OECD

Questionnaire

Corporate Governance in Eurasia

2000

The corporate governance environment in your country and its impact on corporate performance and finance

1. The general economic context

1994-1998 Results

The economy of Kyrgyz Republic cover (for the period of 1994-1998) the economic situation deterioration (1994-1995), then stabilization and reviving of the economy (1996-1997) and later global financial crisis of world economy (1998)

Correlation between state and private sectors of economy is sufficiently changed in this period. The number of state enterprises (excluding the enterprises in agriculture sector) decreased from 3,900 in 1994 to 1,100 in 1998. The production share of these enterprises in GDP reduced from 17,9% in 1994, to 3,4% – in 1998.

The real growth of GDP stated 2,1% last year. Correlation of branches producing goods and providing services is rapidly changed, where the GDP is increased from 30,1 to 34,7%. Net tax for goods is increased by 1,1%.

In spite of the stable growth of GDP for the last three years, the rate stays sufficiently low then it indicated in the beginning of 90th.

Considerable rate of inflation growth begins from early 1990, in 1997 decrease till 13%, then in 1998 increase again up to 16,8%.

Brief results of first half of 2000

Results of first half of 2000 shows the consolidation of positive tendencies in economy development.

Real GDP growth in first half year, according to preliminary evaluation is 107,4%. Increase of GDP is provided mainly in agriculture sector by 2,6%, construction by 2,2, industry by 0,8 and trade by 1,1%.

In the industrial sector of the Republic achieved the growth of production volume. The index of physical volume of industry production is 103,3%, without taking into consideration the mining enterprise “Kumtor ” is - 104,2%. The increase achieved by the production growth in energy sector, fuel industry, light and food industries.

Turnover of external trade (including the non organized trade) compiles in current prices US$ 371,6 millions during the period of January-May 2000 (89,3% to the relevant period of last year). Export decreased to 12,5% for the same period in comparison with January-May 1999, accordingly import decreased to 9,2%.

Export and import operations for the period of January-May determined the deficit of trade balance in the size of 39,8M US$. The level of coverage import by export compiled 80,7% (January-May 1999 - 83,7%).

Official average exchange rate of 1 US$ 47,47 Som in June 2000, in comparison with May it decreased by ,4%. Within six months the average rate of US Dollar increased by 3,5%.

Inflation in consume sector of economy in June of current year compiled 0,7% in comparison with previous month, and 7,1% in comparison with December 1999.

1998 Financial Crisis

Negative impact of financial crisis in 1998 were closely connected with consequences of Russia crisis and reflected in following:

- Decrease of export volume, as well to Russia; increase of import, including Russia;

- Recession of production in the enterprises related with Russian and accompanying to this process the deceleration of production growth in general, deterioration of production and financial ties between kyrgyz and russian enterprises as a result of сбоев in the activity of payment system;
- Increase of hard currency demand related the growth of general import, including Russia (currency conversion (US$) in deals with Russian enterprises) ;
- General growth to foreign currency relates also with psychological impact of the financial crisis in Russia and negative expectation of the population regards to further deterioration of financial situation in the Republic in the nearest future, and as a result – continuing from August 1998 the fall down of exchange rate of national currency;
- Decrease of the level of gold reserves of the National Bank of the Kyrgyz Republic, the volume of monetary basis and monetary массы;
- отток deposits of the population from bank system, strengthening the dollarisation of the economy, deterioration of investment environment to the economy and especially in real sector (first of all, in the result of further growth of credit interest rates in commercial);
- Deterioration of the financial conditions of commercial banks of the Republic in the result of оттока deposits of the population and decreasing the general level of liquidity;
- Sharp growth of profitability on state treasury bills, reduction of indicated volume of their issuance and deterioration of terms for state budget deficit financing.

With aim of overcoming the negative impact of 1998 financial crisis, the government of the Kyrgyz Republic adopted the “Program of overcoming crisis impact to the economy and improvement the sustainability of financial system of Kyrgyz Republic” which includes:

- Strengthen fiscal operations in accordance with changed external and internal resources;
- Review the 1999 budget in accordance with changed external economic situation;
- Measures for reduction of trade balance deficit, particular decrease the volume of import and increase the volume of export;
- Measures on strengthening the financial discipline in regards the enterprises and organizations, which had tax debts;

- Creation of favorable environment for enterprise oriented to export, especially enterprises producing agricultural products;
- Full implementation of obligations on state securities for providing stable development of financial market;
- Banks permitted to use obligatory reservation fund;
- From the National Bank of Kyrgyz Republic implemented the emergency crediting of commercial banks;
- Banks, under bankruptcy procedures, were transferred to the National Bank of Kyrgyz Republic for management or sold to other people.

2. The corporate governance characteristics in your country

a The corporate governance agents

History and mechanisms of privatization, which started in 1990, nowadays mainly determine the structure of corporate property.

One the first mechanisms, used for public privatization, were exchange of privatization bills as it happened in Russia with vauchers.

Later, privatization programs on economy branches were used and as a result all trade and communal services enterprises are private today.

The main participants of these process were labor staff of the companies, population and investment funds. Therefore, the majority of enterprises were privatized free or on a cheapest price.

In general, more then 60% of state property are already privatized in comparison of what indicated in the plan of privatization.

Nowadays, in general structure of property the leading positions are held by:

- Labor staff,
- Population,
- Investment funds,

But all these institutes have a minor quantity of shares.

State is one of the big shareholder in most enterprises nowadays, the state has different share packages in more then 300 joint stock companies. Moreover this situation will keep stable for some time despite of continuing process of privatization as it is impossible in one moment or within short time to sell all state share packages.

Moreover the privatization is becoming difficult due to:

1. There are enterprises, privatization of which will (i) made a great impact to the economic process in the scale of Republic in general, and (ii) the estimated cost of these enterprises are very high. These are huge, so-called natural monopolists and strategically important enterprises therefore the Government of the Kyrgyz Republic prepares their privatization very carefully.
2. Financial sector, especially fiscal (including the depreciation policy) and credit system are nor favorable yet for activity in the enterprise sector.
3. The business class of the Kyrgyz Republic:

- still has no possibilities of placing financial recourses into enterprise acquisition
- still has not enough confidence to the state policy in the field of restructuring of ownership or, in other words, to "fair game" of the state;

4. The foreign investors (from among the strategic investors) are not sure in the safety of long-term investments in real sector.

Therefore, the following corporate groups, such as big investors, corporations, holding companies, non-banking financial institutions and banks are most likely solitary instances and play insignificant role.

The state as a major shareholder cares of the quality of management at the enterprises. With these purposes, basically three mechanisms of observing of state interests are being applied:

- appointment of the state representatives in Executive Body of the enterprises where the state is a major shareholder;
- transfer of state packet of shares in trust;
- transfer of state packet of shares to management group of the company.

But experience shows that the first method of managing of the state packet of shares is imperfect so far as the representatives of the state at the enterprises are state employees, and given method contradicts to the principles of a "Bill on a public service", and therefore can be a source of corruption including for the following reasons:

- enterprise management under state employees do not provide its efficient management. "State - business" dilemma: the state should not interfere to a business sphere but create necessary conditions for its functioning.
- managing by non-professionals. State officials have not enough knowledge and experience in enterprise management, especially in a crisis.
- economic and juridical contradictions as a consequence of holding simultaneously state and commercial appointments.
- obstacles for investments. The Board of Directors settles the agreements on investment conditions. State officials have to make big investment requirements because of budget interests, economic growth and other state issues.

It is necessary to implement fundamental reforming of the system of an enterprise management bodies state representing in accordance with the following principles:

- public service should not be combined with managing activity at the commercial company,
- representing of state interests at the stock companies on the basis of reward of an enterprise financial and economic results,
- managers appointment on the competitive basis.

Institutions on effective management in enterprise sector of the economy such as bank groups, financial or brokerage companies – are not developed yet in the Kyrgyz Republic.

The securities market operating with financial securities but do not attract an additional capital in the companies.

The role of Social (Pension) Fund in the development of companies is also insignificant. In accordance with the Resolutions of the Government of the Kyrgyz Republic of the Kyrgyz large enterprise's 8% of shares was placed under control to

Social Fund. However the shares were placed under control without the right of further sale.

b. Corporate behavior, finance and restructuring

Diversification of corporate groups is very insignificant in economics of the Kyrgyz Republic and may not be considered separately.
Typical stocks sharing in typical company are as follows:

1. Portfolio investors – about 10-35%
2. Staff of the company – about 5-45%
3. State Property Fund – about 20-85%

We could not obtain exact and objective statistics on the return on equity of data-sheet passed companies. The same situation with an investment average rate and with a corporate companies cash flows.

Concerning the company's debt defaults the total amount of liabilities is about 280 million USA dollars. Actually the most of these companies can be characterized as bankrupts.

One of the components of the Program "Corporate Governance and Enterprise Reform" was the capacity building of bankruptcy procedures. In this case there was developed a new Bankruptcy Law. Moreover, there was held a complex training of the staff of the Supreme Arbitration Courts.

Nevertheless one of the typical problem is a low speed of consideration and passing of bankruptcy issues. Figuratively saying the speed of bankruptcy issues decision-making lags behind of the speed of commercial activity.

Concerning the restructuring processes it is necessary to note that there is no clear correlation between the rate of enterprise restructuring of financial crisis of 1998.