Governance in Russia

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1. Introduction

It is sometimes asserted that Russia has a governance problem[2]. That is mostly meant to imply failings in the economic environment and associated juridical and legislative arrangements. However, the dimensions of the problem have increasingly been extended beyond the economic realm into the workings of the political system and decision-making, particularly in the last few years. Concerns over the diminution of political competition as well as the personalization of power, along with its nexus of connections, have surfaced. But if Russia does have a broad problem with governance, what actually does this mean and how best can it be identified?

This paper addresses these issues by organizing the governance problem into three broad but related components. These can be termed the strategic, corporate and political dimensions of governance. The first relates to what can be considered the broad direction of the economy, notably the ownership of assets, the composition of output and the associated sources of growth. The second concerns the way in which the productive core of the economy - its companies - are owned, managed and governed. The third relates to the way in which political decisions are made and with what degree of accountability and transparency. These elements are, of course, closely connected and, in many regards, mutually dependent. But they require a wider – and in many ways, more meaningful – application of the term, governance, than is commonly the case[3].

The paper is organized as follows. *Section 2* outlines the main arguments of the paper and places them in a longer run context that stretches back to the 1990s. *Section 3* then briefly looks at strategic governance dimensions in the recent past and currently. *Section 4* proceeds to describe and analyse the important changes in the configuration of ownership of productive assets that have occurred since 2000. *Section 5* is concerned with measurement of the size of the public sector and particularly the large – and growing - portfolio of state-owned assets. It also discusses the development of a connected or crony sector involving individuals, businesses, activities and networks closely associated with political power. *Section 6* turns to corporate governance. While there have been some clear

[1] Thanks to Valeriya Kriukova for research assistance and to Anders Aslund, Irina Denisova, Vladimir Gimpelson, Christopher Granville, Olga Karaeva, Philippe Le Houerou, Yakov Pappe, Michal Rutkowski, Denis Spirin, Carsten Sprenger, Sergey Ulatov, Natalia Volchkova, Mattias Westmann and, in particular, Birgit Hansl, as well as many other acquaintances, officials and contacts in Russia, for very helpful discussions about the issues covered in the paper. Thanks also to Elena Bondarenko, Olga Emelyanova and Alina Shcherbakova for help with collecting and organizing some of the data. Contact details: Simon Commander, Altura Partners, London and IE Business School, Madrid. Email address for correspondence: scommander@alturapartners.org

[2] For example, in World Economic Forum (2013)

[3] One common dimension of governance – namely, the legal system and its operation - is not discussed in this paper

improvements in recent years, this is less true in the case of state owned companies where governance remains mostly opaque. *Section 7* then explicitly looks at the political governance of Russia and, in particular, the association between politics, policy and attitudes in the population. Although the available evidence suggests that there have been significant and recent shifts in opinion, there is also evidence of a reasonably stable core of attitudes that are not necessarily consistent with current attitudes. *Section 8* focuses on the wider challenges facing the Russian political economy in the light of its current governance arrangements. It makes some specific policy recommendations while also raising a set of questions regarding both the likely durability and desirability of current arrangements.

2. Taking a long view

Russia presently faces falling natural resource prices as well as sanctions imposed after intervention in Crimea and Ukraine. As a consequence, GDP has fallen by around 4% in 2015 and a further decline of around 1% is expected in 2016. Real wages have declined by around 10% on average in 2015, with an even larger fall in public sector wages[4]. While the immediate and adverse impact of oil and gas prices far outstrips that of sanctions, both combined potentially represent a challenge to the political and economic *status quo*. Although the bedrock of the system are natural resource revenues, the paper argues that it is the associated structure of asset ownership and control that now determines much of the economy's vitality – or lack of it – as well as the wider standard of living.

Having emerged from the Soviet Union with most productive assets in state hands, waves of privatisation in the 1990s subsequently gave way to bouts of renationalisation and consolidation after 2000. The paper documents that as a result consolidated government and public sector expenditure now accounts for over two thirds of GDP. In other words, in the course of the last 15 years, Russia has once again changed direction and passed from being an economy that was mainly private to one now dominated by government and the public sector. It is hard to find parallels in the economic and political model to present-day Russia, let alone parallels that hold out the prospect of economic vibrancy. China - for reasons discussed in more detail in *Section 8* below - is *not* one.

Some of the roots of this deviation back towards a state-dominated economy lie in some of the main events of the 1990s. Opinion polls and other surveys suggest that a majority of Russians view that decade as economically painful, disruptive and unjust. In retrospect, that period appeared to have offered up an unenviable trade-off: escape communism (through privatisation and associated actions) but get concentrated capitalism in its place. That translation was not necessarily popular. This was accentuated by the lack of transparency with which concentrated capitalism was engineered, as well as the evident suasion that the new asset owners had over the state. In short, the rebirth of capitalism in Russia was real enough but it had a fragile political legitimacy that has subsequently been eroded.

[4] World Bank (2015)

Since 2000 and the first election of Putin as President, a different dynamic has been set in motion. Initially, constraining and limiting the state capturers (real or putative) was the principal political objective. The first consequence was that a major natural resource corporation (*Yukos*) was taken back into state ownership. Other so-called oligarch assets were mostly left untouched. A second outcome was that real income growth for the bulk of the population occurred on the back of sustained oil/gas prices. Among other things, this allowed public transfers to grow – notably to pensioners, a large and growing part of the demographic. Opinion surveys indicated widespread appreciation of the greater political and economic stability that had emerged[5].

The paper documents how two parallel sets of policies and political argument that gave precedence to the public sector emerged in the 2000s. The first was the progressive limitation of private ownership in natural resources. This was presented in a variety of ways, including safeguarding the integrity of the state. The second was to extract selectively components of industrial policy from other settings (including Israel, East Asia) and to use (natural resource) revenues to fund significant public interventions with the declared aim of modernising and diversifying Russia. Although substantial resources were deployed, these were done in a largely ineffectual manner. With the benefit of hindsight, the main consequence was to bolster the state-centred model with the state this time portrayed as moderniser.

Even with a growing role of the public sector, some important and well-managed private companies emerged in a range of sectors where legislative and other constraints had not been imposed. However, the economic model that took shape after the mid-2000s largely discounted the idea that popular capitalism - small and middle sized firms starting out and growing – would be the main drivers of growth. Rather, the future was seen to lie with a mix of publicly owned companies and assets as well as larger private companies, including the assets of existing and emerging oligarchs. Inefficiencies were effectively camouflaged by the large inflow of natural resource rents/revenues.

The proliferation of the state sector and control offered opportunities for political patronage and rent allocation. This was reflected not only in the selection of management and the balance of control between management and Boards, but also in facilitating private revenue flows off public assets. Major assets – particularly in natural resources – came to be parked behind public ownership, facing little or no competitive challenge and with little effective oversight of managements that were appointed by, and could be responsive to, politicians and incumbent power.

In addition, the paper also chronicles how, over recent years, a significant market presence has been built by companies and individuals closely connected to power. This presence can be traced back to the access and contracts that connections have unlocked, including with government agencies and/or natural

[5] See, for example, EBRD (2006)

resource SOEs, notably *Gazprom*. A further and relatively recent feature is that some of these connected parties have with deliberation set about accumulating major media holdings.

In terms of commonly used measures and dimensions of governance, there is little doubt that Russia scores poorly. Cross-country product market indicators compiled by the OECD showed that by 2008 policy was judged to be the least promoting to competition among the major emerging markets with the solitary exception of China[6]. Although there was some improvement between 2008-2013, both public ownership and direct control over business indicators increased unambiguously over that period. Other measures, such as the scope and governance of state-owned enterprises remained basically stable but with a relatively poor ranking compared to other OECD and emerging market economies[7]. Another recent index ranked Russia worst among a large group of advanced economies, as well as China, India, Mexico and Indonesia, in terms of perceived corruption among public officials and politicians[8]. And although the Worldwide Governance Indicators and rankings show some improvement in indicators for government effectiveness, political stability, control of corruption, rule of law and regulatory quality since the early 2000s, improvements have mostly stalled or even gone in reverse over the past five years. By 2014 Russia ranked below the 50th percentile on all indicators bar one. On one important indicator – voice and accountability - the country has unequivocally gone backwards since 2000, as well as since 2010[9].

The governance features summarized above have deterred private sector entry, entrepreneurship, investment and innovation, while distorting competition in favour of privileged parties, whether incumbents, politically connected entities or the public sector[10]. While it is certainly the case that Russia has some profitable and well-managed and governed companies, the space in which they operate has over the past decade receded significantly. And with this composition of output, an obvious question concerns the future sources of growth.

The enlarged public sector, coupled to connected companies and individuals, cannot be disentangled from the political context and loci of power. The tension between policies that can stimulate growth and those that facilitate rent seeking has sometimes been presented as the central conundrum facing Russian policy-makers[11]. The political equilibrium has been organized around broad-based growth in disposable incomes and a combination of higher transfers and public services, along with the attenuation of political and civic rights and reduced scope for turnover and political competition. This has sometimes been represented as a form of trade-off. But while this might be part of the current government's calculus, it is not at all clear that this is widely accepted trade-off

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[6] OECD (2011)
[7] See http://www.oecd.org/eco/growth/indicatorsofproductmarketregulationhomepage.htm
[8] Transparency International Corruption Perceptions Index for 2012
[9] See; http://info.worldbank.org/governance/wgi/index.aspx#reports
[10] EBRD (2013); World Bank, (2014)
[11] See, for example, Yakovlev (2014)

among citizens[12] and, even if it were, it is unlikely to be a stable one. Further, suppressing investment and productivity growth risks potentially opening the door to social and political discontent. Even if, in response to persistence in low energy prices, policy shifts towards selective liberalization and, possibly, some privatisation, the impact on aggregate productivity would probably not be large and certainly not instantaneous.

3. Strategic governance

Economic or strategic governance relates to the chosen direction of the economy and the structure of output and value added, as well as ownership arrangements, associated with that direction. Since the collapse of the Soviet Union in 1991, the analytical and policy features of main interest have been, first, the extent of diversification in the structure of the economy and, second, the structure of ownership of assets including, but not limited to, the natural resource sectors.

With respect to the first dimension, by 1997 oil and gas revenues had fallen to around 45% of goods exports and amounted to less than 5% of the federal budget[13]. But by 2010 - as also currently - oil and gas revenues had climbed to around 70% of total exports and over 50% of federal government revenues. Since 2008 the non-oil deficit has averaged around 10% of GDP each year. The long upward swing in oil prices that set in after 2000 had a powerful impact on both the level of government spending and the composition of revenues[14]. It also effectively meant that the rhetoric of diversification remained precisely that.

As regards the second dimension, the path has been quite non-linear. By 2000 roughly 70% of GDP was attributable to the private sector. This share then began to fall and by 2010 was estimated to be in the range of 60-65% of GDP[15]. Shortly thereafter, a number of estimates, including by the OECD, suggested that the size of the state owned sector was around 50% of GDP[16]. For example, by 2011 in the banking sector, state owned banks clearly accounted for over half of total bank assets on a rising trend. An estimate from the Russian Ministry of Economic Development indicated that the share of state-owned firms in total profits had risen from around 40% to 50% for the top 40 companies and from 40% to just over 60% in the financial sector between 2006 and 2012[17]. Since then, the trend has been further downwards and it is now conjectured – if imprecisely measured - that the private sector's share of output may have fallen below 40% by 2014/15. The resurgence of the consolidated public sector can be attributed to explicit policy preferences, including, as documented below, a desire to control so-called 'strategic' sectors as well as creating national champions.

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[12] Opinion polls and other surveys aimed at eliciting measures of trust – such as the World Values Survey and Life in Transition survey – paint a more variegated picture, both across income categories, age groups and regions as well as across time, see *Section 6* below.

[13] At present, oil and gas accounts for nearly 10% of GDP – although this is likely to be under-estimated due to continued transfer pricing.

[14] It is also reflected in sectoral contributions. A comparison of the largest 500 companies in Russia and the USA shows that energy companies contribute around 17% to the total revenues of all 500 companies, as against nearly 42% in Russia.

[15] See EBRD (2013)

[16] OECD (2013)

[17] Cited by Ulatov (2014). The calculation might be quite suspect given the use of profits

Placed in longer context, Russia is less diversified now than it was towards the end of the Soviet period while the weight of the state sector and its contribution to output and employment has followed a form of U shape. In retrospect, the emphasis on state-led diversification and innovation produced very limited results. But even if the focus of public policy on modernizing diversification has faded, one common feature has carried over; namely the central role given to the state and public sector.

4. Configurations of ownership over time

4.1 The legacy of the 1990s

Privatization of state owned assets and the entry of new companies transformed the ownership landscape in the 1990s, albeit in ways that left a lingering bad taste in the population about the process - and fairness - of privatization. Consequently, much of the earlier attention was focused on the interaction of state and business and, in particular, the emergence of powerful economic interest groups alongside significant concentration in ownership rights. The second decade of transition has been rather different. Although most of the great fortunes accumulated in the first decade have been maintained, and often consolidated, a parallel process was started in which, among other changes, some renationalisation occurred.

World Bank (2005) provides some useful benchmark evidence for the configuration of the economy near the start of the first Putin presidency. At that time, a high degree of concentration of ownership or broad sectors of the economy had already emerged. There had been a clear shift away from state ownership associated with the various waves of privatisation. Consequently, by the early 2000s, control by financial-industrial groups was particularly strong in banking and industry. In the latter they controlled nearly 39% of total sales, while the combined federal and regional governments controlled nearly 25%. Financial and industrial groups accounted for around 20% of total employment in industry while government's share was around 7% (*see Table 1*). Both financial and industrial groups, as well as government, were concentrated on larger, more capital-intensive firms and sectors. Regarding the sectoral distribution of control, large private owners were concentrated on oil and raw materials, automobiles and chemicals while government was concentrated on gas, energy and pipelines. The main subsequent change has been that the oil sector has largely – but not entirely – shifted into government hands.

Accompanying the growth of large business groups' share of economic activity was the much discussed – and very rapid – accumulation of wealth by a limited number of beneficial owners of these groups. By 2004, the top 10 had net wealth equivalent to 9.7% of annual GDP[18]. Those individuals' interests spanned nickel, non-ferrous metals, aluminium, steel, auto-manufacture, pulp, machine-building telecoms and natural resources. Interestingly, the ranking has been fairly stable over time so that 7 out of the top 10 in 2004 were still there in 2014/15[19]. Guriev

[18] Calculated using the Forbes measures of individuals' net worth in 2004

[19] In 2014/15 the top 10 individuals had a net worth equivalent to nearly 7% of the country's annual GDP, while fewer than 90 individuals had wealth equivalent to around 18% of national

and Rachinsky (2005) provide a similar list of so-called oligarchs – comprising 30 individuals – whose business vehicles accounted for around 40% of sales for the largest firms in industry in the early 2000s.

Table 1: Sales, Employment and Asset Shares by Ownership Type, 2001-02

Sector	*Big Business*	*All Government*	*Federal Government*	*Regional Government*	*Foreign*	*Other Private owners*
Sales						
Industry (32 sub-sectors)	38.8	24.5	19.6	4.8	5.3	31.5
Employment						
Industry (32 sub-sectors)	20.2	7	4.4	2.6	1.2	71.6
Assets						
Banking	17.4	25.6	19.8	5.7	10.8	46.2
Source: World Bank 2005						

In short, by the early 2000s the largest industrial sectors were dominated by Russian big business or oligarchs. It is difficult to draw robust conclusions about relative efficiency. Earlier analysis suggested that firms held by branches of government performed relatively poorly. There was some (weak) evidence that oligarch firms at that time outperformed other private Russian owners[20]. But superior productivity could have been due to other factors, including selection issues, as well as ability to deploy political connections. There was also a body of evidence indicating that oligarchs were able to lobby effectively and in ways that were favourable to their interests rather than to businesses in general or new entrants in particular. Certainly, survey and other evidence pointed to a widespread problem with lobbying and preferential treatment at both federal and regional levels. Although the beneficiaries of preferential treatment were by no means exclusively oligarchic holdings, such groups were nevertheless able to derive specific benefits while distorting the business environment for others[21].

Some six years later, *Rosstat* data indicated that 11% of all registered firms and organisations were either in majority public or mixed ownership and those with majority state ownership accounted for nearly a quarter of total fixed assets in 2007. Sprenger (2010) also provides reasonably detailed estimates of the size of the public sector in 2008. The number of federal state unitary enterprises was then 5709 and the number of Joint Stock Companies with a federal government stake was 3674. These numbers appear to have grown significantly since then, as indicated in *Section 5.1* below.

Table 2 provides some summary information. In 2008 nearly 9% of all registered firms and organizations were either state or municipal and these accounted for

income (compared with 13.4% in 2004). Thus, although the share of the top has fallen, the share for the total group has increased significantly. Data on individual wealth have been compiled by Forbes

[20] World Bank (2005)

[21] See World Bank (2005)

just under a quarter of the total capital stock and over 30% of employment. Fully state owned and mixed ownership companies accounted for over 18% of manufacturing industry. There had already been considerable strengthening of control over the largest companies by the Russian government as a direct result of explicit policy choices and institutional options. For example, companies were consolidated into large state holdings, as was the case in the military-industrial sphere where the public corporation – *Rostekhnologii* – grouped over 400 ex-SOEs in 30 sub-holdings. Some of these consolidations produced highly diverse portfolios in the resulting holdings; - a feature that has persisted to this day.

Table 2: State shares in 2001 and 2008

Category	**2001**	**2008**
Number of companies		
State & Municipal	11	8.6
Private	75	82.5
Mixed		1.8*
Employment		
State & Municipal	37.3	31.4
Private	47.7	57.3
Mixed	11.6	6.3
Fixed Assets		
State	26	24
Private	74	76
Source: Sprenger (2010)		* for 2007

The legal structure adopted for state companies suffered from a variety of shortcomings, including a lack of unified legal framework. In terms of corporate governance, unclear Board responsibilities, skewed incentives for managers, weak disclosure requirements and exemption from bankruptcy law were some of the main features.

4.2 Consolidation and nationalisation in the 2000s

If the 1990s were an era of privatization and asset divestiture, the 2000s have been one of consolidation (e.g., *Rosatom*; *Rostekh*; *Rostelecom*) and nationalisation (e.g., *Yukos; Sibneft; Uralmash; Troika Dialog*) &/or re-nationalisation (e.g., *Bashneft*)[22]. Although these have been distinct and somewhat different processes, they have had one common outcome - to reinstall the public sector at the centre of the economy, notably in the natural resource, finance, defence and some technology sectors[23]. The boundaries of the state and private sector, including big business, have once again been redrawn using a variety of instruments and policies. In addition, there has been some recasting of the boundaries within the private sector as newer connected parties have emerged and used their connections to their benefit. This wider process has been associated with a set of formal decisions and government or Presidential edicts/orders.

[22] Pappe and Antonenko (2014a&b) provide a detailed analysis of these processes and the motives behind them

[23] Sprenger (2010) details the legal forms for SOEs, namely Joint Stock Companies; Unitary Government Enterprises and State Corporations

In January 2003, Government order no 91-p was issued which listed the companies in which the government held an equity interest. These included entities such as Russian Railways. In addition, there followed a series of executive orders that have laid out the boundaries of the private sector by defining sectors and firms that are deemed strategic. The first executive order was no.1009 – the list of strategic enterprises and joint-stock companies – that was issued in August 2004. Those listed companies were prohibited from being privatised without a specific presidential decree, while in addition special measures were to be invoked in the case of prospective bankruptcy. This order has been subsequently modified on multiple occasions. As of 2015, the list of specified strategic companies was 140, of which 34 had been added since 2006/7. Many of these entities are research or technical institutions, as well as media companies. A further 44 strategic joint stock companies were listed, of which 12 have been added since 2007. These included *Aeroflot* and *Transneft*. FZ 57 from April, 2008 further laid out a list of so-called strategic activities relating specifically to national defence and state security.

Publicly owned assets have been subordinated to a variety of institutions since 2000[24]. From 2008 onwards they have been managed by the Federal Agency for State Property Management (*Rosimushchestvo*) that is meant to act as the controlling shareholder. The agency has a very large number of companies under its notional control (see *Section 5.3*). Presently, there are 1677 first tier companies in its portfolio with a far larger number of subsidiaries.

5. Measuring the public sector

Calculating the relative contributions of sectors to national income is not at all straightforward. This is because of missing data - notably for value added - and the ways in which evidence is also reported, whether regarding specific companies' balance sheets and other information, as well as lack of clarity concerning ownership. The public sector suffers from quite non-transparent and incomplete statistical coverage – for example, only a relatively small fraction of companies are required to publish accounts. This means that a clean and unambiguous measure of the size of the public sector is presently not feasible. What can be done, however, is to piece together specific pieces of information relating to sales, assets and revenues over time so as to draw a picture of the evolving dimensions and trajectory of the public sector. This is attempted in *Section 5.1* below.

However, simply measuring the size of the 'formal' public sector is likely to be somewhat misleading when trying to get a sense of how the state and its actors affects the economy. As indicated above, the problem of close connections to the state has been a constant area of debate since the 1990s. In addition, over the last decade, some specific connected or crony entities appear to have benefited

[24] May 18, 2000 – March 9, 2004: Ministry of Property Relations of the Russian Federation [Министерство имущественных отношений Российской Федерации)
March 9, 2004 – May 12, 2008: Federal Agency of Federal Property Management (Федеральное агентство по управлению федеральным имуществом)
June 5, 2008: Federal Agency for State Property Management (Федеральное агентство по управлению государственным имуществом (Росимущество)

from proximity to power. Such benefits – it has been alleged – have flowed through access to finance, contracts and other privileges. While it can be argued that in the current context, almost all large businesses have to be mindful of the state's objectives and other requirements, there is a subset of companies that have developed and/or grown in particularly close proximity to political power. Although, identifying with any precision the benefits of proximity to power is very difficult, *Section 5.3* attempts to identify the main connected entities and to draw some conclusions about their scale and dynamics.

5.1 Dimensions of the public sector

5.1.1 Fiscal indicators

Although measurement is certainly problematic, it is possible to get some simple benchmarks. Approached from the perspective of the fiscal accounts, IMF (2014) found that in 2012 the aggregate public sector accounted for expenditure of over 68% of GDP. *Table 3* gives a breakdown of the consolidated government as a share of GDP in 2012. It can be seen that roughly 60% of expenditure was attributable to the general government and 40% to public corporations. The latter share was, however, an under-estimate as it was based on the 26 largest public corporations[25]. The study considered that the public sector comprised nearly 82,000 separate institutional entities under a variety of legal formats. Excluding the budgetary and extra-budgetary central government entities, social security funds and sub-national governments, there were over 31,092 public corporations composed of 22,440 unitary enterprises, including, for example, Russia Post, that operate at all levels and close to the borders of the government, 308 government corporations – classified as non-profit but in some instances clearly implementing elements of public policy (e.g., *Vnesheconombank*) and 8,344 joint stock companies. Most of these were closed joint stock companies with very limited reporting requirements. There were a further 10,799 unspecified government controlled entities.

To put the substantial size of the public corporations sector into further context, their gross liabilities were around 150% of GDP (of which two thirds were attributable to the largest companies)[26]. The 18 largest of these state-controlled joint stock corporations had liabilities equivalent to around 17% of GDP in 2012, of which *Gazprom* and *Rosneft* combined accounted for nearly 50%. As regards financing, subsidies and equity purchases for public corporations had risen from around 7% of general government expenditure to >11% by 2011[27].

Aside from noting that precise information on the size and composition of public sector companies is not available - the Federal Agency for State Property Management has yet to produce a complete and publicly available register of public sector companies - the IMF study also recommended that public corporations publish financial accounts. In addition, it was noted that there are

[25] The IMF also noted that there was no information or analysis of the overall size and composition of the public corporations sector, let alone regarding their performance including subsidies and other supports received

[26] Note that general government liabilities were only 11% of GDP

[27] Subsidies to unitary enterprises were considered to be far lower at around 0.2% of federal government expenditure

not clear boundaries between the government and the public sector, including in terms of the budget and other quasi-fiscal operations.

Table 3: Russia – Fiscal Measures for Size of Government in 2012 (as % GDP)

Category	Revenue	Expenditure	Balance
General Government	44.4	41.4	3
Public Corporations	28.6	28.6	
Public Sector Consolidated	71.3	68.3	3

Source: IMF (2014)

5.1.2 Public enterprises and the corporate sector

To get a sense of the weight of public enterprises in the corporate sector, *Table 4* now lists the largest 15 Russian companies in 2014 when ranked by both sales and employment. It can be seen that publicly owned or controlled entities accounted for nearly 70% of the turnover or revenues of the top 15 companies and over 85% of employment for the top 15 companies. Put in wider context, employment in the largest publicly owned or controlled entities accounted for between 5-6% of total employment in Russia. In specific sectors, publicly owned entities are particularly dominant. These include oil and gas but also finance. Ranked by assets, in early 2014 private banks controlled less than 10% of total assets, while over three quarters were controlled by just two state controlled institutions; *Sberbank* and *VTB*[28].

Table 4: The 15 Largest Russian Companies in 2014

Rank by Sales	*Company*	*Ownership*	*Sales (Rbns)*	*Employment (000s)*	*Rank by Employment*
1	Gazprom	Public	5477	450	3
2	Lukoil	Private	4718	110	12
3	Rosneft	Public	3681	249	8
4	Sberbank	Public	2155	330	4
5	Russian Railways	Public	1796	1085	1
6	VTB	Public	989	101	13
7	Rostec	Public	965	900*	2
8	Surgutneftgaz	Private	875	118	9
9	Magnit	Private	764	258	6
10	Rossetti	Public	760	218	9
11	Inter RAO	Public	741	48	25
12	Transneft	Public	695	106*	13
13	X5 Retail Group	Private	634	117	11
14	Rosatom	Public	618	255	7
15	Megapolis	Private	507	15	88
Reference					
63	Russia Post	Public	140	295	5

Source: RBC Information Systems Database for Top 500 Russian Companies: www.rbc.ru/rbc500
Note that employment numbers for *Rostec* and *Transneft* are taken from Wikipedia and relate to 2008

[28] When scaling by profits, the inverse emerges.

Data are also available for the largest 628 Russian companies in 2014[29]. The total revenues of these companies amounted to nearly 80% of Russia's GDP in that year. Companies in the oil and gas sector accounted for around a third of the total revenues. Mean revenues in 2014 were 97 billion roubles while the median was 36 billion, indicating considerable concentration. The largest company – *Gazprom* - had annual revenues of 5.5 trillion roubles while the smallest had around 15 billion roubles. The list includes state, mixed and private companies. In all there were around 90 state companies and 19 joint ventures; the rest were private.

It is clear that state owned or controlled companies tend to be relatively large, whether measured in terms of revenues, assets or employment. For example, the total revenues of the top 10 companies accounted for over 50% of the revenues of the top 100 companies in Russia. *Table 5* provides the shares of total revenues and employment accounted for by companies with majority state ownership. State owned entities accounted for over 71% of total revenues for the top 10 companies. This share exceeded 66% for the top 25 and over 54% for the top 100 companies. In terms of employment, these shares were 85%, 77% and 68% respectively (although it should be noted that many (>20%) companies lack data on employment). Placed in the wider context of the >600 largest companies in Russia, the top 10 accounted for between 35-40%, the top 25 for between 47-54% and the top 100 for 69-78% of total revenues and employment respectively.

Table 5: Shares of revenues and employment in 2014

Category	**Top 10**	**Top 25**	**Top 100**
State owned			
Revenues	71.3	66.5	54.2
Employment	83.4	76.9	68.2
State + Large Private			
Revenues	75.3	73.4	62.7
Employment	87.4	84.3	76.0

Source: Calculated using RBC data cited in Table 4

In addition, the table repeats the exercise but this time adding in companies that are owned privately including by so-called oligarchs, and, for the most part, assembled in the 1990s privatizations[30]. For revenues, the combined share of state and these interests climbs to 75-73% for the top 10 and 25 companies respectively and to 87-84% for employment.

To get a sense of what this means relative to the economy as a whole, *Table 6* assembles a very approximate estimate of the structure of employment across the economy as a whole. The general government (including health and education and community services) appears to account for up to 25% of total employment[31]. The consolidated public sector, which includes public

[29] The data have been compiled by RBC

[30] Examples include, *Norilsk Nickel, Rusal* and *Severstal*

[31] Another estimate for 2008/2010 had government employment comprising nearly 25% of total employment with the greatest part of that - >17% - being in education and health and a further 7.5% in the public administration and defence, see World Bank (2013), pp10/11

enterprises, accounts for around 30% of total employment. The corporate sector - comprising organizations registered as legal entities - accounts for around 38% of employment and the informal economy may account for around 30%.

Table 6: Estimate of the structure of employment in Russia in 2014

Category	Number (millions)	Share (%)
General Government *(including Public Administration, Defence, Education, Health & Community Services)*	15-17	22-25
Consolidated public sector *(including state owned enterprises)*	20-22	29-32
Formal private sector	24-28	35-41
of which;		
Large & Medium sized firms	14-16	20-24
Smaller incorporated companies	10-12	15-18
Informal sector		
Unincorporated workers	20-22	29-32

Source: *Rosstat* for General Government and total employment level (68m in 2014)

5.2 Portfolio of state owned assets

State owned assets are presently placed under the aegis of the Federal Agency for State Property Management. At present, there are 1677 parent companies in its portfolio[32]. *Table 7* puts together information on the total value of assets, revenues and employment for those main companies in the portfolio. Coverage is, however, quite poor and between 20-37% do not report data for one or more of these basic indicators.

At the level of the parent company can be found, as expected, many of the principal state companies. For whatever reason, in a significant number of cases the listed company – for instance, *OAO Transneft* – is actually a subsidiary. Similarly both *Rosneft* and *Gazprom* are located as subsidiaries of *Rosneftegas*. Larger entities are required to provide regular financial reports to the Stock Exchange, if listed, and to the statistical agency, *Rosstat*. However, there is no obligation to submit data on subsidiaries.

Regarding the sectoral affiliation of the parent companies, it can be seen that the largest number and share (a third) are in real estate with manufacturing accounting for just over 18%. Real estate entities also accounted for over 60% of reported employment and for an even higher share of total revenues. Although not trivial, the total employment reported by 1050 parent companies (viz., 63% of first level companies in the Federal Agency's portfolio) was 1.2 million; amounting to less than 2% of total employment in Russia.

[32] This total and the list of companies under the Federal Agency are drawn from *Ruslana*

However, looking only at these first level entities is likely to be very misleading. Many of these entities have multiple subsidiaries that are also included in the Federal Agency's portfolio. Indeed, the total number of subsidiaries down to the tenth level is in excess of 1.2 million. However, this includes many subsidiaries in which the prior level may only have a small or minority interest. Further, there may be multiple listings of a subsidiary if shares in it are distributed across a range of higher-level subsidiaries[33]. Indeed, when considering only subsidiaries in which a majority (>50%) share is held at every level (there are up to 10 levels in the data), the number falls to around 3500. Even so, the complex skein of subsidiaries can be illustrated for some major companies. For example, *Russian Railways* has over 23,000 subsidiaries, *Gazprom* 4328, *Rosneft* 945, *United Aircraft Corporation* 7433 while *VTB* and *Sberbank* have 2513 and 3677 subsidiaries respectively. State corporations, such as *Rosatom* also have a large number of subsidiaries; 757 in this instance.

Although the subsidiaries include fully owned and controlled entities, there are also other entities in which investments are held, as well as some cross-holdings. However, for many of these subsidiaries, basic financials and other information are missing. At this point, we have only been able to get access to information for roughly 50% (1-828) of the parent companies and their subsidiaries. The number of companies comprising the parent plus subsidiaries where there is >50% direct interest is over 18,000 of which 9342 contain information about sector of operation[34]. The sectoral disposition of these subsidiaries is similar to that for the parent companies, but an even higher share (>41%) is in real estate with wholesale and retail trade accounting for just over 10% and manufacturing a further 13.5%.

Why do these state owned companies have such significant numbers of subsidiaries? Looking at private companies operating in a number of sectors, it is striking that their number of subsidiaries is far smaller. For example, *Yandex* has 11 subsidiaries; *Magnit* and *X5* – both retail companies – have 24 and 11 respectively. Part of this difference may, of course, be related to sector of operation. Additionally, when operating abroad a separate legal entity has to be created. Soviet-style accounting and administrative practices - including taxation jurisdictions and coverage between federal and regional government, as well as the post-privatization accretion of resources and creation of holding entities - are further factors. For example, in the oil industry in the early 1990s large holding companies were put together into which were transferred the state's majority shares in various oil producers and refiners[35]. The latter became subsidiaries.

[33] For example, in the case of *Transneft*, shares in a fully owned subsidiary – *Transneft –Vostok LLC* – are distributed in varying amounts over 13 other subsidiaries as well as the first level subsidiary.

[34] This includes all subsidiaries in which a >50% share exists, even if at an earlier level the share was <50%

[35] This meant, among other things, that the holding companies had most decision-making power and control but the assets were concentrated in the subsidiaries allowing them to be associated with share swaps and other manoeuvres detrimental to subsidiary stock holders

Other possible explanations are that subsidiaries can provide a means for revenue diversion or tunnelling. In some instances – particularly in the oil and gas sectors – it is likely that subsidiaries have been – and maybe are - linked to the use of transfer pricing and/or tax optimisation[36]. In addition, significant transactions involving subsidiaries are generally not subject to approval by Boards of Directors, even in companies using IFRS accounts, let alone in SOEs. As Russian courts up to now have tended not to recognize group structures, preferring to focus on discrete companies, the use of subsidiaries permits transactions to take place at the subsidiary level without necessarily any scrutiny or approval by the Board of the parent (see also discussion in *Section 6* below).

Subsidiaries can also be used as a way of diluting benefits to specific classes of shareholders. In the case of the state owned oil pipeline company, *Transneft*, the parent company has 28 fully owned first level subsidiaries but also a further 235 subsidiaries down to the 5th level. Preferred shareholders who are entitled to receive up to 10% of net income of the main company have consistently received far lower dividends. Instead of a yield close to 8%, such shareholders have received yields of as low as 0.5%. Although the main company has to file IFRS accounts, its subsidiaries only file under Russian accounting standards (RAS). *Transnef*t's RAS net income has historically been only around 5% of its consolidated IFRS net income. The large discrepancy is due to the fact that dividends are calculated on RAS, so the great bulk of *Transneft's* income is not reported to, or accounted for, by the parent company. Because the government is the sole ordinary shareholder while market participants hold preferred shares, this signals a conflict of interest. It also shows the way in which subsidiaries can be used to game both the accounting system and, in this instance, dividend payments[37].

Although the *Transneft* example illustrates one particular use of subsidiaries, it would require detailed case studies to form a clear view as to the dominant motivations across this large portfolio of companies nested under the Federal Agency. What is clear, however, is that the number of total subsidiaries is large while publicly available information about most of them is either very limited or non-existent.

There are, of course, many examples of holding companies outside of Russia – e.g., Berkshire Hathaway in the USA – with highly heterogeneous portfolios but most companies tend to have relatively limited sectoral dispersion in their subsidiaries. A highly dispersed portfolio could indicate an idiosyncratic strategy or process of asset accumulation. To explore this a bit further and to get a sense of both the scale and the nature of the subsidiaries, *Table 8* provides information for three of the largest entities in the Federal Agency's portfolio; namely,

[36] Major Western oil companies also tend to have a number of subsidiaries with the locations suggesting that they are linked to tax planning strategy

[37] At time of writing, the Federal Property Agency and Ministry of Economic Development have floated the idea of all SOES being required to pay 25% of IFRS net income as dividends when IFRS net income exceeds that reported under RAS. This is doubtless in part a refection of budgetary considerations, although there is considerable doubt whether the proposal will fly

Gazprom; *Sberbank* and *Russian Railways*. Between them, they have nearly 35,000 subsidiaries for which data on sectoral affiliation are available. The table shows that their subsidiaries operate in a wide range of activities. The largest number and share is in all cases real estate, but there is significant exposure to other sectors. The exposure to real estate is not surprising, given the nature of the three parents. But it also reflects a feature that is common in many countries of a significant part of the public asset portfolio being in property. In most instances, such assets tend also to be poorly managed with little attempt at creating a return. Some suggestions as to how this might be addressed are contained in *Section 8.* More generally, the impression is that these companies operate with complex structures and with portfolios that are quite heterogeneous. A business model with a relatively narrow, core focus seems not to be present, although that picture might change if we were able to weight by assets and other indicators.

In conclusion, although it is now possible to know the broad universe of state-owned assets under the Federal Agency, it is difficult - if not impossible - to get a sense of the ultimate scale, scope and structure of the full portfolio of state owned assets. Excluding the net present values of future revenue and expenditure streams, a conventional balance sheet of the consolidated general government and Central Bank would be as represented in *Table 9.* What is incomplete concerns the assets side, *K*, where the current system provides an inaccurate and partial set of accounts. While part of this incompleteness may relate to the size of the portfolio and some of the inherited ownership and control structures, it is likely that part relates – as elsewhere – to less desirable reasons, including the use of public assets to appropriate and allocate rents.

Table 7: Descriptive data for Main or First Level Companies under Federal Agency for State property Management (*Rosimushchestvo*) by Sector: 2015

	Sector	Total no of firms	No with Total Assets	Value of Total Assets	No with revenues	Total Revenues	No with Employ-ment	Total Employ-Ment
A	A. Agriculture, Hunting and Forestry	151	125	1615	125	637	96	10168
B	B. Fishing	27	21	2129	21	671	17	9410
C	C. Mining and Quarrying	18	15	379	15	70.8	12	965
D	D. Manufacturing	305	235	19966	235	4826	183	31347
E	E Electricity, Gas and Water	15	13	9	13	5	10	911
F	F. Construction	100	77	51889	77	15365	65	36297
G	G. Wholesale and Retail Trade	116	103	10312	103	2945	77	48568
H	H. Hotels and Restaurants	9	9	22	9	17	6	1240
I	I.Transportation, Storage and Communication	184	144	62413	143	8782	115	314124
J	J. Financial intermediation	37	30	1263	30	631	22	3474
K	K Real Estate etc.,	559	440	812868	443	288798	339	740492
L	L. Public Administration	101	73	16118	73	1287	62	39969
M	M. Education	9	8	0	8	0	8	0
N	N. Health and Social Work	21	17	0	17	0	17	0
O	O. Other Community, Social and personal Services	25	23	62	23	22	21	798
P	P. Activities of Private Households	0	0	0	0	0	0	0
Q	Q Extra territorial organisations	0	0	0	0	0	0	0
	Totals	**1677**	**1333**	**979047**	**1335**	**324057**	**1050**	**1237763**

Source: Author's calculations using Bureau van Dijk's *Ruslana* database (http://www.bvdinfo.com/en-gb/our-products/company-information/national-products/ruslana)

Table 8: Sectoral affiliation of subsidiaries for Gazprom, Russian Railways and Sberbank

Sector	Gazprom		Russian Railways		Sberbank	
	Subsidiaries	*>50% interest*	*Subsidiaries*	*>50% interest*	*Subsidiaries*	*>50% interest*
Agriculture	37	22	90	36	119	65
Fishing	3	2	3	0	5	2
Mining	136	101	704	167	195	128
Manufacturing	319	194	5899	1363	597	332
Electricity, Gas, Water	541	332	1097	270	658	386
Construction	327	184	676	251	531	356
Wholesale & Retail Trade	398	229	2202	773	610	321
Hotels & restaurants	61	39	393	116	121	85
Transportation	319	197	1160	297	413	266
Financial Intermediation	435	272	3004	731	1282	904
Real Estate	1085	753	6672	2174	2335	1622
Public Administration	14	10	11	5	23	18
Education	62	55	299	9	91	78
Health etc.,	58	51	584	239	111	92
Other Community	259	219	520	163	465	401
Private household activity	0	0	5	2	0	0
Extra-territorial	0	0	0	0	2	1
Total subsidiaries	4054	2662	23319	6596	7558	5057
Source: Author's calculations using *Ruslana*						

Table 9: Complete conventional balance sheet of the State (Consolidated General Government and Central Bank)

Assets		**Liabilities**	
K	Value of real assets, equity in public enterprises & other financial assets	Base money	M
		Non-monetary liabilities of Central Bank	N
		State debt held by public	B
		State net worth	W

Source: Buiter 1983

5.3 Connected or crony parties

The importance of connections has been a consistent feature of Russia post-1992. But exploiting connections or cronyism can take a variety of forms. It may be associated with superior access to contracts, finance and other implicit and explicit forms of non-transparent and non-market priced services and access. It is often difficult to identify with any precision, as many relevant decisions tend to be made in obscurity and sometimes by bureaucrats and others who may be seeking to reward connected or crony parties. Cronyism may also take the form of acquiring management, ownership or Board positions on the basis of connections rather than suitability or competence. Indeed, journalists have noted how in Russia the top management of some large state-owned enterprises has historical connections to the President, whether in terms of location or prior occupation.

Cronyism can be reflected not only in the size of asset accumulation but also in the composition of those assets held by connected individuals. Evidence from autocratic political systems suggests that the portfolios of cronies tend to be quite heterogeneous, reflecting a complexity of motives behind their assembly[38]. This, in turn, can be reflected in the performance of the assembled companies. The reliance on connections to assemble assets may reflect a form of entrepreneurialism but not necessarily one consistent either with good management or governance, let alone growth[39]. A further feature of cronyism is that the benefits they confer may be transient or at least subject to shifts in the extent or quality of their connections to power and its perquisites. This may then be associated with greater volatility in terms of performance or, even, longevity. Finally, a common dimension of cronyism is that it confers considerable discretionary authority on beneficiaries that facilitates corruption and/or abuse of public resources. There is evidence that this is the case in contemporary Russia[40].

Much of the earlier discussion about connected parties was about the manner in which firms and assets were privatized and the bargaining power that their new owners had vis-à-vis government. This was summarized by the idea of state capture by influential groups. Post-2000, the focus has shifted. Continuing control over assets by so-called oligarchs appears to have been linked to elements of reciprocal behaviour, whether involving specific economic projects and/or financial contributions, as well as foreswearing political involvement. Further, with both a larger and more autonomous state, the question of whether specific individuals, companies and/or holding groups have been able to benefit from proximity to power has become more prominent. With the increasing

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[38] This is the case, for example, in Azerbaijan where the portfolios of local connected parties are very mixed in their sectoral, employment and profitability dimensions. This appears to reflect not only the way in which they have been accumulated and the timing but also the fact that some assets are held for non-profit maximizing reasons, such as maintaining employment in specific regions. See Commander and Ramazanov (2014)

[39] Bagchi and Svejnar (2014) argue that when controlling for how wealth has been accumulated, crony-type wealth accumulation tends to be associated with weaker aggregate growth. They further suggest that such wealth may act as a wider proxy for attributes that are growth limiting

[40] See, for example, the various narratives contained in: http://www.reuters.com/investigates/section/comrade-capitalism

personalization of power, this has also become more a question about proximity to Putin.

The sanctions lists issued by the European Union and the governments of Canada and USA (see *Annex 1* for the sanctions lists) after the invasion of Crimea provide one view of the locus and value of connections[41]. Around 50 entities, as well as selected individuals, have been sanctioned. Some are specific to Crimea/Ukraine or are explicitly defence-related companies. In addition, large natural resource companies, including *Gazprom* and *Rosneft*, as well as major publicly owned or influenced financial institutions including, inter alia, *Vnesheconombank*, *VTB*, *Sberbank, Gazprombank* and *Bank of Moscow* have been included. Although all have in common that they are majority state owned, there is some heterogeneity in other important dimensions, including proximity to power.

In addition, companies and financial institutions controlled by individuals considered to be particularly close to Putin have been included in the sanctions lists. The most notable are; Gennady Timchenko's *Volga Group* and associated companies, such as *STG Group,* as well as companies in which Timchenko has a significant stake, such as *Novatek* and *Sibur*; the Rotenberg brothers – principally their SGM Group and their financial institutions, such as *SMP Bank and InvestCapital Bank* – and Yuri Kovalchuk's *Bank Rossiya* and a number of related entities, such as *Abros*, *Zest* and *Sobinbank*.

There is limited information available in the public domain about these assets. In 2014 *SGM* was ranked 42nd*, Stroytransgaz* 60th and *Bank Rossiya* 240th out of the top 500 companies in terms of revenues. However, the transparency of their functioning is low and financial disclosure is limited. However, these assets are concentrated in several types of activities – oil or gas, financial services, construction and transportation. A common feature is that they have often had close commercial and other links with the main state companies in natural resources, principally *Gazprom* (*STG* was originally a subsidiary). In addition, complementary exposure to publicly funded projects appears to be a significant part of portfolios, particularly for infrastructure and construction.

What is clear, however, is that their beneficial owners have accumulated significant wealth. By 2014, the net worth of Timchenko, Kovalchuk and Rotenburg combined was estimated at around $17 billion. (Current 2015 estimates are closer to $13 billion). None of these individuals had an estimated wealth of ≥$1 billion in 2004. While a part – possibly the largest part - of Timchenko's wealth has come from oil trading through his erstwhile vehicle, *Gunvor*, other entities associated with these individuals have been largely domestic market-oriented and have seen rapid growth in the past 15 years.

One example of the possible gains that such links can open up is illustrated in the case of *Bank Rossiya.* That bank is documented as having gone from around $5 million in assets at the end of the 1990s to nearly $11 billion by 2013 with most

[41] A number of other countries including Australia, Japan, Norway and Switzerland have also imposed sanctions but mostly by following the EU or US lead

of that growth occurring in the five years after 2008 when its assets more than trebled. In that space of time, it acquired multiple assets from *Gazprom*, as well as significant business with *Gazprombank* and a growing portfolio of media interests. Currently, the bank is the 17th largest in Russia, as ranked by assets. The path and growth rate for the bank illustrates the scale of benefits flowing from connections to power[42]. It is hard to identify evidence that the bank has commercial abilities sufficiently superior to competitors to warrant this rate of expansion.

With regard to the construction sector in which a number of connected parties are now major players, the most recent available financials indicate that *SGM* and *STG* Groups accounted for around 43% of total revenues of the 20 largest companies in the sector in 2014. Their share was up by over 8% compared with 2013[43]. Market share had been gained mainly by *STG* at the expense of the previous leader, *Stroygazconsulting*[44]. Much of the portfolio of *SGM* and *STG* comprises contracts with major state owned companies, mainly *Gazprom*, as well as with various branches of government.

The sanctions lists thus provide an explicit identification of perceived connected parties, although the decision rules that have been applied in selection have not been fully exposed. While these lists – and the underlying thinking behind them – reflect a particular view of relations at the pinnacle of the Russian system of power, corporate connections to politicians can exist through a variety of channels. For example, it can be through the latter holding equity or ownership rights, as well through management connections to politics/politicians either directly or through their relations[45]. Faccio (2006) assembled a dataset that attempted to measure such connections for a large number of countries, including Russia. For 2001, she identified 25 firms with available evidence and found that over a third of the top 50 firms were connected to either a minister or MP in Russia. Connected firms accounted for around 87% of total market capitalization. Although more exigent conditions for disclosure of interests have subsequently been introduced for Members of Parliament and government officials in Russia, these are recent and it is also not clear how robust is compliance. The nature of informal networks further complicates identification. And many connected entities are presently privately held.

However, some evidence, assembled mostly by journalists, suggests that some individuals in and around the government, as well as their relations, have benefited through jobs and other benefits. It has been documented that offspring and relations of several of Putin's close associates hold high positions in major

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[42] See the following article; http://www.nytimes.com/2014/09/28/world/europe/it-pays-to-be-putins-friend

[43] Data from SPARK/Interfax and RBC

[44] *Stroygazconsulting (SGC)* has been losing out on contracts with *Gazprom* and was acquired in 2015 by *Gazprombank* and others. In 2013, the top three companies – *SGC, SGM* and *STG* – accounted for over two thirds of total revenues for the top 20 companies in the sector with *SGC* alone accounting for just under a third. The latter's share has subsequently fallen away dramatically

[45] For example, Faccio (2006) classifies companies as connected if one of the large shareholders or top officers is in parliament, is a minister or is closely related to a top official.

state-owned corporations, as well as, in some instances, large stakes in mainly natural resource companies[46].

We have also attempted to identify whether particular types of news or events have an impact on listed companies[47]. A list of 'events' that could be considered to carry adverse news regarding the status or durability of Putin and/or the political dispensation associated with him at various times in the last five years was assembled. Those events comprise the protests and demonstrations in December 2011, the imposition of sanctions starting in March 2014 and continuing into 2015, as well as (rather more conjecturally) rumours about Putin's absence and health in March 2015. These events have then been linked with daily observations for individual equities of all listed (766) companies on the Moscow Stock Exchange for the period from 1 January 2010 to 23 October 2015. Equities that displayed little or no variance over the period, as well as those with missing values, were excluded, reducing the number to 121[48]. Although, there is clearly some general responsiveness of equity prices to events – indeed particularly since 2014 the market index has headed strongly downwards[49] - there is no robust pattern indicating that specific listed companies have been especially sensitive to these events.

6. Corporate governance

Standards of corporate governance and financial disclosure in many private and public sector companies in Russia have historically been low. Entrenchment of managers, allowing insiders to extract the private benefits of control, has been a pronounced feature. Where public sector companies control sectors with strong cash flows, the agency problem has also been serious with large opportunities for managers to allocate resources with little oversight. Public sector companies also operate under a variety of institutional formats, some of which have been inherited from the Soviet era and which are peculiarly opaque. Further, despite the relatively recent introduction of disclosure requirements for public officials and politicians, including for income, there is still little effective regulation of conflict of interest or separation of responsibilities.

Against the backdrop of cautious and incomplete reform, there have been a variety of positive changes in corporate governance rules since 2010 (see *Annex 2* for chronology and list of major changes). These have included the adoption in 2014 of a new Corporate Governance Code[50]. There are also now mandatory requirements for IFRS accounting for publicly listed companies, including those

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[46] Some details are given in, http://www.reuters.com/investigates/special-report/russia-capitalism-daughters

[47] Drawing on earlier research, such as for Indonesia by Fisman (2001). A key methodological paper is Brown and Warner (1985)

[48] For most Russian listed companies the majority of shares are narrowly held either by an individual, entity or control group. One consequence is that many equities are effectively untraded or very lightly traded

[49] Note that given the relatively thin nature of the market and small pool of long term investors, significant sensitivity to country rather than company specific risk, particularly on the part of international investors, has translated into sharp movements in equities

[50] For a copy see; http://www.ebrd.com/downloads/legal/corporate/russia_code.pdf

SOEs that are listed. However, enforcement – which lies with the Central Bank – is still relatively weak. Many companies still have financial disclosure arrangements and procedures that are not robust. And even listed companies that file IFRS accounts often use RAS for subsidiaries. That is partly because current legislation for public joint stock companies on disclosure does not actually cover controlled entities or subsidiaries.

The gap between laws or rules and enforcement is also present with regard to disclosure of beneficial ownership and related party transactions. At present, any interest in a public company >5% triggers disclosure requirements including about any controlling persons. But, again, the Central Bank's ability to enforce has been fairly limited. In the case of related party transactions, there is the additional issue of the design of current regulations. The definition of affiliation currently used allows relatively easy circumvention, although a new law in draft attempts to shift away from a definition based on affiliation to one based on control.

There are also some issues concerned with the relationship between parents and subsidiaries. Thus, although transaction values in excess of 25% of the book value of a company's assets have to be approved by the Board of Directors or GSM, the situation with subsidiaries is different. If a transaction is less than 50% of the book value it needs only to be approved by the Board of the subsidiary and not be approved or even necessarily scrutinized by the Board of the parent. These arrangements have allowed transactions, sometimes involving asset stripping, to proceed at the level of the subsidiary, extending practices that were earlier more common at the parent level itself[51]. Limiting the ability of SOEs to pass transactions largely un-scrutinized through subsidiaries is clearly an issue.

A wide gamut of listed companies have corporate governance arrangements that are often insufficiently transparent and do not conform to the requirements of the Corporate Governance Code agreed in 2014. These include most SOEs. However, the Moscow Stock Exchange has used the Code to draft mandatory requirements – including, inter alia, independent directors and an audit committee - for companies wishing to be listed at a higher (A1) level. Although the adoption of the Code has been associated with widespread improvements in transparency and information, the situation is that most listed companies have done little to address the management-Board relationship and relative disposition of responsibilities and powers. As such, most remain non-compliant with the Code so that management continues to exert considerable discretion and the role of Boards and independent Directors remains largely weak and, sometimes, non-existent.

In the case of private companies, the main issues continue to be around full disclosure of ownership and beneficial rights; discrepancies with respect to the payment of dividends and their calibration and a widespread lack of transparent

[51] The Russian Ministry of Economic Development has recently proposed changes that would address some of these loopholes, at least for companies following IFRS accounting standards. See article in *Vedomosti,* 27 July, 2015

and robust accounting and business disclosure, including lack of enforcement[52]. There are also broader issues about the objectives of companies, including share-value maximization, given the role of non-shareholders and other factors in decision-making. Certainly, there is significant anecdotal evidence that even large private companies have to be attentive to the interests or requirements of government (regional and federal) as well as other interests[53].

Although the situation regarding corporate governance of private companies clearly reflects work-in-progress, the situation with respect to SOEs is both less advanced, possibly more complex and increasingly more pressing, given the growing role of such entities in the economy. Most outsiders have argued that they should operate on corporate and commercial lines consistent with guidelines adopted elsewhere, such as those drawn up by the OECD for SOEs[54]. These involve separation of ownership and other functions, such as regulation; clarity and simplicity of legal form; specification of non-market or wider obligations and non-discriminatory coverage of general laws and regulations. Other recommendations relate to the equitable treatment of shareholders, stakeholder relationships and objectives and reporting as part of wider transparency and disclosure. The guidelines also argue for full operational autonomy along with recommendations for Boards to exercise independence and oversight.

A recent review by the OECD concluded that there had been some progress but also many ambiguities, including regarding the composition of SOE boards, Board voting rules and the extent of political interference[55]. Presently, even many of those SOEs that are listed do not have corporate governance standards that allow admittance to the higher level (A1) on the Moscow Stock Exchange and hence trade at the lowest (B) level. Of the largest listed SOEs (n=12) on the Moscow Stock Exchange about 40% have an A1 listing level. However, the Federal Property Agency is currently attempting to implement the new corporate governance code in 15 large companies. Even so, some of the larger and most strategic companies – principally in oil and gas - are only notionally under the oversight of the Federal Property Agency, responding instead to Government and President. This effectively allows them exceptional status while compromising the accountability and transparency of their management. Other non-listed publicly owned firms – such as those in defence or defence-related activity - provide even less scope for public scrutiny.

For its large portfolio of companies, the Federal Property Agency has only been able to act as the controlling shareholder in some selective instances. This is because of a combination of factors; the number of SOEs, lack of adequate resources – human and material -in the Agency as well as a belief that control

[52] For a discussion of some of these issues, see Fox (2014)
[53] A classic example – and piece of political theatre – concerned a factory in a town with highly concentrated employment - *Pikalevo* - owned by Deripaska's *Basic Element* group where wage arrears and other complaints had spilled into open protest in mid-2009
[54] http://www.oecd.org/corporate/ca/corporategovernanceofstate-ownedenterprises/34803211.pdf
[55] See OECD (2013), pp18-19

can best be exercised by the Agency's representative(s) on the Board. The first constraint could be addressed by reductions to the portfolio through asset disposals but this would probably require political sanction. In addition, there is the question of whether to try and dispose with or without restructuring. With restructuring would, in principle, secure better value but would mostly be time-consuming. The second set of constraints could be addressed through additional resources and training but it begs the question of whether this is the right approach to managing public assets. As discussed below (as well as in *Section 8*), a combination of greater use of independent professionals on Boards and a separation of functions whereby public assets are actively managed by funds could provide an approach more likely to extract value from this large assembly of public assets. There is also the specific issue of subsidiaries (highlighted above), their lack of transparency and the apparent lack of effective governance. There is a clear need for simplification and a radical reduction in the number of subsidiaries[56]. The recent re-nationalisation of *Bashneft* has been done with consolidation and a simple structure while other companies, including *Aeroflot*, have also tried to achieve similar ends. As yet, these remain exceptions.

A further aspect is that government as the controlling shareholder has until now almost exclusively communicated with management. In short, a multiplicity of corporate forms (e.g., State Corporations, Unified Enterprises and so on) under which SOEs function and the varying extent of autonomy of individual companies masks a common feature: the entrenched power of management (and sometimes politicians) with little weight as yet attached to Boards, let alone independent directors, at state owned companies. In addition, many of the Soviet-like entities, such as *Russia Post*, would benefit from transformation into joint stock companies[57].

7. Political governance

The structure of ownership and control and the systems of economic and corporate governance presently existing in Russia have evolved over the past quarter century but have been strongly coloured by the legislative, juridical and political agenda of the current President and his respective government(s). But there is also an obvious link back to the broader economic governance agenda, as well as the way in which publicly held entities operate vis-à-vis the political authority and state. For example, it is clear that the current economic structure is used to finance and support specific political objectives, including particular spending programmes. An example is transfers to areas of employment concentration, such as one-company (*monogorod*) towns, from fiscal, quasi-fiscal or connected entities[58]. Less obvious is the way in which that structure is used to support the political elite and parties, whether in terms of direct employment and income, indirect access to resources or contributions to political parties or through providing constituencies (and voters) to support the political agenda.

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[56] For example, at the Sochi Forum in 2015, the Deputy Minister in charge of the Agency openly proposed reductions in the number of subsidiaries

[57] An obvious caveat is that acquiring joint stock company status may not necessarily radically change behaviour or performance, an example being *Russian Railways*

[58] See Commander, Nikoloski and Plekhanov (2013)

Measures of the political system, including the extent of political competition, indicate that Russia has become less open and less democratic, particularly in the last few years. The Polity IV measure, for example, has its democracy indicator rising from 5 to 6 between 1992 and 2000 before falling back to 5 by 2014. The combined Polity score similarly exhibits an inverted-U shape. The evisceration of opposition parties and the declining political space allowed to opponents has, if anything, been consolidated, particularly since the Crimea/Ukraine interventions. On one interpretation, Russia has shifted towards a presidential autocracy with diminishing tolerance for opposition alongside a declining transparency with regard to decision-making and economic activity, a symptom of which is the pervasive opaqueness concerning the growing population of public sector companies. Media ownership has shifted increasingly into the hands of connected parties or state institutions.

Given the increasingly 'managed' nature of the political process with a lack of vibrant opposition parties and a media whose independence has increasingly been compromised, it is of obvious interest to try and understand what are the underlying preferences of citizens and, in particular whether the present configuration of public policy commands support among the population and with what possible nuances. Opinion polls have been fairly unanimous in reporting a clear break that started in 2014. At that point – following the intervention in Crimea – Putin's popularity jumped from the mid-50s to over 80%, a level of popularity last reported around 2008[59]. Confidence in the federal government also jumped from 39% to 64% between 2013 and 2014. At the same time, confidence in the armed forces and other public institutions also rose sharply. These discontinuities raise the obvious question of whether the growth in approbation of the President and other public institutions can largely or entirely be attributed to the actions taken with respect to Crimea and Ukraine and, if so, whether they reflect a genuine shift in opinions – including about related elements of public policy - that is likely to persist. But subjective responses – as in opinion polls or focus groups – have obvious shortcomings. It could be argued that the quality of responses would be seriously impaired in an autocratic context. This is a valid concern but it is not evident that Russia has yet become sufficiently autocratic to imperil the responses of individuals to surveys.

7.1 Attitudes to the economy, power and policy pre-sanctions

To get some benchmark evidence, we can turn to the World Values Survey which has been implemented in multiple rounds in Russia, the latest being in 2011. At that time – shortly before the re-election of Putin to the Presidency – responses indicated that although there was a clear majority preference for democracy, nearly 30% considered the country actually not to be very democratic and a clear majority favoured a strong leader unrestrained by parliament and elections. Responses also indicated lack of interest and/or involvement in political activity, although nearly half – with a bias towards younger respondents - reported having recently participated in a peaceful demonstration.

[59] Gallup Poll with a sample of 2000 interviewed between April-June, 2014

As regards the economy, over 40% were in favour of greater public ownership of business and industry and an even higher share (>70%) favoured a strong role for the state in providing for citizens[60]. Attitudes suggest a greater degree of caution about the merits of competition, at least when compared to some other emerging markets (such as China and Brazil) or, indeed, most advanced economies[61]. Although a higher share of respondents with lower educational attainments and lower self-reported income status had a negative view of competition, there was relatively little variation when controlling for age, social status, sector of employment and other attributes. There was an ambivalence or hostility towards competition in around 15% of survey respondents[62]. In addition, when asked whether a better life was associated with hard work or more related to luck and connections, the mean response gave significantly more weight to the latter than, for example, in either China or the USA. Confidence or trust in the government (and civil servants) at that time was quite high – approaching 50% - but less than a third had significant confidence in either parliament or the courts and a yet lower level of confidence in political parties. A Gallup Poll taken slightly later (in 2013) reported falling ratings for the government with only 39% expressing confidence in the federal government. A similar (and declining) share expressed satisfaction with a key public service, education.

Regular opinion surveys also offer some insight into perceptions across a range of relevant dimensions; political, economic, financial and prospective. For these purposes, it is possible to use surveys mounted by the main independent survey agency in Russia, the Levada Centre[63]. They have been interviewing individuals on a regular (monthly or higher frequency) basis for over a decade using a so-called Omnibus survey instrument, with around 1600 respondents in each round. While the questions in each round have varied, some core questions and controls have been maintained.

Data from 2012/13 permit getting a sense of attitudes among the populations to particular policy orientations, political systems, as well as personalities and actions. Although simple responses to questions about trust in leading political figures, notably the President, then showed quite high levels of support, other questions around this theme showed a more nuanced picture. For example, nearly half of respondents thought that Putin was guilty of abuse of power and favoured turnover at the end of the President's term in power. Similarly, responses to questions exploring the priorities of those in or near power indicated a dominant belief that personal enrichment and other material interests were uppermost.

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[60] This share rose to over 30% among the self-employed, as against around 22% for full time employed and only 16% among the retired. The total sample size for this round of the WVS was 2500.

[61] Respondent were asked on a scale of 1-10 whether competition was harmful and brings out the worst in people (10) or whether competition was good and stimulates people to work hard and develop new ideas (1). The mean response was 4.4 with a standard deviation of 2.7. For reference; China was 3.7 (2.1); S. Korea 3.9 (2.1); USA 3.4 (2.2) and Brazil was 3.7 (2.9).

[62] This was the share that responded [8…10] to the question on competition

[63] Data for the rounds of the Omnibus survey were provided by the Levada Centre

With respect to attitudes to political systems, nearly two thirds of respondents considered that Russia needed democracy, although an equivalent share had little or no pride in the country's current democratic system or, indeed, in its economic achievements to date. The main obstacle – indicated by around 40% - to democratic reforms was considered to be a corrupt ruling elite. As in the WVS responses, there was also a wider lack of trust and respect for business which translated into a preference for an 'etatiste' system, rather than one based on private property and the market. Approximately half of all respondents had a strong/reasonably strong preference for the former. Indeed, it was striking that when asked as to reasons for Russia's growth record, most attributed relatively poor performance to factors relating to adverse behaviour by 'big' business, politicians and bureaucrats, including capital flight, endemic corruption and self-interested actions, as well as abuse of power and privileges. Around a third of respondents also held a negative view of the fact that many wealthy individuals and businessmen were in the State and Federal Council.

Some additional evidence from focus groups has found growing concern – albeit with variation across oblasts - with the extent of regulation and, in particular, the ability of state institutions to interfere with the business process, including inspections, tax raids and other forms of perceived predation on businesses[64]. The judicial process was considered to be commonly corrupt and cumbersome. Changes in formal rules were also perceived to be often ineffectual and dominated by the local and informal pattern of decision-making by government figures and connected parties. In addition, there was a dominant perception that fostering relationships with government were essential in determining business success. Firms with connections were perceived as securing important advantages of a largely competition-limiting or excluding nature. Many of these findings are broadly consistent with firm-level responses[65].

With regard to public services, the Levada 2012 responses indicated a relatively low satisfaction with both health and education provision. In the former case, over 60% of respondents were unsatisfied with the current health system and around two-fifths perceived a deterioration in the quality of health care services over the previous year. Over 70% of respondents thought that they were unable to receive good medical services. While this level of dissatisfaction was lower for education, nearly a third considered that the quality of education had deteriorated in the last year, while nearly three quarters considered that the education system was ether mediocre or plain bad.

The Levada surveys pre-Crimea and sanctions suggest a citizenry with ambiguous attitudes to political power and personalities. This appears to translate more into a form of cynicism and distance from politics than any coherent sense of remedy. And although around 2012/13 respondents had a clear preference for a democratic system, this was not reflected in a positive view of their own democracy. Finally, the attitudes to economic policy reveal several strands: a limited appreciation of government policy and integrity but

[64] See Ulyatov (2014)

[65] Including the region-level Business Environment and Economic Performance Survey implemented by EBRD and the World Bank

also a wider belief in the preferability of a state-dominated economic system. Private business and businessmen did not attract widespread trust or confidence even if the state itself was considered limited in its ability to provide services and effective policy. These ambiguities – and their underlying features – may explain in part why some attitudes/preferences appear to have shifted after the Crimea intervention.

7.2 Attitudes: evidence from 2015

Turning to the current situation, the obvious paradox is that despite the reality – and perceptions – of falling incomes and growth, a majority of respondents have a relatively positive outlook, as well as having a strongly positive attitude towards Putin. In mid-2015 around 92% of respondents approved of Putin and around two thirds similarly approved of the Government. This cut across age groups. Indeed, younger people – irrespective of the work status – reported relatively high approval ratings. There was also a higher acceptance of the proposition that the Government was going to be able to improve the situation in the country in the coming year than there was in 2012/13. A complementary sociological study carried out in 2015 argued that there was a clear inverse relationship between the level of trust in impersonal or formal institutions and the amount of social or network capital that an individual perceived him/herself to have[66].

The strong support for Putin and his government in 2015 has further echoes in responses to questions concerning the desired form of political power. Nearly 40% of respondents fully agreed with the proposition that Russia needed a strong leader even at the cost of elections and temporary restrictions on freedom of speech, while a further third were in broad agreement. In related fashion, nearly 70% viewed western culture as having a negative impact on Russia. The great majority of respondents also considered there to be a low probability of mass protests either in the country or their locality and fewer still (7%) expressed any willingness to participate.

These responses represent clear shifts from reported attitudes in 2012/13. However, simply focusing on these responses is likely to be misleading. In fact, there is evidence of persistence in many attitudes, whether to power or economy-wide or personal financial circumstances. Around 60% of respondents considered that those in power had little or no accountability and a similar share attributed this to either explicit policy or the behaviour of officials. Further, nearly two thirds of respondents considered that those in power were mainly interested in staying in power rather than the prosperity of the country[67]. Although a large majority considered that Russia needed a market economy, only a minority considered that is was possible to become wealthy honestly. And with respect to perceptions of economic conditions, around a third of respondents considered that the current economic situation was poor or bad, whether at the level of the entire economy or in their locality. Perhaps more informatively, over two thirds considered that their financial position had worsened in the last year

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[66] Bardina et al (2015), 'Russians' optimism in a time of crisis', in Russia Direct (2015)

[67] In 2012/13 a clear majority of respondents also considered that officials and parliamentarians had no care/interest in citizens' welfare

with only one in eight considering that their financial position was likely to improve in the coming twelve months.

An earlier study of the factors behind approval ratings for both Yeltsin and Putin found that they were closely linked to public perceptions of economic performance. As such, Putin's superior ratings between 2000-2008 were attributable to the strong performance of the economy in that period[68]. This link suggests that perceived and actual income decline – as is currently the case – should ultimately be reflected in approval ratings. Survey responses also point to significant ambiguities about both the nature of political authority and the material consequences of that authority. Although these do not necessarily amount to any major or near term challenge to incumbent power, they do suggest that there is a core of beliefs that are far from supportive to the aims or methods of current arrangements. However, this caution or even hostility (at least among a minority of respondents) is evidently more consistent with political passivity than any necessarily active form of opposition.

8. Dynamics, risks and some policy implications

The Russian economy has not exactly gone full circle since the collapse of the Soviet Union but, at least superficially, some features of that past appear to have been recreated. This paper has chronicled in particular how the balance between the quadripartite components of the economy – state enterprises, large business groups and/or holding companies, politically connected entities and the private sector - has shifted over time. Comparing the present day with the early 2000s, the main difference is that the size and scope of the public sector has grown significantly, as has the composition of connected parties and individuals as well as the scale of benefits flowing to them. Many state companies operate either effectively as monopolies or with considerable market power. The composition of some sectors, notably finance, has changed radically so that institutions where the state exercises a majority interest now dominate. Crony entities by their reliance on access to power and its perquisites are also operating in ways that shield them from competition, let alone transparency.

There has, of course, been one constant throughout much of the post-Soviet period - the continuing reliance on natural resource revenues and its associated volatility. Such revenues have accounted for over half of federal government revenues. The natural resource sectors are now mostly in the hands of public sector companies with a declining private sector involvement. Those private firms operating in oil and gas also tend to have participation in ownership by persons or entities closely connected to power, hence, for instance, the inclusion of the largest independent gas producer, *Novatek,* as well as *Sibur* and *Surgutneftgas*, on the sanctions list[69]. The present economic and political dispensation is still predominantly based on access to natural resource revenues,

[68] Treisman (2011)

[69] As with many other Russian companies ownership is rather concentrated. In *Novatek's* case its CEO holds around 28% of equity with Volga Group (Timchenko) holding a further 23% and Gazprom around 9.5%

whether directly (as in production assets) or in the up- or downstream of those assets[70].

Given that natural resources effectively fund a wide spread of public expenditure programmes – including some of the large public projects with which connected parties have been involved - the sharp fall in prices since 2014 clearly imperils the size of those commitments. Already, real public spending is expected to decline by at least 5% in 2015. These risks are exacerbated by structural factors, notably with regard to the demographic structure and its dynamics. Some simulations show, for example, that current fiscal rules will not permit sufficient savings from natural resource revenues to cover the additional costs of financing from an ageing population[71].

The growth of the consolidated public sector since 2000 has been driven by a combination of a declared preference for state-led modernisation (and diversification) along with a politically viable framework for rent seeking[72]. The motivations for the first have stressed market and coordination failures and other well-rehearsed arguments, sometimes using East Asian examples[73]. But it is important to emphasise that following the highly unpopular privatisations of the previous decade, not only has the approach taken subsequently been politically attractive but has also facilitated shielding private access to cash flows and even assets (some set up as subsidiaries of state owned companies) behind the cover of publicly owned entities. It has also been a way of shielding analysis of the performance of these companies[74], let alone their accountability to their notional owners (i.e., Russian citizens).

Although it is not presently possible to conduct a robust quantitative analysis (given the paucity and impaired quality of what is available), earlier evidence from Russia, as well as from the extensive wider literature[75], has indicated that publically owned companies tend to perform relatively poorly. In contexts, such as Russia, where weak or captured institutions are present, comparisons may be particularly difficult as what may appear to be positive relative performance may be largely a function of preferential arrangements, whether in access to credit

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[70] Not surprisingly, a significant part of crony activity is in or around natural resources, as can be seen in the company profiles for those listed in *Annex 1*. The first derivative of that – publicly funded expenditure/contracts – appears to account for the next highest exposure

[71] See *Section 3.3* and *Annex 1* in World Bank (2015)

[72] It is important to emphasise that key elements of the 1990s privatizations were done in ways that effectively qualified their legitimacy in the eyes of many Russian citizens. Since 2000, gaining access to rents in companies that are part of the public sector has been the dominant strategy for politicians and their connections

[73] Note that this rhetoric is still deployed. In his annual state of the nation address in December 2015, Putin was quoted as saying that 'diversification should be the top priority of economic development'

[74] Declared profits at *Gazprom* have fallen in nominal terms in every year since 2011 while *Rosneft* declared profits having jumped in 2012/13 then fell by around 40% in the subsequent year. More importantly, there has been limited discussion of the longer run benefits and costs of public ownership and control

[75] The literature includes, Broadman and Vining (1989), Dewenter and Maltesta (2001) and Estrin et (2009)

and inputs or through lack of competition. These factors may be hard to control for adequately.

In the important oil and gas sectors, comparative study of state-owned and private companies has found that the major players – *Gazprom* and *Rosneft* – performed particularly badly in terms of technical efficiency, measured as revenues per worker[76]. Interestingly, although other Russian oil companies performed slightly better, all ranked low in terms of technical efficiency when compared to non-Russian companies. This has been attributed to a variety of factors including complexity in objectives, pricing regimes that are heavily politically influenced and highly heterogeneous portfolios of interests and subsidiaries (as indicated in *Section 5.2* above). There is almost universal agreement that these companies suffer from weak corporate governance and pervasive politicisation of decision-making. The generally weak relative performance of Russian oil and gas companies also suggests an adverse impact on productivity originating from the wider business and investment environment whose limitations have been mentioned above and are well documented.

From a policy perspective, Russia's public sector is marked by the considerable lack of clarity of both its actual size and composition, as well as lack of comprehension of its value. The assembly of its constituent parts has accelerated over the past decade and more through nationalisation while consolidation has attempted to instil more central control. The largest parts of the public portfolio are in oil and gas, transportation and financial services. The portfolio as a whole is notionally under a controlling shareholder, the Federal Agency for State Property Management (*Rosimushchestvo*). The evidence suggests that the control exerted by that Agency is both variable and limited. Larger and politically important entities *de facto* have their own governance and reporting arrangements. Many others have sufficiently complex structures – notably the number of subsidiaries – that oversight is consequently difficult. Thus, although having publicly owned entities under the Federal Agency is a first step in managing and even detailing the public sector, it is a far cry from a transparent system of control that allows for clarity of purpose/objectives for individual companies/entities, let alone freedom from interference by politicians and reduction in rent seeking. In reality, Russia's present system for managing public assets does a poor job at even cataloguing those assets, let alone their value.

The size of the public sector is often discussed in terms of the desirability or otherwise of the public/private balance in the economy. However, in principle, securing a higher return on those assets ought to be a major objective of any government that has, for whatever reasons, made a large assemblage of public sector assets. Yet – as comparative experience forcefully testifies[77]– the size of the public sector and the return on those assets often appear to be inversely correlated. Pervasive rent seeking, politicisation and a woeful lack of

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[76] See Eller, Hartley and Medlock (2007) as also for *Gazprom*, Victor (2008)

[77] Acemoglu and Robinson (2012) offer a wide range of examples across time, region and political-economic system

transparency and accountability are common. Presently, the appetite for privatising public assets appears to be very limited, despite periodic statements by parts of the government to the contrary.

As noted earlier, a more open attitude towards privatisation may emerge in Russia if natural resource prices remain low for an extended period. But at that point, an obvious question will concern the appetite for participation – and on what terms – by possible investors. Even if some of the large state corporations are broken up prior to disposal, it is quite likely that the only realistic bidders would be foreigners or domestic oligarchs. Both carry political drawbacks, not least the fact that in oil and gas, domestic owners have in the past preferred to behave more like private equity than long-term investors.

Putting to one side the matter of the balance between public and private sectors, the consequence of policy over the last decade and more in Russia means that two requirements now stand out as being priorities. The first is to get a reasonably accurate measure of the size of the public sector and the value of its constituent parts[78]. As indicated above, proper balance sheets are required and for several reasons. The most obvious is that such information is essential for basic control and management, including any attempts to improve the return on such assets[79]. For example, more accurate valuation of public assets would tend to a higher valuation by being more inclusive. This in turn could positively influence the cost of borrowing by reducing the risk premium. But the current system – with its lack of transparency and adequate measurement – largely precludes those objectives being realized. And it is likely that this very system is perpetuated by interests whose objectives do not even approximate the maximization of the assets' values and where lack of transparency is actually integral to rent taking and tunnelling of resources from public to private hands. The latter appear to be composed primarily of insiders – management, in particular – as well as connected parties and politicians.

With these objectives in mind, *Box 1* now summarises some of the main policies and actions that would be desirable in addressing these combined and related issues of measurement, value maximisation and governance. It should be emphasised that while these might almost be considered basic preconditions for any reasonably efficient control over public assets, there has as yet been a distinctly limited appetite for pursuing such actions.

[78] Note, for example, that in many countries real estate is the largest part of total public commercial assets. In Russia, many SOEs also have significant real estate holdings and/or interests

[79] Detter and Folster (2015) suggest creation of ring-fenced holding companies with professional and active management for varieties of state assets. This should facilitate insulation from political interference. Such an approach seems rather unlikely in the current Russian context

Box 1

Recommendations for improving documentation, governance and performance of assets in the consolidated public sector

Public Assets Registry and Fiscal Accounts

- Create a comprehensive register/cadastre of all public corporations or State owned enterprises (SOEs) - including all subsidiaries - that is transparent and accessible and follows international best practice
    - Use comprehensive register to measure value of public assets, including real estate, applying International Public Sector Accounting Standards (IPSAS)
    - Move towards a consolidated measure of non-financial and financial assets relative to GDP consistent with measures applied by IMF for other countries
    - Comprehensive register to be administered by one designated authority, such as *Rosstat*
- Link comprehensive register to preparation of consolidated fiscal accounts using internationally accepted criteria for classification of entities
    - Adopt internationally comparable criteria – GFSM 2013 – for classification of public sector entities
    - Make explicit what SOEs are contained in so-called secret lists and take out non-defence companies

Company accounts for state-owned enterprises

- Address shortcomings in accounting standards by requiring all SOEs to publish audited accounts within a reasonable timeframe
- Larger SOEs (with the threshold determined in terms of assets and/or liabilities) should be required to submit IFRS accounts with an announced period of phasing-in
- Subsidiaries' transactions and accounts should to be made more transparent and audited with the latter being phased in over time
    - For larger subsidiaries, IFRS accounts, rather than RAS, should be required and also phased in
- Publish annual report on the financial situation and risks for all SOEs including accounting for subsidies, explicit and implicit to SOEs

Raising return on public assets

- Benchmark performance indicators starting with larger and more important SOEs and then proceeding through the portfolio
    - Benchmark performance to similar private sector entities and/or publicly owned companies in similar sectors/activities in other countries
- Raise return on public assets by considering different models of public stewardship, including;
    - Separating formal control of SOEs by Federal Agency for State Property Management (*Rosimushchestvo*) from day-to-day oversight

- Outsourcing governance within public sector ownership envelope to independent holding companies with arms-length relationship to government and politicians
- Independent holding companies could be set up at federal, regional or municipal levels with view to installing better management and incentives for performance

Corporate Governance

- *Rosimushchestvo* should develop clear ownership policy for SOEs, starting with larger entities. Such policy should involve adequate specification of company objectives and targets
- Accelerate the transformation of SOE holdings and other institutional formats into joint stock companies
- *Rosimushchestvo* should press parent SOEs to consolidate and simplify their structures, dropping non-core assets
- The shareholding structure for all SOEs should be simplified and the number of controlling shareholders simplified with clearer focus on the governance role for *Rosimushchestvo*
- Given the size of its portfolio, *Rosimushchestvo* should improve its technical capacity to act as the controlling shareholder while also considering other options for improving oversight and quality of asset management (see section above)
- OECD Guidelines on Corporate Governance of SOEs should be adopted
- Specific attention should be paid to ensuring that oversight of subsidiaries rests with the Boards of the parent companies for any significant transactions
- *Rosimushchestvo* should broaden nomination of Directors to include independent persons reporting to them, thereby alleviating the burden on officials nominated to Boards
- *Rosimushchestvo* should help empower Boards more and place less reliance on communicating directly with management
- *Rosimushchestvo* should encourage listing of more SOEs and motivate existing listed SOEs to take steps to meet standards demanded by Moscow Stock exchange for higher level listing (A1)
- More generally, the Central Bank of Russia should initiate steps to:
    - Accelerate full adoption of 2014 Corporate Governance Code with more enforcement of mandatory requirements particularly concerning financial disclosure and accounting practices
    - Strengthen the regulation of related party transactions and mandatory tender offers
    - Shift emphasis towards control rather than affiliation in terms of related party transactions
    - Bolster authority of parent Boards’ oversight of transactions in subsidiaries by requiring Board approval at lower thresholds than currently used
    - Improve rules regarding shareholder rights in the context of restructuring, including conversion ratios and rights of preferred shareholders
    - Block quasi-treasury shares from voting

- Press for larger role for Independent Directors on Boards
- Extend the rights of Board Directors to access corporate controlled information
- Review restrictions on dividend payments

The paper has also highlighted that there is an important private sector in Russia comprising a core of productive, competitive and well-managed companies. With these companies, adoption of improved and more transparent codes of corporate governance has been proceeding and some of the more egregious abuses of control that were prevalent earlier have declined. But the space in which such firms operate has narrowed. Although with current data restrictions it is not really possible to calculate their contribution to GDP with accuracy, it does seem unlikely in the current policy and institutional framework that their contribution will be able to grow substantially. This is quite unlike a China-like transition in which a declining state sector has been cushioned but where private activity – formal and informal – has been the main motor of growth.

It is worth briefly considering what China's experience might suggest for Russia's future growth prospects. The first point is to recognize that in China (as in Russia) the distinction between state and private sector remains often quite murky. This is partly for reasons relating to ownership and control rights but also because of the way in which connections and networks linking public figures and institutions to private entities may operate. The accumulation of wealth by officials and party members and their offspring also has some parallels with Russia, not least in the way in which public assets have been used to extract private gain. Even so, and despite the caveats regarding the separation between state and private, Lardy (2014) has recently argued that the private sector in recent years has contributed between two-thirds and three-quarters of annual GDP. The share accounted for by state owned enterprises has continued to fall, while their return on assets has fallen below half the cost of capital. For example, the state sector share in industrial value added fell from 80% in 1978 to under 30% in 2008 and from 50% to 6% in terms of employment shares. The productivity of non-state firms has also surpassed that for state companies. Bulman and Kraay (2015) confirm that marginal products of capital were higher in non-state firms than in state owned companies[80]. Although SOEs' share in the economy has fallen very sharply, they still act as a drag on aggregate growth, as well as a lobby against some market-oriented reforms.

In short, the available evidence for China shows a very different trajectory than in Russia. Some less desirable features – notably the importance of politician-business ties and networks, regulatory interventions and non-transparent pricing, including for inputs, such as energy – still exist in China, as they do in Russia. But the economic territory occupied by private companies is far larger in the former which, when combined with superior productivity, has delivered strong aggregate growth.

[80] They also found that while most of the contribution to annual GDP growth over the past thirty years was attributable to factor accumulation, there were significant contributions from capital reallocation

As regards dynamics, the paper has highlighted several important and closely related dimensions. The first concerns the ability of a public sector-led, natural resource dominated economy to generate growth and development, both in general and with respect to the particular redistributive goals that are likely to be required for continued political support[81]. Such goals include not only transfers to selected constituencies – including increasingly important demographic targets, such as pensioners - but also the provision of adequate public services to citizens. A sustained fall in natural resource revenues would severely impair the ability to finance given the relatively limited possibilities for raising non-oil and gas revenues.

The second is the ability of the current system to generate sufficient rents to the benefit of current insiders and/or connected parties. Accumulated experience since 1991 suggests that management and politicians have favoured rent seeking. Current beneficiaries will work to limit challenges to their rent-raising capacity including through curtailing entry, maintaining market power, as well as weak investor protection. Offsetting factors, such as the need to enlist external financing, seem at this point in time to be of limited relevance or weight. Although the dangers of elite rivalry certainly exist, to date these have been largely contained. Further, given the scale of rents available, the pressure to consolidate privileges will likely dominate any broadening of access. As such, the very process of reinforcement of privileges and rents will make institutional development largely endogenous. The obvious risk is that the current system will be perpetuated, ensuring that the governance dimensions discussed in this paper become entrenched.

The third concerns the sustainability of the political regime. Presently, there are high levels of personalization of political power around the Presidency (linked to tightening control of mass media), an associated attenuation of competition among political parties and an absence of ideologically driven politics. Put simply, present arrangements are not sanctioned or sustained by either an explicit ideology or a stable political party or apparatus. Outside the conventional structures of government, political and economic power is increasingly focused on large public sector companies and financial institutions, along with politically connected entities[82].

Aside from the tensions that chronic under-performance might create, a big question-mark exists as to the stability of the system and, in particular, its political dependence on one individual. Current high ratings for the President and even the government are clearly not an aberration or mis-measurement[83]. But they sit on top of, or alongside, perceptions that are far less comforting to power and whose dimensions have already been visible for some time. These perceptions include ambiguities about the direction of change in personal and family economic circumstances, as well as a pervasive mistrust of politicians and businessmen. These somewhat cynical perceptions of the nature of government,

[81] Points also made and documented in Kudrin and Gurvich (2015)
[82] Other oligarchic structures may formally fall outside this ambit but, nevertheless, have to be responsive to power
[83] See also Frye et al (2016)

power and commerce have also been – and are – associated with relative political passivity. And while the latter may be viewed as supportive to the current regime, it is notable how unexpected were the protests at end-2011.

In the longer run, the stability of the current arrangements is inevitably challenged by two factors. The first is that the current system is highly dependent on the personalization of power. While this does not preclude an orderly transfer to an anointed successor, there are also some obvious pitfalls. These include the inability to bind any potential successor to maintaining the main features of the *status quo* and its allocation of power and resources. The second factor is that while the current economic structure or model is quite successful at generating rents for management and connected parties, it is less good at generating productive and profitable companies. Further, by squeezing the space for more productive companies, this configuration serves to depress the potential running speed of the economy as a whole. Assuming little *manna* from heaven – no sustained increases in appropriable oil and gas revenues – the political-economic model that is installed will struggle, thereby opening the door to either a bout of liberalisation or to the application of further, regressive and illiberal measures aimed at shoring up control and political authority. Both strategies – given what has already happened – carry their own risks.

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Annex 1: EU, Canada and USA sanctions lists; 2014-2015

Russian Companies sanctioned by EU

Public Movement "New Russia"

Chernomorneftegaz, Crimea

Company "Theodosia"

GSK "Kerch Sea Ferry"

SE "Sevastopol Sea Trade Port"

SE "Kerch Sea Commercial Port"

Crimean GAP "Universal-Avia"

Sanatorium "Oreanda"

SE "Azov distillery"

State Concern LOD "Massandra"

GP Agricultural company "Magarach"

GP "Noviy light"

OJSC "Concern PVO" Almaz - Antey "

Ltd. "Dobrolet"

Russian National Commercial Bank (JSC)

United Industrial Corporation, "Oboronprom"

Russian aircraft manufacturer KLA

Koproratsiya "Uralvagonzavod"

"Rosneft"

"Transneft"

"Gazprom Neft"

Companies sanctioned by USA

Volga Group, a private investment company of G.Timchenko
LLC "Avia Group" Aviaservisnaya company
(74% of "Avia Group" owned by Volga Group)

LLC "Avia Group Nord" (70% of "Avia Group Nord" belongs to Volga Group)
"Akvanika" producer of drinking water AQUANIKA and soft drinks.
(100% owned by Volga Group)

"Sahatrans" transport company, sold in 2012 to Volga Resources
"Stroytransgaz" Russian engineering and construction company,
(96.27% owned by STG Holdings Ltd; around 63% of STGH belongs to Volga Group)

"Holding Stroytransgaz" (STG Holdings Ltd), belonging to the group "Stroytransgaz"
OAO Stroytransgaz, construction of energy facilities particularly pipelines
Stroytransgaz Ltd., along with GK "SARK" and SC "Insurance Bridge", transport infrastructure

Stroytransgazmontazh - SGM Group, an international diversified construction holding

“SMP Bank”. Controlling stake owned by Arkady and Boris Rotenberg.

“InvestCapitalBank”, regional retail bank and daughter of SMP

“Bank Rossiya", co-owned by Yury Kovalchuk

LLC "Investment Company Abros", a subsidiary of the Bank "Rossiya"

JSC "Zest", a leasing company, a member of the banking group "Rossiya"

JSC "Sobinbank" universal commercial bank owned by Bank "Rossiya"

“TRANSOIL", rail transport of oil and oil products

“Chernomorneftegaz”, Ukrainian public joint stock company

OJSC Concern PVO "Almaz-Antey", air and missile defence

OJSC "Research and Production Corporation Uralvagonzavod", military equipment

JSC MIC "NPO Machine Building", rocket and space businesses
Parts of "Rostekh": (1)"Constellation" producing complexes, systems and equipment for the Armed Forces of the Russian Federation; (2) "Kalashnikov", manufacturer of weapons;
(3) "Radio-electronic technology," avionics and electronic warfare;
(4) "NGOs Basalt", ammunition; (5) "Instrument Design Bureau", guided weapons

OAO NK "Rosneft

OAO "Novatek"

Theodosia Oil Terminal

"Vnesheconombank”

OAO "Gazprombank"

OJSC "Bank of Moscow"

"Bank VTB"

JSC "Rosselkhozbank"

JSC "United Shipbuilding Corporation"

"Asia Bank" ("Asia Bank")

Russian National Commercial Bank (RNCB)

JSC "IMZ"

Concern "Izhmash"

Yevpatoria Merchant Sea Port

Feodosia sea trade port

Kerch Sea Commercial Port

Sevastopol sea port

Yalta port
GSK "Kerch Sea Ferry"
SouthEast Trading OY (offices in Romania, Russia & Finland)

Companies sanctioned by Canada

Rosneft.
Public Movement , New Russia"
InvestCapitalBank
JSC "Sobinbank"
SMP Bank
Volga Group
"Akvanika"
LLC "Avia Group"
LLC "Avia Group Nord"
JSC "Zest"
LLC "Investment Company Abros"
"Sahatrans"
SGM Group
"Holding Stroytransgaz" (STG Holdings Ltd)
"Vnesheconombank"
OAO "Gazprombank"
OAO "Novatek"
OJSC Concern PVO "Almaz-Antey"
JSC MIC "NPO Machine Building",
Parts of "Rostekh": (1) "Constellation"; (2) "Kalashnikov"; (3) "Radio-electronic technology; (4) "NGOs Basalt"; (5) "Instrument Design Bureau"
Company "Expobank"
JSC "Commercial Bank" Rosenergobank "
Kerch commercial port
Kerch Sea Ferry
Wine factory "Massandra"
Winery "New World"
Commercial port of Sevastopol
National Institute of Vine and Wine "Magarach"
Airline "Universal-Avia"
JSC "Sberbank Russia"
"Research and Production Center in Dolgoprudny"
JSC "Machine-Building Plant named after Kalinin" (MZiK), included in OAO "Concern PVO" Almaz-Antei "
JSC "Mytishchi machine-building plant"
JSC "Tikhomirov Scientific Research Institute of Instrument Design" (NIIP),
JSC "Marine Scientific Research Institute of Radio" Altair "(JSC" MNIIRE "Altair")
Marshall Capital Fund
Motorcycle club "Night Wolves"
"Gazprom"
"Gazpromneft"

"Surgutneftegas"

"Transneft"

Eurasian Youth Union

JSC "Sirius" (optoelectronics for military and civilian use)

OAO "Tula Arms Plant"

PJSC "United Aircraft Corporation"

"Himkompozit" (manufacturer of materials for the defence industry)

"Precision complexes", Manufacturer of arms

"Association Tools" (mechanical engineering)

OPK "Oboronprom"

Annex 2: Changes in Corporate Governance between 2010-2014

2010
DIVIDEND PAYMENT PERIOD
SHORTENED TO 60 DAYS:
Improved dividend payment procedure
- since 31.12.2010.

MORE TRANSPARENCY AND
OPENNESS OF BUSINESS:
Mandatory annual and half-year IFRS reports for
public open joint-stock companies
Started with reports for 2012.

2011
MORE TRANSPARENCY AND
OPENNESS OF BUSINESS:
Disclosure of the total number of shareholders
- since 17.07.12

2012
MORE TRANSPARENCY OF DEPOSITARY
RECEIPT OWNERSHIP
• Advance notifications for dividend list cut-off date
- since 01.01.2014
• Mandatory distribution of all GSM materials via email
- since 01.01.2014
• Mandatory posting of the GSM notification on the
corporate website - since 01.01.2014

2013
MORE TRANSPARENCY AND OPENNESS
OF BUSINESS:
Advance notifications for GSM participants list
cut-off date - since 01.01.2014

CLARIFIED LIABILITY OF EXECUTIVES
AND DIRECTORS:
The Supreme Arbitration Court issued detailed
clarification on the liability of executives, including
conflict of interests, shared *onus probandi*, and
presumption of Director's misconduct

- since 30.07.2013

2014
NEW CORPORATE GOVERNANCE CODE:
Approved by the Government of the Russian Federation
and Board of Directors of Bank of Russia.

NEW RULES FOR PUBLIC AND NON-PUBLIC
JOINT STOCK COMPANIES:
Amendments to the Civil Code passed to liberalise the
regulatory treatment of corporate governance in
non-public joint-stock companies and expand the
scope of application of shareholder agreements
- since 01.09.2014

RUSSIAN CIVIL CODE AMENDED
Right of members of Boards of Directors to access
corporate data and documents – since 1.09.2014
Russian Civil Code amended by rule that bans placement
of preferred shares by public joint stock companies if the
stock has lower par value than ordinary shares – since 01.09.2014

FINANCIAL MARKET MEGA-REGULATOR
- since 01.09.2013

NEW LISTING RULES APPROVED 02.06.2014

NEW PREEMPTIVE RIGHTS PROTECTION
TOOLS – since 02.01.2013

IMPROVED DELISTING REGULATION
PROCEDURE - since 02.01.2013
The decision to delist is now passed by the GSM
only and requires a minimum 75% vote share by
the holders of shares slated for delisting. Shareholders
who vote against or do not take part in the voting must be
offered a buy-out option

SIMPLIFIED IPO PROCEDURE
- since 02.07.2013

IMPROVED DIVIDEND PAYMENT PROCEDURE
- since 01.01.2014
Transfer to umbrella dividend payment mechanism and
shorter payment period.

2014/2015
ADDITIONAL CHANGES
Mandatory electronic distribution of GSM documents
Electronic voting, i.e. no paper ballots
Permission for custodians to vote on behalf of their clients without PoAs
All corporate action will be in electronic format (from July 2016)
Rights for Directors to access documents and corporate information
and to contest a company's transactions
Shareholder rights to contest a company's transactions if seen as fraudulent
Additional defensive shareholder rights for the placement of preferred shares
in public companies and for mandatory tender offers

Source: Prosperity Capital