structure of Belon:*

**Total number of shareholders – 18.**

**Major shareholders:**

**CEO – 24%**

**CEO spouse – 34. 25%**

**3 other senior company executives – 6%, 5% and  
5% each.**



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## **CORPORATE GOVERNANCE ISSUES IN RUSSIAN “QUASI-PUBLIC” NON-LISTED COMPANIES**

### **NON-TRANSPARENT OWNERSHIP STRUCTURE**

#### **OJSC “VSMPO”**

**The major world producer of titanium, a large Russian producer of aluminum alloys, steel and the controlling shareholder of OJSC “AVISMA”, the world’s largest producer of untreated titanium and a major world producer of magnesium.**

**2004 sales - \$360 mln. AVISMA sales in 2004 - \$166 mln.**



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## CORPORATE GOVERNANCE ISSUES IN RUSSIAN “QUASI-PUBLIC” NON-LISTED COMPANIES

### *VSMPO ownership structure (disclosed holders of over 5%)*

*DKK depositary (nominal holding) – 78.8339% of voting stocks*

*ING Bank (nominal holding) – 7.1648% of voting stocks*

*Unofficial market data on the VSMPO ownership structure:*

*30% - CEO*

*30% - chairman of the Board (who is also a CEO deputy)*

*12% - Renova company (the controlling shareholder of SUAL Holding, Russia's second largest producer of aluminum )*

*28% - minority shareholders (personnel, investment companies, etc.) and free float.*



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## **CORPORATE GOVERNANCE ISSUES IN RUSSIAN “QUASI-PUBLIC” NON-LISTED COMPANIES**

### **NON-TRANSPARENT OWNERSHIP STRUCTURE**

**Magnitogorsk Metallurgical Plant (MMK)**

**2004 sales - \$4 bln**

**A major Russian steel producer.**



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## CORPORATE GOVERNANCE ISSUES IN RUSSIAN “QUASI-PUBLIC” NON-LISTED COMPANIES

### *MMK ownership structure (disclosed holders of over 5%):*

<b>KUB company (nominal holder)</b>	<b>32.28%</b>
<b>UFG IS Structured Holdings Limited (nominal holder)</b>	<b>23.79%</b>
<b>UFG IS Structured Trading Limited (nominal holder)</b>	<b>17.24%</b>
<b>VBRR company (nominal holder)</b>	<b>6.87%</b>
<b>ODK depositary (nominal holder)</b>	<b>6.63%</b>
<b>Mosstroieconombank (most likely - nominal holder)</b>	<b>6.63%</b>
<b>Settlement Stock Center depositary (nominal holder)</b>	<b>5.94%</b>

*Unofficial market data on the MMK ownership structure:*  
**Over 90% are owned by the top management of MMK.**



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## **CORPORATE GOVERNANCE ISSUES IN RUSSIAN “QUASI-PUBLIC” NON-LISTED COMPANIES**

### **NON-TRANSPARENT OWNERSHIP**

**Shares actually owned by the controlling stockowners are registered with a number of formally unaffiliated offshore companies.**

**Minority shareholders have been offered buyouts in control acquisitions only in a few cases.**

**Extensive opportunities and practices for “profit tax optimization” at the expense of minority shareholders.**



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## CORPORATE GOVERNANCE ISSUES IN RUSSIAN “QUASI-PUBLIC” NON-LISTED COMPANIES

### Cash flow rights

#### the case of the pulp and paper producing plant in the Upper Volga region (annual sales - \$270 mln):

- Declared taxable profits dropped from Rub 1.999 bln in 2000 to Rub 291 mln in 2003.
- All sales are made through reportedly affiliated offshore trading companies at €280-285/ton (referred world market price at that period – €360-380/ton).
- Raw materials are purchased from the reportedly affiliated offshore trading companies.
- Annual payments of \$5 mln for “market research” to a reportedly affiliated UK-registered company, whose key personnel are the managers of the controlling shareholder company.
- Not a cent in dividends.
- Cutting of wages.



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## CORPORATE GOVERNANCE ISSUES IN RUSSIAN “QUASI-PUBLIC” NON-LISTED COMPANIES

### *Latest trend covering the minority of Russian non-listed companies:*

- **Transfer of ownership rights to a single company (still, mostly registered outside Russia) which is the parent company in a holding group.**
- **Disclosure of beneficiary ownership.**
- **Downsizing of transfer pricing and illegal “tax optimization.”**

**The scale of this trend is limited to a small, though gradually growing, number of companies.**

### *Drivers behind the trend:*

- **The need for external finance**
- **The impact of the Yukos case and a tougher tax payment policy.**



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## CORPORATE GOVERNANCE ISSUES IN RUSSIAN “QUASI-PUBLIC” NON-LISTED COMPANIES

### *Boards of Russian quasi-public NLC:*

- **Absolute domination by executives and their close business partners.**
- **Usually a minimal number of members allowed by law.**
- **Very few outside directors, mostly none.**
- **Powers and functions are defined barely in compliance with the letter of law, with very little or no specification.**
- **A very high ceiling for assets disposal by management.**
- **No special elaboration for arrangements on major transactions and related party transactions.**
- **No committees or resort by board to independent outside expertise.**
- **No special arrangements to protect minority rights.**



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## CORPORATE GOVERNANCE ISSUES IN RUSSIAN “QUASI-PUBLIC” NON-LISTED COMPANIES

### *OJSC “VSMPO” board of directors:*

- deputy CEO for marketing (chairman)
- deputy CEO for planning and production
- deputy CEO for technologies
- head of the moulding shop
- vice president of SUAL Holding
- US citizen, vice president of *Tyrus US* and *Metallurgist* companies
- US citizen, vice president of *Tyrus US* and *Timet* (a major world titanium producer).

**Foreign directors apparently have very close business ties with the company  
and its controlling shareholders.**



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## CORPORATE GOVERNANCE ISSUES IN RUSSIAN “QUASI-PUBLIC” NON-LISTED COMPANIES

### *Board of directors of JSC “Belon”:*

- **executive of a partner research entity (chairman)**
- **“Belon” CEO**
- **2 “Belon” executives**
- **president of a Switzerland–registered company  
reputed to have specialized in offshore company  
services (non-Russian).**



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## CORPORATE GOVERNANCE ISSUES IN RUSSIAN “QUASI-PUBLIC” NON-LISTED COMPANIES

### *DISCLOSURE REQUIREMENTS*

#### Major weaknesses:

- **Little relation to the legal form of business entity (main focus on formal registration of equity issues).**
- **Soft requirements to the disclosure of beneficiary ownership.**
- **Unworkable definition of related and affiliated parties in the law.**
- **Very weak sanctions for violations of disclosure requirements (small fines, no criminal prosecution).**
- **Inefficient court enforcement.**



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## CORPORATE GOVERNANCE ISSUES IN RUSSIAN “QUASI-PUBLIC” NON-LISTED COMPANIES

### CURRENT DEBATES ON ENFORCING MINORITY RIGHTS IN RUSSIAN NCLs

- **To tighten disclosure requirements.**
- **To impose mandatory 10% dividends for companies with profits.**
- **To let the holders of up of 90% stock squeeze out minority shareholders.**



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# CORPORATE GOVERNANCE ISSUES IN RUSSIAN “QUASI-PUBLIC” NON-LISTED COMPANIES

## RECENT TRENDS IN CORPORATE GOVERNANCE PRACTICES OF RUSSIAN NCLs

### *Positive changes:*

- **NLCs with high economic and financial performance in industries with good prospects seek for more external finance to boost their growth (especially those preparing for IPOs).**
- **NLCs with ambitious plans in industries with good prospects but inadequate financial performance seek for more external finance.**
- **Very little or no change:**
- **Majority of NLCs**



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# **CORPORATE GOVERNANCE ISSUES IN RUSSIAN “QUASI-PUBLIC” NON-LISTED COMPANIES**

## **ECONOMIC PREREQUISITES FOR CORPORATE GOVERNANCE IMPROVEMENT IN RUSSIAN NCLs**

- Continuous macroeconomic growth.
- In-flow of foreign investment.
- Sustainable growth of domestic stock market.
- Further growth of domestic corporate bond market.



## **CORPORATE GOVERNANCE ISSUES IN RUSSIAN “QUASI-PUBLIC” NON-LISTED COMPANIES**

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### **LEGAL PREREQUISITES FOR CORPORATE GOVERNANCE IMPORVEMENT IN RUSSIAN NCLs**

- **Tougher *current* disclosure requirements for open joint stock companies with a special focus on the disclosure of beneficiary ownership.**
- **Much tougher sanctions for violation of current disclosure requirements.**
- **Tougher regulation of acquisition of controlling rights with a focus on clear and workable definition of related and affiliated parties and much stronger sanctions for violation of that regulation.**
- **Tougher disclosure requirements for corporate bond issuers.**
- **Clear tax regulations and tough and equal sanctions for their violations with the focus on transfer pricing**
- **Close international cooperation on the regulation of offshore businesses.**



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# CORPORATE GOVERNANCE ISSUES IN RUSSIAN “QUASI-PUBLIC” NON-LISTED COMPANIES

## *BUSINESS PRACTICES PREREQUISITES* *FOR CORPORATE GOVERNANCE* *IMPROVEMENT IN RUSSIAN NCLs*

- **IFIs’ stronger attention to corporate governance practices in their partner Russian NLCs.**
- **Stronger attention of private foreign investors (creditors and shareholders) to corporate governance practices in their partner Russian NLCs.**
- **Stronger attention of private Russian investors (creditors and shareholders) to corporate governance practices in their partner Russian NLCs.**
- **More *systematic approach* of foreign and Russian investors (creditors and shareholders) to corporate governance practices in their partner Russian NLCs. Danger of PR approach!**