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**CORPORATE GOVERNANCE OF STATE-
OWNED ENTERPRISES IN CHINA**

State-Owned Holding Companies in Russia
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1. Introductory notes

The establishment, functioning, and legal regulative procedures of holding structures in the Russian economy has been among the least developed economic matters. The first holding structures in modern Russia were established between the '80s and '90s¹. By their origin, they can be divided into four large groups:

- Pseudo-holdings, which were created on the basis of the former USSR and Russia's Ministries and government agencies, following the interests of the respective high-rank authorities, and initially emerged as various concerns, unions, associations (with such distinctive features as the vague system of ownership relations, high level of management centralization and low efficiency of management which they inherited from the former bureaucratic structures)²;

- Industrial holdings, which were created voluntarily (a) in the process of developing horizontal links between state-owned enterprises - SOE (with the initial low level of management centralization, which was growing in the course of capital concentration, and the scarcity of capital as their distinctive features), (b) on the basis of state-owned (industrial and/or research) associations or (c) in the course of separation of structural subdivisions;

- Combined (production-finance-trading) holdings which were established, particularly, under large SOE (of which the strict "mother company - daughter company" relationship is characteristic);

- Banking, financial, exchange holdings (their specifics are attempts to optimize the control over the accumulated capital).

The emergence of classical «combined» holdings (i.e. the combination of production activity plus control over the stake in the daughter companies) distinctly coincided with the enterprises incorporation and privatization after 1992. As to the financial ('pure', from the viewpoint of the classical concept) holdings (i.e. only participation in the joint-stock capital) those began to emerge in the country after the mass privatization. They primarily have become characteristic of the organization of the banks' expansion to the real sector, at least up to the 1998 crisis.

In light of the above, one should first of all specify *the object for further analysis*.

(1) The standard interpretation of the concept of "holding"³ allows recognition, as the state-owned holding, of any group of the Russian enterprises, which have (a) the "mother company-daughter company" system of relationship and (b) the principal enterprise having a certain government share. On these grounds, one can consider the overwhelming majority of privatized enterprises and SOE, without singling out any specific features in the context of the object of this presentation.

(2) To single out *distinctive features* of corporate governance in the state-owned holdings, accordingly, one needs a narrower interpretation. As a rule, the term "the state-owned holding (SOH)" used below is applicable only if the government is the single or dominating (blocking) owner in the "mother" head company. Therefore, two types of structures may constitute the object of analysis, namely: large corporations with the fixed stake and unitary enterprises with their daughter companies (federal and regional)⁴.

¹ See, for example: Radygin 1992, 1995; Dolinskaya, 1997

² The first well-known example of pseudo-holding in the form of joint-stock company (closed type JSK) on the basis of a ministry is "Avtoselkhoz mash- holding" established in October 1991. The company was headed by the former Minister. That structure was characterized with all the typical legal collisions of that time: the holding comprised state-owned enterprises of the whole former USSR, the enterprises had a right to acquire the holding's stocks, the prohibition for the holding to possess the enterprises' assets (!), etc. On the whole, by early 1992 there were a. 3,100 associations, 227 concerns, 189 unions, and 123 consortiums in Russia.

³ See, for example: Pearce, 1992; Downes, Goodman, 1991

⁴ There also are SOH in the banking and insurance sectors, which are not considered in this presentation as well as the related problems of privatization policy, cross-ownership, residual state-owned stake, conversion of enterprises' debts into shares (with the return of those to the state), and some other technical matters. We do not consider the genuine private holdings, which were established beyond privatization.

First of all it is necessary to single out *special legal procedures of regulating holding structures*. That will allow identification of specificity of their emergence within the framework of a more general problem of corporate governance. On this base, we should consider *concrete types of SOH* and their distinctive features. Sometimes it would also be expedient to consider already completely private holdings. In fact, initially (prior to privatization) practically all of them had been state-owned, that is why the specifics of their establishment and further functioning may also become important to estimate the role of the state. On the contrary, the state-owned unitary enterprises, which have their daughter unitary enterprises, may be considered classical holdings with a higher level of conditionality.

To estimate prospects of the development of corporate governance in the Russian SOH, one also needs to consider general approaches, which the state («principal») use to manage the property being at its disposal. That can be attributed primarily to estimates of *the current instruments and efficiency of the state's activities* as principal in the structures concerned.

The documents, facts and statistical data used in this presentation are given as of December 1, 1999. Despite a rigid selection of data sources, some of them may become obsolete or insufficiently objective (due to the traditional problems of companies' informative closeness or a trivial lack of the respective data).

2. Holdings in the Russian legislation

(1) In the Russian law, the holdings were first referred to (but not defined in legal terms) in the RF Law "On Privatization of State-Owned and Municipal Enterprises in RF" of July 3, 1991 (Art. 8). The creation of holdings was allowed to assist to the cooperation of enterprises- suppliers/consumers, except the monopolization of production of goods (work, services).

(2) The legal definition of holdings and procedures of their establishment (in the course of privatization, with the share of the state not less than 25%) were first formulated in the "Temporary Provision on Holding Companies established in the Course of Transformation of State-Owned Enterprises into Joint-Stock Companies" (approved by President's Decree of November 16, 1992, #1392 "On Measures on Implementation of Industrial Policy in the Course of Privatization of State-Owned Enterprises").

Under holding company the law understands an enterprise, the assets of which, regardless of its organizational and legal form, comprise the control stakes in other (daughter) companies. At the same time, the control stake is understood as any form of participation in the capital, which provides an unconditional right of making (declining) certain decisions in the managing bodies of the joint-stock company (JSK), (including "gold share", the right for 'veto', the right to appoint directors, etc.). The establishment of holdings and daughter companies is made in the form of 'Open Joint-Stock Company' (OJSK). The daughter companies are prohibited to own the holding company's stocks (including mortgage and trust)⁵.

Creation of holding companies is permitted in four cases: in the course of reorganization of large enterprises with the separation of their subdivisions into daughter companies; in the course of unification of legally independent enterprises' blocks of shares (in order to maintain economic ties and pursue the single policy); in the course of establishment of new JSK; in the course of incorporation of concerns, associations, unions and other analogous governing structures of enterprises.

At the same time, the said legal acts provided two options of establishment of a holding: "voluntary" and "commissioned" ones. In the former case, enterprises (with the consent of the government and 'labor collectives' voluntarily) unite their stock packages in the holding, as, for example, it took place in the course of establishing "Mostex" holding on the basis of the former textile industry concern which comprise enterprises according to the territorial principle. The pretext for the unification became the need to establish the raw material base (cotton). The other option is provided

⁵ The legal documents also introduced the concept of "financial holding company" (other issuers' securities and other financial assets make up 50% of its capital, and the activities of such a company is limited to investment business).

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for the largest enterprises (amalgamations), the privatization of which is restricted, or the maintenance of the government's influence is necessary (fuel and energy sector, military-industrial complex (MIC), communication, forestry, etc.).

(3) The Civil Code of RF (effective as of January 1, 1995) due to conceptual reasons bears no concept of "holding" as an independent entity. At the same time, the Code introduces the concept of "*daughter company*" (Art. 105), of which characteristic: the dominating participation of *the principal company* in the latter's authorized capital, or an agreement, or other means using which the principal company can determine decisions on the daughter company. The aforementioned system of relationship is very much similar to the concept of "holding" in the US and the concept of "concern" in Germany⁶.

The establishment of the liability of the principal company (holdings, the state-owned ones inclusive) becomes of crucially important in the following cases: the joint liability for the daughter company's transactions (should those be enforced by the principal company), subsidiary liability for the daughter company's debts in the event the latter goes bankrupt (should that be caused by the principal company), the right of the participants in the daughter company to claim for compensation for losses inflicted by the principal company, provided that the daughter company is not liable for the debts of the principal company.

As concerns the state-owned unitary enterprises, which have a right to conduct economic activities and some property rights (Art. 113)⁷, the law permits the establishment of "*daughter enterprises*". According to some estimates, such an enterprise is not a special kind of commercial organization (institution) or unitary enterprise. Such an enterprise is not an owner of its property, but it is granted with limited *in rem* right to exercise economic management of the property. The distinctive feature of the enterprise is that though not being a proprietor, such an enterprise has another enterprise-non-proprietor as its founder (Braginsky, 1995, p. 145). In the current Russian law, the question as to whether the unitary enterprises have legal rights to enter into commercial societies (partnerships) remains unanswered.

(4) The RF Law "On Competition and Restriction of Monopolist Activities in Commodity Markets" (of March 22, 1991, revised May 6, 1998) introduces the concept of "group of persons" (the group of legal entities and/or private individuals, who jointly, directly or indirectly, through property or various contracts control the decision making in the management bodies of the concrete legal entity). The acquisition by the person (group of persons) of over 20% of voting stock⁸ or the rights which allow determining the conditions of the economic agents' activities, requires the preliminary consent on the part of the anti-trust agency (Art.18).

It should be noted that these requirements are subject to the mere identification of a "threat-to-competition" fact (establishment of the monopolist state in the market), and all transactions are considered only in that context. Nevertheless, the actual governance and ownership interconnections between enterprises (including the acquisition of a large stake, take-overs, etc.) not at all are always aimed at the market monopolization.

(5) Some provisions, which are related to the actual regulative procedures of establishment and activities of holding institutions, are also stipulated by other normative acts:

- the RF Law "On Joint- Stock Companies" of November 24, 1995 (daughter and dependent companies, procedures of take-overs and large- scale transactions);
- the RF Law "On Financial and Industrial Groups" of November 30, 1995 (methods of establishment of FIGs' central companies, participation of the government);

⁶ Art. 106 also describes "dependent company" (provided that another company owns over 20% of its stock). This norm has only an informative importance.

⁷ Word for word: "gosydarstvennoe unitarnoe predpriyatie s pravom honyastvennogo vedeniya".

⁸ Previously, the acquisition of 15% of stock required the notification to the RF Ministry of Finance

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- the Tax Code of RF (Art.20, interdependence of persons for the purpose of taxation, starting from the 20 per cent benchmark of participation in property)⁹;
- normative acts of the Federal Commission for Securities Market enacted between 1996 through 1999 (disclosure of information on other companies' participation in the capital, on affiliated persons etc.);
- normative acts of the Central Bank of Russia enacted between 1998 through 1999 (the consolidated reporting of the members of a banking group), and others.

(6) The numerous normative and legal acts enacted between 1992 through 1999 constitute a separate matter. These acts regulate concrete procedures of governing the state-owned stake, unitary enterprises and establishment of holding companies (by their name or by the essence, for single enterprises or industries) according to individual schemes. Some of them will be briefly considered below, in the course of the analysis of types of holdings.

3. Types and specific features of state-owned holdings.

The objective reasons for the emergence of holdings (as well as for the emergence of other forms of corporate ties) can be attributed to the break-up of the production and economic links after the collapse of the USSR, liquidation of the sectoral management in the national industry and actual discontinuation of the financing of the real sector from the state budget. That led to the broken production technological chain, the imbalance of activities by stages of the products' life cycle (research and design, production, marketing and sales), crisis of the enterprises' sources of funding.

As it was noted above, the former Ministries (or their departments) are also maintained in a form of holding, that is why holding is often perceived as a modified element of the administrative system of the state governance. At the same time, the main objective reason for holdings' emergence in Russia became a natural "protective" reaction of enterprises to the dissipation of their former usual environment and previously established links.

General advantages of the holding structure are well known: the possibility of control over the capital which substantially exceeds the mother company's capital; securing conditions of vertical (horizontal) integration of enterprises; economizing on trade operations; price control; consolidation of enterprises (their financial reporting) with respect to taxes; optimization of production capacities; centralization of participation in other companies' capital; penetration into commodity markets; optimization of large companies' strategy, finance, governance; manipulation with the prices for the mother and daughter companies' stocks; liquidation of a destructive competition; possibility of establishment of the relationship between the holding's subsidiaries as legal entities; maintenance of the daughter companies' formal independence to support their managers' prestige; stronger immunity towards the influence of external factors, etc.

Nevertheless, it should be noted that not all the enterprises are in favor of their incorporation into holding structures (private or mixed). The data available on the Russian corporations' ownership structure for the period between 1994 through 1999 testify to an extremely low share of holdings in the authorized capital of "standard" Russian corporations (Radygin, 1996, 1999). According to the survey on 160 enterprises held in 1996, only 11% of them reported an attractiveness of holding structures (Vinslav, 1996). For some of them, that is related to the lack of capital to acquire stake, while the others are either reluctant to become a daughter company, or encounter difficulties in the course of the registration in several government agencies. The majority of enterprises are focused on a "softer" form of cooperation. Holding, as a form of relationship between enterprises, to the greatest extent is characteristic of those enterprises, which: (a) find themselves in the "stabilization" or "growth" phase, (b) can be attributed to industries with a relatively high profitability rate or to those with a clear vertical integration.

It should also be noted that there is a whole range of specific motivations for the formation of holding structures: control over financial flows, control and redistribution of the state property, capital

⁹ The idea of "consolidated group of enterprises" for the purpose of taxation (with the share of participation in each other's capital of not less than 80%) was not included into the final variant of the Tax Code of RF

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fleet, political and budgetary interests of federal and regional authorities, etc. That to the same extent concerns the SOH.

Let us consider main types of SOH, which emerged in the country during the '90s (the brief references to the largest SOH are given in the Appendix)¹⁰.

(1) The first type of such structures is most simple and evident: the *SOEs which were transformed into JSKs* without any preliminary re-organization and/or compulsory integration into larger structures. Their control (large) stake was fixed as the government property (see section 3 for some statistics). To this group one may also attribute those companies, whose authorized capital included "the gold share", which provided the government with certain possibilities to influence the JSK's activities, and JSKs with the remainder stake owned by the government. The formation of the holding was taking place spontaneously, from "the grass-root" level, through separating subdivisions, foundation and acquiring daughter companies.

(2) The second type of holding structures is represented by the *largest companies (mostly monopolies)*, which were established according to special decisions.

The first of those became RJSK "UES Russia" and RJSK "Gasprom" created yet in autumn 1992. Their authorized capital was established at the expense of the contribution to that with the total amount of capital (assets) of SOE *in toto* (in this case, the largest producers of electric power and gas), plus the control stakes of their daughter JSKs. For all those companies, RJSK "Gasprom" and RJSK "UES Russia" have become holding companies.

As concerns the electric power holding RJSK "UES Russia", among the key corporate governance problems one should note the control over regional companies and the holding's relationship with local authorities. During the '90s, many daughter companies of the holding became a notorious example of discrimination of their shareholders' rights: in this connection, one can refer to the proposition which RJSK "UES Russia" made in October 1998 to its 45 (of over 80) daughter regional companies regarding bringing some provisions of their charters into line with the Law "On Joint-Stock Companies". Thus, the provision, in compliance with which the increase of the shareholder's stake by over 1% of voting shares requires the preliminary consent of the Board of Directors, is illicit and discriminatory. One could also note in 1998 a notorious attempt to discriminate the holding's foreign shareholders' rights (restriction of their share to 25% by a special Law).

Between 1998 to 1999, due to envisaged difficulties with internal gas supplies, the transition of power plants to coal fuel became an urgent matter. In this connection, projects were developed with respect to creation of energy power-coal companies through integration of enterprises of the electric power sector and coal-mining companies (so far, only in those regions in which coal is produced in an "open" way, not in mines). The first company of such type became LuTEK (the Primorsky Krai, currently operates), BurTEK (Byryatia, designed), UralTEK (the Chelyabinsk Oblast, designed). The consideration of projects of establishing power-metallurgical companies (the merger of the Sayano-Shushenskaya hydroelectric power plant with "Sibirsky Aluminum" group) currently is under way.

As to RJSK "Gasprom", let us give some examples related to successful lobbyist activities of the "entrenched management":

- On January 20, 1999, the State Duma passed the second reading of the Law "On Gas Supplies in RF". The Law, particularly, provides a fixing of only the blocking package of RJSK (25% plus 1 share) in the state ownership, provided that the share of non-residents is 25% minus 1 share (vs. 9%, as stipulated by presidential Decree # 529 of May 28, 1997). That, unquestionably, meets the RJSK's interests: the smaller is the share of the state, the less is the number of the government's pressure and control instruments in the Board of Directors, given that other shareholders are affiliated, controlled, dispersed, or they are strategic partners to RJSK. Furthermore, Art. 15 of the Law prohibits the division of the "single system of gas supplies", which implies that any reforming of the RJSK as natural monopoly would be impossible¹¹;

¹⁰ See also: IET, 1998

¹¹ Nonetheless, in 1999, Gasprom's 17 daughter companies were transformed into OJSK with their own financial reporting and ousting of all the non-profile structures. It is envisaged that this reorganization should meet requirements of "transparency" put forward by the World Bank.

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- Some sources note that in order to undertake an additional measure of political pressure (against attempts to change the top management and reorganization) Gasprom considered an option of selling a part of the stake controlled by the RJSK and using the respective funds for the pre-election campaign (according to some estimates, RJSK's management controls 7% of the company's stake, and yet 15% is controlled by the RJSK itself);

- Blocking in the State Duma of amendments to the Law "On Joint- Stock Companies" (the essence of which is an introduction of amendments to the corporate governance procedures in favor of minority of shareholders), etc.

The process of institutional transformations in the oil sector started with the establishment of single oil-extracting corporations and their privatization between 1992 to 1993. Then the state-owned block of shares was accumulated in the respective holdings, and between 1995 to 1997 the privatization of the newly established structures was accomplished. Since that time, their authorized capital comprised control blocks of enterprises, which previously had been incorporated into those amalgamations, as well as the stakes of oil-refining and other related companies. It was the largest oil companies LUKoil, YUKOS, Surgutneftegas, oil- transportation companies (Transneft), and companies, which transport petroleum derivatives (Transnefteproduct), which held a special position among other structures. Their distinctive feature was the formation of their authorized capital by contributing with control stakes of JSKs, which had been created on the basis of whole amalgamations.

The buyers of the "second wave", who obtained the majority control over holdings, inevitably entered into conflict with the minority shareholders- buyers of the "first wave". According to some estimates, due to such conflicts, the creation of "efficient owners" in the oil sector was delayed for minimum 3 years. It is likely that some exception became LUKOil, which transferred itself to single share yet in 1995. The conflict between "two privatizations" became one of the symbols of corporate wars of 1997-1999 and a permanent source of ownership rights destabilization.

By 1999, the majority of those companies became private. The structure of some oil companies have experienced numerous changes, due to organizational and legal reorganizations and re-division of "influences", which resulted from multilateral lobbying. That was made in a form of reassignment of the stake of single enterprises' fixed in the government ownership from one company to another. In addition, there are some well-known examples of attempt to change some companies' management, which was dictated by financial and political motives (Gasprom and Transneft in 1999).

(3) The third type of holding structures comprise SOE (companies) which were *established for a specific purpose of governing the stakes* of some industries' amalgamations and enterprises, which were fixed in the state ownership.

Such state-owned companies, though not being formal capital owners (like Gasprom), were designated for exercising, on behalf of the government, the functions of holding companies towards those JSKs in which the government had its stake. At the same time, the companies were bound to carry out the state support to enterprises and implement the industrial policy. The example of such a company is Rosneft (in addition to the said tasks, the company also sells the state share of hydrocarbons received by the production-sharing agreements and is the general commissioner of research and design work), Rosugol (also deals with distribution of budgetary funds to support the subsidized coal-mining industry, construction of mines, production of equipment), Roslesporm.

In 1995, the SOE Rosneft became a vertical-integrated oil company in a form of OJSK. The company's authorized capital was established on the basis of 32 companies' stakes fixed in the federal ownership, and the company was entrusted with the stake in yet 98 companies. At the same time, Rosneft became a symbol of the failure of the "cash privatization" policy of 1998-1999. Rosugol has also attained the OJSK status, but the company was liquidated shortly afterwards.

(4) A special kind of SOH structures became the holdings *with the unitary SOE' participation*, which are established in compliance with special acts. The example of such institutions is OJSK "Industrial company 'Antei'" (a 51% stake is owned by the state). In the course of establishment of the company, the SOEs and JSKs participating in that were given the daughter company status.

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“Holdings” (quasi-corporations) with the participation of unitary enterprises are not corporations *per se*. Created as a rule to maintain the research, industrial, and export potential in the MIC they are used in order to achieve a certain level of competitive capacity. In organizational terms such structures are created as follows: the parent enterprise of the “corporation” is granted the ownership of SOEs, which become daughter unitary enterprises. Simultaneously, blocks of shares in JSKs, which are parts of a technological chain, and which are temporarily owned by the state, are transferred to the parent enterprise.

In the MIC the idea of the sectoral organization as a few state-owned concerns dominates at present. In 1999 a first step in this direction may become the merger (and issuance of common shares) of two existing holdings producing military aircraft VPK MAPO (part of which is ANPK “MIG”) and AVPK “Sukhoi.” At end-June of 1999 a decision of the RF Government on the merger of ANTK named after A. N. Tupolev and “Aviastar” (Uljanovsk) was adopted, the state share in the new holding was 50 per cent plus one share. Another holding - Interstate Aircraft-Construction Company “Ilyushin” – was formed in organizational terms only in December of 1998. At present the Tashkent Aircraft Industrial Association named after V. P. Chkalov (Uzbekistan) is expected to join. It seems that creation and reorganization of holdings in this industry will take certain time still.

(5) As an example of “*financial*” SOH (and, simultaneously, an ineffective managing strategy) may be given the creation of OJSK “Rossiyskaya Metallurgia” (Russian Metallurgy) in 1995. The charter capital of this holding was formed of 10 per cent blocks of shares in several Russian metallurgic JSK, including largest integrated iron-and-steel works in Cherepovets, Lipetsk, Magnitogorsk, and of some other property (including a number of research institutes and centers).

These blocks of shares should have been transferred in trust of the new JSK, or purchased at the expense of the sale of 49 per cent of the company itself, while 51 per cent remained in the ownership of the state. As per available appraisals, this holding was created with the real purpose of preserving blocks of shares in order to prevent “outside” shareholders from buying them. The liquidation of the holding in 1997 was yet another example of ineffective privatization strategy (an attempt to sell 49 per cent of the shares in the holding) in the situation of relatively formed ownership (control) structure at the majority of the metallurgic enterprises.

Yet another example of a financial SOH is “Svyazinvest” (mixed aims of preserving sectoral control and budgetary revenues via privatization). First regional communications companies were created and privatized (as well as “Rostelekom”), then controlling interests (38 per cent of shares) were transferred to “Svyazinvest.” As a result, at present for “Svyazinvest” holding it is of principal importance to improve the situation in corporate governance sphere in order to overcome trends towards disintegration and possible sale of a block of shares in 2000. For instance, in order to strengthen control over the property transfer of daughter JSKs to third parties, it is proposed to include representatives of largest shareholders (first of all, of Mustcom Ltd. consortium) in Boards of Directors of daughter regional electric communications companies. It is also possible that most profitable lines of business will be amalgamated in special daughter companies.

In 1998-1999 holding’s shareholders also discussed possible alternatives of a merger of “Svyazinvest” holding with its daughter company “Rostelekom” (50.67 per cent of shares owned by the holding). In 1999 the holding’s charter was amended in favor of minority shareholders (election of the general director by $\frac{3}{4}$ vote, etc.). In addition, the amendments implied the necessity that new issues of shares of daughter JSKs should be approved by the holding’s Board of Directors. In 1999 plans of creation of 10 to 15 large daughter companies on the base of existing regional companies were also discussed.

(6) Yet another variety of SOH structures are *newly created companies with mixed capital* with a certain state investment. It may be done by several methods:

- in the process of implementation of investment projects, real estate and equipment operation, some commercial activities;
- privatization of an enterprise by contributing its property in the charter capital of economic entities (2 known instances in 1998).

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(7) At last, it is the contribution of state-owned property in *financial and industrial groups*. The law on FIGs does not limit the share of state property in FIGs in quantitative terms. Moreover, Presidential Decree No. 141 of April 1, 1996 allows FIGs participants to contribute state-owned property to charter capitals of FIGs' central companies, to let this property out and to mortgage it. Central FIG companies may be trusted with state-owned blocks of shares¹².

The *common flaws* of these structures are well known: a trend towards monopoly (oligopoly) behavior, additional costs for procedural questions and audit of integrated companies, difficulties in control over the redistribution of resources (assets) and revenues, a trend towards politization, bureaucratization, etc. However, at least three aspects shall be taken into account for a deeper understanding of flaws of Russian holding structures:

- at the stage of initial and essentially non-economic reorganization of largest SOE (ex ante) there were no possibility to create optimal market-oriented managing structures aimed at economic efficiency;
- a chronic inability of public authorities to manage their property is coupled with general problems of corporate governance of, and control over Russian corporations;
- the general economic, financial, and political instability in 1990s.

That resulted in two processes characteristic of 1990s:

- permanent reorganization of holding structures (state-owned, private, mixed) accompanied by infringements on property rights, struggle for control, transfer of blocks of shares, etc. In this process the economic effectiveness and rational management did not dominate in all cases. In formal terms, motives of reorganization of state (politics, lobbyism, different types of ownership transfers, budge, IMF pressure, corruption) and private (optimization of management, mergers, disposal of companies operating at a loss, banishment of "outside" shareholders, expansion, tax avoidance, export of capitals) holdings shall be differentiated, however, they often interlace;
- use of the holding scheme (including holdings with the state participation) for servicing narrow group interests of governmental officials and private structures, the removal of financial resources (offshore holdings, transfer prices, profit centers outside of formal SOH, infringements on the rights of shareholders in holdings and daughter companies, etc.). The 1998 crisis increasingly intensified these processes (see Radygin, 1999).

In terms of corporate governance in all these situations, it is important to analyze how the state interests are represented in holdings' managing bodies and how effectively the controlling functions are exercised.

4. Existing Instruments of State Management and Their Effectiveness

As of November of 1999, there are 13,786 unitary SOEs and 23,099 agencies in Russia. The Russian Federation is a participant (shareholder) having over 25 per cent interest in charter capital of 2500 JSCs representing basic sectors of the national economy (including 382 JSCs with 100 per cent interest, 470 JSCs with over 50 per cent interest, 1601 JSCs with 25 to 50 per cent interest). Besides, the "golden share" is applied in respect of 580 JSCs.

Blocks of shares in 697 JSCs producing products (goods, services of strategic importance for ensuring national security (the list of such JSCs was approved by Decision of the RF Government No. 784 of July 17, 1998, "On the List of Joint Stock Companies Producing Products (Goods, Services) of Strategic Importance for Ensuring National Security, Shares in Which Fixed in the State Ownership are not Subject to Anticipatory Sale") were fixed in the federal ownership. According to other acts, shares in 847 JSCs are fixed in the RF ownership.

¹² The RF Goskomimuschestvo letter of October 17, 1994 states that the FIG status is incompatible with the holding company status. A holding company can not be a FIG participant in case (1) tangible assets make less than 50 per cent in the structure of its total assets and (2) the share of state-owned property in its charter capital exceeds 25 per cent.

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Dividends on the federal block of shares make Rub. 574.6 million in 1998, Rub. 270.7 million in 1997, Rub. 118 million in 1996, Rub. 115 million in 1995 (on the price scale of 1998).

In this presentation, it is impossible to make a detailed analysis of all aspects of managing the state property. The research section below will be limited to a short survey of existing instruments and the appraisal of their effectiveness¹³.

As the major element of the state policy in this area, the *institution of state representatives* may be singled out. Presidential Decree No. 1200 of June 10, 1994 "On Some Measures for Ensuring State Management of the Economy" envisaged: (1) framework requirements applied to contracts between the government (a federal agency) and respective chief executive officer of a federal SOE; (2) framework requirements applied to private individuals representing state interests in JSCs. These representatives were divided into two categories: (1) governmental officials; (2) other RF citizens (on contracts for representing state interests in JSCs).

At present their number is about 2,000, of whom 92 per cent are officials of federal executive bodies, 8 per cent – officials of different agencies. Only in few cases professional managers were invited to manage state-owned blocks of shares (the major reasons being unregulated issues of payment for their work, a complicated mechanism of transfer of blocks of shares in trust).

As per available appraisals, this institution is ineffective due to the following reasons: simultaneous common representation in several JSCs; lack of expertise; lack of material (legal) incentives, lack of clear (fixed in contracts) aims of representation; lack of mechanisms of property accountability aimed at lowering risks for the state; lack of reports on the situation of JSCs and of approved decisions, etc. However, the same requirements are applied to JSCs with different state shares although the degrees of the state influence are unequal¹⁴.

Among instruments the state used on a limited scale, or selectively, in 1992-1999 there were:

- individual "strategically" important instances (for instance, personal trust agreement concerning 35 per cent of state-owned shares in "Gazpom");
- boards of state representatives at largest holdings;
- "strengthening" of enterprises (holdings) with state participation by contributing to their charter capitals of state-owned blocks of shares in other enterprises (coal JSCs, "Svyazinvest," etc.);
- transfer of state-owned blocks of shares in trust (oil, coal, electric power engineering in 1992, general "Rules of Transferring Blocks of Shares Fixed in the Federal Ownership in the Process of Privatization in Trust, and on Concluding Trust Contracts for These Shares" 1997-1998);
- transfer of blocks of shares in trust of managing (central) FIG companies, or in management of holding companies (FIGs "Ruskhim," RJSK "Biopreparat," "Nosta-Gaz-Truby," JSC "Rosmyasmoltorg," special construction, etc.);
- personal appointments to Boards of Directors by decisions of the RF Government, or by Presidential instructions (RJSK "Gazprom," RJSK "Norilski Nikel," oil companies, etc.);
- determination of the order of voting by state-owned blocks of shares at shareholders' meetings (of oil companies – by RF Governmental decisions, of RJSK "EES Rossii" and JSC "Rosgazifikatsia" – by decisions of state representatives' boards);
- re-attestation of state representatives, investigation of instances when federal blocks of shares were diluted.

At the present situation the main complaints of the state as a shareholder about operations of these JSCs in principle coincide with complaints of other categories of shareholders. Major complaints are:

- lack of transparency both for ordinary shareholders, and for the state;

¹³ See also: Papers of the All-Russian Conference "On the System of Managing State Property in the Russian Federation." M., November of 1999.

¹⁴ The dilution of the state-owned blocks of shares approved by state representatives inflicted considerable losses to the state. It happened at a number of enterprises of strategic importance for ensuring national security: JSC "NII "Delta" (from 25.5 to 17 per cent), "Irkutskoye Aviatsionnoye PO" (from 25.5 to 14.5 per cent) in 1996, JSC "Permskiye Motory" (from 14.25 to 6.7 per cent) in 1997. Of course, there are unique instances when state representative actively influenced operations of respective enterprises. For instance, they initiated resignations of chief executive officers who were responsible for wage and budgetary payment arrears at 22 JSCs across different sectors.

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- less share of “outside” shareholders of JSCs achieved by additional issues of shares (without their consent) in favor of “inside” investors;
- transfer of tangible and financial assets from parent to daughter companies, as a rule controlled by managers, or companies connected to them.

At *unitary SOEs* (including “quasi-holdings” having daughter unitary enterprises) there are specific problems of management:

- absence of a complete register of unitary enterprises containing information on their assets and major results of their financial and economic operations;
- the number of unitary enterprises does not correspond to the state ability to manage them and to control their operations;
- absence of clear criteria concerning the necessity and functioning of unitary enterprises;
- major lines of business of unitary enterprises not always agree with the state interests (many of them keep their status due to insufficient liquidity of their property for privatization);
- functions concerning management of unitary enterprises are not clearly divided between different federal executive bodies;
- a number of unitary enterprises created before the Civil Code came in force does not agree with the current legislation in organizational and legal terms;
- no contracts were concluded with a majority of chief executive officers (CEO) of unitary enterprises; contracts in force do not include terms of CEO’s accountability, while the labor legislation effectively protects the rights of CEOs, it creates considerable difficulties in applying measures making them responsible for results of enterprises’ operations;
- the legal construction of full economic jurisdiction granting to its subjects (in reality – CEOs of enterprises) a broad authority in regard to the property of the owner (including independent management of financial flows and utilization of profits)¹⁵, while the authority of the owner is exhaustively determined;
- no mandatory regular audits are envisaged, it makes more difficult the control over their financial and economic operations.

In practice broad authority of CEOs of unitary enterprises at the background of lacking effective instruments and order of management, control, and incentives for CEOs results in re-direction of some financial flows of unitary enterprises to satellite firms, to conclusion of “inside” deals in the CEO’s interests, and to losses of budgetary revenues.

In this connection it is not surprising that law “On State- and Municipally-Owned Enterprises in the RF” (which were intended to amend respective provisions of the Civil Code) have not been approved yet.

When the new privatization law (Article 20) was adopted in 1997, it was expected that unitary SOEs could be reorganized in JSCs where 100 per cent of shares would be transferred in the state (municipal) ownership upon making inventories and audits. Via this instrument, the state enjoys an additional opportunity to sell certain property, though that case remains hypothetical in the event unitary enterprises preserve their right of “full economic jurisdiction.”

All the above considerations clearly testify to desirability of achieving positive shifts in the system of managing the property owned by the state in the framework of a large-scale comprehensive reform of the system of managing the state property at large¹⁶. Political and economic constraints on such a reform are also well known.

¹⁵ However, lack of interest (wish) of governmental officials to settle this questions officially (in the framework of charter) may be noted among reasons of uncontrolled utilization of profits. This right was granted to them by the Civil Code of the RF (Articles 294 – 295: the owner has the right to receive a share in profits).

¹⁶ Certain measures are envisaged in “Concept of Managing State Property and Privatization in the Russian Federation” (approved by Decision of the RF Government No. 1024 of September 9, 1999).

5. Concluding remarks

By 2000 about 100 officially created holdings with state participation exist in Russia. While evaluating the process of creation of holding structures on the whole, it may be agreed that the compulsory integration dictated by the state may be considered as justified in regard to the fuel and energy complex (FEC), some other industries (atomic power engineering, communications, MIC), individual unique enterprises (for instance, Russian Space Company “NPO “Energia” named after Academician S.P.Korolev,” aircraft holdings formed around major design offices etc).

This permitted to maintain the state control (at least in formal terms) over largest natural monopolies and some strategic enterprises (industries), to prevent the disintegration of traditional economic relations and full degradation of unique R&D projects, to maintain the manageability of the link “enterprise – association” and in the framework of integrated industrial and technological complexes.

At the same time, there appear doubts to what degree the creation of such structures in other sectors of the economy (construction and production of construction materials, civil engineering, textile and light industries, wholesale trade, etc.) is justified and to what extent it meets the requirements of the transition to market economy. As the practice shows, factors of (a) “voluntary” affiliation in holdings and (b) justification of affiliation in economic (managing) terms were not always taken into account.

It is also important to note that the formation of new structures of this type (as privatization progresses) is possible to the detriment of the existing corporations, established ownership relations, shareholders’ rights. In the process of redistribution of the ownership structure at the existing holdings political decisions often dominate. So, the importance of this trend will depend exclusively on the pragmatism and the common sense of the executive authorities.

A principal problem of the functioning of SOHs in Russia is the use of these structures (first of all in FEC) for (a) extra-economic goals (elections, financing of certain political elites) and (b) momentous (all-out effort) budgetary decisions. The consequence of such approach (in combination with the high level of corruption) is the general ineffectiveness of the state as an owner and, accordingly, minimal revenues from available assets.

The RF legislation (even while certain concrete issues are elaborated) has not presented a comprehensive basis for the regulation of holdings in Russia as yet. It is obvious that the approval of RF law “On Holding Companies” (or considerable amendments to law “On Competition...”) is necessary. The fragmented legislation is not the only problem. From the author’s point of view, the following interrelated questions are necessary:

- to reject the domination of “anti-monopoly” approach while registering transactions (even recognizing the importance of ensuring competition, the protection of shareholders’ rights, including the state, is not less important, what requires a *more comprehensive approach*);
- to introduce more strict transparency requirements (in terms of organization, finance, information) to the whole holding (group) structure;
- to introduce more strict requirements in regard to disclosure of information on real owners (covering chains of affiliated and interlacing structures), and, what is more important, their accountability;
- to ensure control over redistribution of resources (assets) and real results of holdings’ operations which may inflict losses for holdings’ participants;
- to introduce taxation within the holdings’ structures frameworks.

Alongside with a comprehensive development of the legislation related to holdings, it is also necessary:

- a serious reform of managing the state property (set of instruments, objects, enforcement);
- transparent privatization policies (in this case as a factor in corporate governance);
- the transition from the system of “hierarchical bargaining” between the state and largest SOHs to strict budgetary discipline;
- the rejection of extra-economic motives while reorganizing, redistributing ownership and finance, making changes in top management at state-owned holdings.

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- Many of these recommendations may seem trivial or naïve taking into consideration the Russian realities. However, in the most broad terms it concerns the global ways of development of the organizational and managerial structure of the Russian economy.

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Annex: Major Holdings with State Participation in Russia

Sector and company (State-owned share in parent company, % *)	Basic Documents on the Creation of Holdings and References	Holding's (Enterprise) Structure and % of Charter Capital Owned by Parent Company
1. Electric Power Engineering		
RJSK "EES Rossii" (53*) Natural Monopoly	Presidential Decrees (1992). The JSC's operation is regulated by laws: "On Governmental Regulation of Tariffs on Electric and Heat Energy," "On Natural Monopolies," "On Specifics of Disposing of Shares in RJSK..." Board of state representatives	(I). 9 JSCs-energo – 100%, 44 JSCs-energo – 49-100%, 15 JSCs-energo – 49%, 3 JSCs-energo – less than 49%; (II). 33 electric power stations, incl. 5-7- lease JSCs-energo, 5 – subsidiaries, 22 – daughter JSCs(in 12 – 100%, in 10 – 51-87%) (III). System-forming network, Central Dispatch Directorate – 100%; United Dispatch Directorates – subsidiaries; (IV). GBTs, JSC "Dal'niye elektropredachi", 4 construction organizations, over 60 institutes
2. Natural Gas		
2.1. Gazprom (37,5* (35#)) Natural Monopoly	Presidential Decree No. 1333 of November 5, 1992 35% of shares from the state owned block have been transferred in trust of the management of RJSK on the basis of Presidential Decree No. 478 of May 12, 1997 Board of state representatives	(I). 2 extracting associations, 6 extracting enterprises, 17 transport, 2 drilling, 1 foreign trade enterprises, 2 institutes, 1 association and 2 supplying and completing enterprises, 2 firms, 1 construction directorate, a communication station and directorate, 2 offices (dispatch and gas inspectorate) – 100%; (II). 2 associations including affiliated engineering works, 1 drilling, 3 service, 1 motor transport enterprises, 1 enterprise for constructing materials production, engineering association (1) and enterprise (1), 6 institutes, 5 construction-and-installation enterprises – in the capacity of daughter enterprises (51% and over) . (III). Daughter Banks. Some attempts are being made to organize daughter holding structures in other sectors (gas-and-petrochemistry, "Gazmetall," communications)
2.2. Rosgazifikatsiya (50% + 1 share #)	Board of state representatives	-
3. Oil		
3.1. Bashkirsкая Toplivnaya Kompaniya (100**)	Real specialization in electric power engineering, chemistry and petrochemistry	"Bashneft" (incl. 2 daughter enterprises) – 65 (68) %, "Baskirenergo"–32% (estimated), "Basknefexhim" (incl. 3 daughter enterprises) Republican branches of "Transneft", "Transneftprodukt"
3.2. Lukoil (27* before the sale of some shares at end-1999)	Presidential Decree No. 1403 of November 17, 1992	NGD –5 , NP –2, NO –7 (X) Probable merger of "KomiTEK"
3.3. Onako (85*)		NGD – 1, NP –1 , NO – 1 Control "Orenburgeologia" (a clash about the sale in the spring of 1999)

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Sector and company (State-owned share in parent company, % *)	Basic Documents on the Creation of Holdings and References	 Holding's (Enterprise) Structure and % of Charter Capital Owned by Parent Company
Rosneft (100*)	Presidential Decree No. 1403 of November 17, 1992; (for the state-owned enterprise); Governmental Decision No. 971 of September 29, 1995 (for OJSK)	NGD – 6, NP –3, NO – 15 Control "Arkhangelskgeologia"
Slavneft (86*) (10,8% - MGI of Belarus)	1994	NGD – 1, NP –2 + 26% of shares in Mozyr oil-processing plant (Belarus), NO –3
3.6. Tatneft (30**)	1994	
3.7. Tumen Neftyanaya Kompaniya (49-50*)	August of 1995 A sale of the state-owned share is envisaged	НГД – 6 , NP – 1, NO - 4 Attempts to merge daughter companies of an oil holding "SIDANKO"
3.8. Tsentral'naya Toplivnaya Kompaniya (100**)	Beginning of 1997	NGD – 0 , NP – 1, NO – 1
3.9. Transneft (75)	Presidential Decree No. 1403 of November 17, 1992	Natural Monopoly
3.10. Transnefteprodukt (75)	Presidential Decree No. 1403 of November 17, 1992	Natural Monopoly
4. Coal		
Situation differs very much across regions	In the framework of numerous acts on reforming of the coal industry	As examples: (1) Concern "Kuzbasrazrezugol" (27 enterprises, including 13 open pits). All blocks of shares in the holding owned by the regional administration were transferred in trust: 15% - "Kuzbasenergo" (November of 1998); 15,2% - "Mir-Ivest" (structure "Transraila" as the security against credit, February of 1999); (2) "Kuzbasugol": 37% blocks of shares in leading daughter enterprises have been sold.
5. Telecommunications		
5.1. Svyazinvest (75% - 1 share)	1995 Board of state representatives	(I). In 84 regional companies – communication operators 38-51% of voting shares (II). "Moskovskaya gorodskaya telefonnaya set" – 23%; Komi – 25%. (III). "Giprosvyaz" – 52% Under discussion is the amalgamation with daughter OJSK "Rostelekom"
6. Atomic Industry		
6.1. Rosenergoatom (100)	Status of a State Concern	8 NPS (Nuclear Power Station) (all, excluding Leningrad NPS)
6.2. TVEL (100)	Real specialization – fuel elements and installations, high-grade materials, also engaged in engineering, instrument production, conversion	"Mashinostroitel'nyi zavod" (Elektrostal'), Novosibirsk Plant of Chemical Concentrates, Moscow Plant of Poly-Metals, Chepets Mechanical Plant, Krasnoyarsk Chemical and Metallurgic Plant, Volzhski Engineering Works, Zabaikalski GOK, "Kommercheski Tsentri 100" (Moscow)

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Sector and company (State-owned share in parent company, % *)	Basic Documents on the Creation of Holdings and References	Holding's (Enterprise) Structure and % of Charter Capital Owned by Parent Company
MIC		
7. Aircraft Industry	- VPK MAPO - AVPK "Sukhoi" (KB "Sukhoi", 3 industrial associations, etc.) - Aircraft-Constructing holding company "Tupolev" (25,5#) - Interstate Aircraft-Constructing Company "Ilyushin" (Russia's share in the holding is over 51%, affiliated companies: OJSK "AK imeni Ilyushina – 60% and "Voronezhskoye aktsionernoye samoletostroitel'noye obschestvo – 30%) - Holding Company "Aviapriborkholding" (25,5#) As it seems, the creation of holdings has not been completed yet.	
8. Radio Engineering	Industrial Company "Kontsern Antei" (51#), products for AAD; Interstate Joint Stock Corporation "Vympel" (38#) etc.	
9. Rocketry and Space Industry	Rocketry and Space Company "Energia" (38)	
10. Electronic Industry	Rossiyskaya elektronika (51#). 10 % of shares in newly created JSCs are transferred to the holding, the rest is fixed in the state ownership.	
11. Special Construction		
11.1. Chief All-Regional Construction Department "Tsentr" (25,5#)	Presidential Decree No. 588 of May 25, 1998	(I). 3 integrated works, 4 plants, 1 supply enterprise – daughter enterprises; (II). 11 construction departments, 1 supply enterprise – 10% + 25% from the federal block of shares in trust
11.2. Joint Stock Holding Company "Glavstroiprom" (25,5#)	Presidential Decree No. 589 of May 25, 1998	(I). 4 integrated works, 3 plants, 1 supply enterprise – daughter enterprises; (II). 9 plants, 5 integrated works, 1 supply enterprise – 10% + 25% from the federal block of shares in trust
12. Medical and Microbiological Industry	RJSK "Biopreparat" (51#)	

* - sign (*) - with the federal executive bodies, sign (**) – with the regional executive authorities.

- fixed as per Decision of the RF Government No. 784 of July 17, 1998, "On the List of Joint Stock Companies Producing Products (Goods, Services) of Strategic Importance for Ensuring National Security, Shares in Which Fixed in the State Ownership are not Subject to Anticipatory Sale" (as amended on October 16, 1999) and other documents. The present size of the block of shares actually in the federal ownership is unknown.

X – for oil holdings: among system-forming enterprises of holdings the following categories have been singled out: NGD – oil and gas extraction, NP – oil processing, NO – supply with oil products.

Note:

Among largest holding structures with state participation (with some limitations) the following entities may be also listed: "Khimvolokno" (on the basis of enterprises and organizations of the State Concern of the same name), MGO "Tekhnokhim," "Energomash," concerns "Tyazhenergomash," "Transmash," "Khimneftemash," "Rostekstil," GJSK "Stankoinstrument," company "Roslesoprom," JSKOT "Korporatisya Farminindustria," JSC "Rosmestprom," "Roslegprom," JSC Federal Contract Corporation "Roskhleproduct," "Almazy Rossii-Sakha," "Sibirsko-Ural'skaya neftegazokhimicheskaya kompaniya" ("Sibur"), "Norsi-Oil," "Rosshina," "Ural'skiye mashinostroitel'nye zavody."

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Some of them are genuine holdings of mixed type. Some can be only capital-located offices performing in some cases the functions entrusted with them (as it was instructed by RF Governmental Decision No. 674 of June 15, 1994 in regard to 51 per cent of shares in 38 refrigerating integrated works). Regional holdings created “from below” at the level of the subjects of the Russian Federation are in a separate bloc.

Table data was prepared by G. Mal’ginov.