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**FACTORS INFLUENCING
THE CORPORATE GOVERNANCE
OF POST-SOCIALIST COMPANIES.
EXAMPLES FROM THE OIL INDUSTRY**

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1. Introduction

This working paper aims to explain the corporate governance performance of post-socialist companies and discusses strategies to improve it. Corporate governance describes mechanisms which allow all company owners (shareholders) fair participation in decision-making and ensure that the management acts in the common interest. Basic components of this kind of corporate governance include accountability of managers to owners, transparency of the company's financial situation and ownership structure, integration of all relevant shareholders into decision-making processes (usually through representation at the company board) and a fair distribution of profits among all shareholders (meaning dividend payments and the absence of manipulations, such as asset stripping and dilution of shareholdings, to the benefit of a specific group of shareholders. These basic components are present in all four major corporate governance models (i.e., the Anglo-Saxon, German, French and Scandinavian models) commonly identified in the literature (La Porta et al. 1998; Baker/Wallage 2000).

In general, shareholders can be distinguished according to their ownership stake in a company which provides them with specific rights. In international comparison, the rights of a shareholder increase significantly with a stake of 10% or more of a company's share capital (La Porta et al. 1998, p. 1122). While minority shareholders can be defined as owners of less than 10% of the share capital, a substantial minority shareholder or blockholder has an ownership stake of more than 10%. A blockholder has the incentive to collect information and monitor the management, thereby avoiding the traditional free rider problem. He or she also has enough voting control to put pressure on the management in some cases, or perhaps even to oust the management through a proxy fight or take-over (Shleifer/Vishny 1997, p. 754).

Traditionally, the main focus of corporate governance research has been on the role of minority shareholders in the case of widely dispersed ownership, i.e. of a dominant role of publicly traded companies and extensive share ownership by private households. Along the lines of Anglo-American experiences with companies owned by a large group of small private shareholders, the way in which the collective action problem can be overcome in order to prevent these small shareholders from monitoring and controlling the management has been examined (Grossman/Hart 1980; Roe 1994; Black 1998). However, small private shareholders are of only minor relevance in post-socialist economies, where large blockholders dominate in most companies.

2. An analytical framework

In the socialist system there was no need for corporate governance, as all bigger companies were state-owned and -controlled. Therefore, there were no corporate governance regulations in place when the socialist system disappeared, nor were there state agencies capable of controlling private companies.

In this paper corporate governance is defined as the way a company behaves towards its owners. Accordingly, changes in a company's corporate governance performance primarily affect the owners, i.e. shareholders. At this junction, it is necessary to distinguish between majority and minority shareholders.

The post-socialist institutional environment in the early stage of transformation gave the owners of a company — majority shareholders (outsiders)³ and managers-owners (insiders) alike — little incentive to restructure the firm or maximise its value. As long as ownership rights were insecure, owners typically withdrew cash flows from their enterprises through fictitious expenses or outright theft at the expense of minority shareholders, instead of increasing the firm's value through reinvestment. Within short time horizons, the owners diverted cash flows to offshore accounts and shell corporations, concentrated losses among subsidiaries held by outsiders (rather than evenly distributing them between the insider-owned holding company and the subsidiaries), and delayed the payment of dividends (Desai/Goldberg 2000).

Even owners interested in the long-term performance of their enterprise did not automatically improve corporate governance. Under the socialist central planning system, enterprises externalised business functions to government ministries and other organisations. Accordingly, owners had to rectify the enterprise's lack of resources and capacities. In the weak post-socialist institutional environment at the early stage of transition, the concentration of ownership was a necessary precondition for restructuring measures designed to secure full control over a company and to enable the owners to benefit from a successful reconstruction and increased competitiveness. To wield this control, the owners used informal practices (including violations of shareholders' rights) to increase their stake and to dilute the shares of minority shareholders. During corporate restructuring, the owners again utilised informal methods, such as centralising the cash flows generated by subsidiaries in a holding company, thereby violating the interests of

³ According to Manne (1965, p. 13) an outsider can be defined as a person who is «not presently controlling the affairs of the corporation». Therefore, insiders are persons who control the affairs of a company. Insider directors include officers, former officers, and those directors with family ties to officers or former officers (see also Fama/Jensen 1983).

the shareholders in these subsidiaries. This enabled the owners to bring the various business functions under a single controlling mechanism within the administrative framework of the firm — possibly including vertical integration (Iji 2003; Yakovlev et al. 2004, p.148—155; Adachi 2005).

Only when owners with an interest in long-term profitability had (in their own assessment) secured property rights in a consolidated enterprise were they likely to be interested in good corporate governance, i.e. the protection of shareholders' rights, to attract finance and business partners or to enter new markets.

Minority shareholders, on their part, have an interest in improved corporate governance when they suspect that the company management is trying to profit at their expense by manipulating corporate information and financial statements. However, outside minority shareholders can only translate this interest into improved corporate governance when they have the means to exert pressure on the company board.

In the literature on corporate governance, three groups of shareholders are assumed to be especially likely to enforce improvements in a company's corporate governance behaviour. First, financial institutions, such as banks or investment funds; second, strategic investors with a strong minority shareholding; and third, foreign investors, who are normally outsiders and therefore rely on good corporate governance to obtain attractive returns on their investments. In this sense the ownership structure of a company is linked to its corporate governance performance.

However, this link is far from being absolute. For post-socialist countries it has been claimed, for example, that no relevant role in corporate governance issues is played by financial institutions, as they are underdeveloped and themselves badly regulated (Dittus 1996; Frydman et al. 1996; Estrin/Wright 1999). For Ukraine, an empirical study bluntly concludes that no ownership form has managed to change corporate behaviour there (Estrin/Rosevear 2003) and similar scepticism has been voiced for Russia (Krivogorsky 2000; Peng et al. 2003). Contrary to the argument above, it is reasoned that in Russia's case strong outside minority shareholders often lead to the deterioration of corporate governance as majority shareholders, along with the management, try to oust troublemakers by dodgy means. Though ideas about the causal mechanism vary, all studies focusing on ownership structure examine the position of outside minority shareholders as an explaining variable for a company's corporate governance performance.

Improvements in corporate governance can also be the result of cultural learning. In the post-socialist cases, where the domestic economy is initially

marked by the absence of corporate governance regulation, the main source of learning is activity on foreign markets characterised by higher corporate governance standards. When a company wants to enter a foreign market, it has to make an effort to adapt to the foreign business environment, potentially including the adoption of foreign corporate governance standards. In other words, the more important foreign markets become to the company, i.e. the more the company becomes internationalised⁴, the likelier it is to at least partly assume the foreign corporate governance practices (Walsh/Whelan 2001; Heinrich 2004 and 2005). Accordingly, internationalisation is another possible explaining variable for a company's corporate governance performance.

Finally, the state may develop an interest in corporate governance in order to improve the investment climate and to thwart the criminalisation of the economy, as the financial manipulations related to bad corporate governance are often fraudulent and used to avoid taxes. Accordingly, the state can create legal regulations to foster good corporate governance whose enforcement would then lead to improved corporate governance.

In summary, there are four factors which can influence corporate governance performance: (1) pressure from majority shareholders; (2) pressure from outside minority shareholders; (3) pressure resulting from internationalisation/globalisation; and (4) pressure coming from the state in the form of legal regulation.

These four factors will be illustrated in the following part with the help of cases studies of major oil companies in post-socialist countries. The oil sector was chosen because it is among the most internationalised sectors in post-socialist countries and has also attracted numerous foreign and domestic outside investors. Russia's Yukos is presented as an example of the potential impact of the collective efforts of majority shareholders and the effects of internationalisation. Ukraine's Ukrnafta was chosen to exemplify the role minority shareholders can play, and Poland's PKN Orlen demonstrates the effects of legal regulation.

Though the companies are from three different countries, they have several things in common. They all belong (or it least belonged in the period under investigation from 1997 to 2004) to the biggest companies in their respective countries. They were all privatised in the 1990s. Additionally, they were all partly owned by individuals dubbed «oligarchs» in the mass media of their respective countries, indicating their less than stellar reputation.

⁴ Here internationalisation refers solely to a company's efforts to enter foreign markets and to find partners abroad. It does not include co-operation with foreign companies on the domestic market. First, in this instance it is the foreign partner and not the domestic company that is forced to engage in cultural learning. Second, if the foreign partner acquires a share in the domestic company, this will be covered by the ownership structure.

In order to compare the corporate governance performance of these companies, the Heinrich Index will be used, which is a composite of indices developed by the World Economic Forum, the Institute of Corporate Law and Corporate Governance (Moscow) and Standard & Poor's. It consists of the following indicators: (1) disclosure of financial information; (2) transparency of ownership structure; (3) management and supervisory board structure; (4) dividend payments; and (5) a company's violation of shareholders' rights. Thus, the index includes and tests the basic components of corporate governance which are commonly cited as essential for the protection of shareholders' rights (and, therefore, good corporate governance) throughout the literature. An index value of -0.5 stands for the worst corporate governance possible, whereas the maximum score is +1.6. The maximum score indicates a level of corporate governance considered normal by Western legal standards. A detailed description of the index together with the index values for 15 post-socialist oil and gas companies can be found in Heinrich et al. (2005).

3. Case studies

3.1. Yukos — Company consolidation and internationalisation

Yukos was founded as a fully state-owned oil company in 1993. The privatisation of Yukos started in 1995. In December 1995, the Rosprom-Holding of Bank Menatep, which was controlled by «oligarch» Mikhail Khodorkovsky, acquired a 78% share of the company. The bank was able to increase its shareholding to 85% in the following year. These privatisation auctions were manipulated in favour of Rosprom and led to repeated allegations of corruption. They established Khodorkovsky as one of Russia's leading oligarchs (Pleines 2000; Allan 2002).

Rosprom overstretched the financial capacities of Yukos through the acquisition of additional assets (including the Russian oil company VNK) and asset stripping. As a result, a serious conflict with minority shareholders in Yukos production subsidiaries, namely with the American investor Kenneth Dart, arose. Low oil prices and the Russian financial crisis of 1998 then brought the company to the brink of bankruptcy. A planned merger with Sibneft, another major Russian oil company, was cancelled.

In 1997, Bank Menatep pledged a 30% stake of Yukos to procure a loan from Standard Bank (South Africa), West Merchant Bank (Germany) and Daiwa Bank (Japan/UK). When the bank was unable to meet its liabilities in the wake of the 1998 financial crisis, the Yukos stake was claimed by its creditors. However, shortly after a debt-for-equity swap agreement with the lenders was

reached, the Yukos supervisory board decided to double the company's share capital, thus diluting the stake to be handed over to the banks. During 1999 Standard Bank acquired the shareholdings of its partner banks. The Russian investment bank Troika Dialog alleged the existence of a personal link between Standard Bank and Yukos and concluded that Standard Bank was securing internal control of Yukos⁵.

The ownership structure of the company remained more or less opaque from 1995 to 2001, as only nominal shareholders were disclosed. Only in 2002, when Yukos' major shareholder, the Group Menatep, disclosed its ownership structure did it become public knowledge that Yukos president Mikhail Khodorkovsky was the largest Yukos shareholder.

In the second half of the 1990s Yukos' corporate governance was characterised by significant violations of corporate governance standards. In addition to the dilution of minority shareholders through the emission of new shares and their sale to insiders or companies controlled by Yukos, the company has been accused of asset stripping via transfer pricing and the illegal transfer of shares to unnamed Cypriot companies.

After Bank Menatep collapsed in the course of the financial crisis in 1998, its chairman Mikhail Khodorkovsky transformed himself from banker to oil magnate as he turned his attention to re-building Yukos. The oil market began to improve, and the situation for export-oriented businesses was looking favourable after the devaluation of the Russian ruble in the wake of the financial crisis. The year 1999 then became a turning point in the company's history, when it started to adopt a more investor-friendly stance.

Table 1. Yukos economic performance 1997–2004

	1997	1998	1999	2000	2001	2002	2003	2004
Total crude oil production (mt)	35,6	44,6	44,5	49,6	58,1	69,5	80,8	85,7
Oil exports (mt)	9,1	13,3	17,9	22,4	30,1	35,5	43,0	34,0
Net sales (US\$m)	4,619	2,480	2,110	8,948	10,135	11,373	13,349	22,100
Net profit (US\$m)	171,6	-1,735	254,2	3,331	4,006	3,065	N/A	N/A

Note: Due to back claims by the tax administration, which resulted in long-lasting court proceedings, Yukos could not present final financial results for the years 2003 and 2004.

Sources: Yukos company information.

⁵ Troika Dialog (1999). Bulletin on Corporate Governance Actions, 23 June, p. 5 and 1 December, p. 8.

In 1999, Yukos disbursed its first dividend payments meeting the legally required 10% of the company's net profit, amounting, in fact, to nearly 50% of profits. In 2000, the company started to publish financial reports in international accounting standards. In the same year, three independent directors were elected to the company board for the first time. At the end of 2000, the reduction of corporate debts was almost completed. Yukos was also able to secure control over its production subsidiaries that year. With that the company management could focus on a long-term business strategy (Mazalov 2000; Reznikov 2000).

In a globalised sector like the oil industry, a long-term business strategy nearly automatically includes internationalisation. Since the Russian government keeps domestic energy prices artificially low, the Russian oil and gas industry receives nearly all of its profits from exports (Smirnov/Posvyanskaya 2003). As the sale of oil products directly to the end consumer offers considerably higher profits than the sale of unrefined products at the border, Yukos soon developed an interest in entering the EU downstream market. In this context, Yukos saw investments in post-socialist EU candidate countries as an entry ticket into this lucrative market. Major acquisitions included stakes in a Croatian pipeline project, in Lithuania's premier oil company and in Slovakia's oil pipeline operator (Pleines 2006).

As a result, Yukos became the most successful Russian oil company in terms of increase in production and share price. In 2003, Yukos again announced a merger with Sibneft. However, Khodorkovsky's subsequent attempts to engage in politics in opposition to Russia's President Vladimir Putin led to the destruction of the company by state agencies from 2003 to 2005. Tax claims were used to confiscate Yukos' major production unit and charges of economic crimes were used to put the company's leading owners and managers, including Khodorkovsky, in jail (Tompson 2005).

In conclusion, there is a sharp contrast between the company's bad corporate governance in the 1990s and its adherence to virtually all major corporate governance rules since 2002. The corresponding values of the corporate governance index are indicated in Table 2. This contrast can be explained by a shift in the strategy of the majority shareholder. In the second half of the 1990s, Menatep tried to gain control over all Yukos subsidiaries and to unite them into a vertically-integrated holding structure. To achieve this it had to get rid of minority shareholders in the subsidiaries. The best way to achieve that aim was to deny them their share in profits through asset stripping, i.e. through transfer pricing, and to dilute their share (Iji 2003; Adachi 2005).

Once this aim was achieved Khodorkovsky, the majority owner who made himself manager, started to develop a long-term business strategy. In the oil

industry this strategy had to focus on exports and on the expansion into foreign markets, i.e. internationalisation. This re-enforced the improvements in corporate governance, as the experience of 1998 had made foreign partners suspicious and with that more demanding in terms of corporate governance performance (Heinrich 2005).

Table 2. Yukos corporate governance index 1997–2004

	1997	1998	1999	2000	2001	2002	2003	2004
Index value	0,4	0,2	0,0	1,0	0,8	1,4	1,4	1,4

3.2. Ukrnafta — The power of minority shareholders

In 1992, the first year of Ukrainian independence, the Ukrainian State Property Fund lost no time initiating the reorganisation of the oil and gas sector. After more than one year of administrative proceedings Ukrnafta was established as a national oil and gas company; a plan for its privatisation was finally agreed on in January 1995. By summer 1995, 8.6% of Ukrnafta shares were sold to its workers and 3.4% to Ukrainian citizens. However, the progress of the company's privatisation was hampered by parliament when it decided, in disregard of the existing law on privatisation, that some of Ukrnafta's subsidiaries could not be privatised because of their national relevance. However, after 1996 major stakes in Ukrnafta were sold (Pleines 1998).

Fully 20% of Ukrnafta was sold on stock markets, of which 6% was offered in Germany and the United States in the form of American Depositary Receipts (ADRs). In addition, stakes adding up to 10% were sold to financial investors. As a result, Ukrnafta's minority shareholders included Alfa Nafta (which belongs to the Russian Alfa Group), Privatbank, Ukrsibbank and affiliated companies, such as Copland Industries S.A., Watford Petroleum Ukraine, Occidental Management Co. Ltd. and others. The state retained an absolute majority of shares in Ukrnafta, which was transferred to the national oil and gas holding company Naftohaz Ukrainy. In the late 1990s, the management of the effectively state-controlled oil company engaged in asset stripping and did not develop any long-term business strategy (Prudka 2001).

However, by 2001 Privatbank and Ukrsibbank had jointly gained control of 41% of Ukrnafta, mainly through companies registered in Cyprus. In 2002-2003, Ukrsibbank transferred full control over the stake to Privatbank⁶.

⁶ Information on the ownership structure is based on information provided by the company (www.ukrnafta.com, only available in the Ukrainian version) and by MFK Investment Bank (www.mfkgroup.com).

Privatbank, controlled by Ukrainian «oligarch» Igor Kolomoysky, had become one of the largest holdings in the country in the wake of privatisation. (Maskalevich 2003) As a consolidated and powerful minority shareholder Privatbank demanded an end to asset stripping and a say in the company management.

According to Ukrainian legislation, 60% plus one share must be registered in order for a general shareholder meeting to take place. Privatbank and Ukrsibbank, which gained two out of eleven seats on the supervisory board at the September 2000 general shareholder meeting, used this statute to block subsequent shareholder meetings in order to pressure for a total of five seats. Such an increase would have meant a veto position on key issues, where a 60% quorum is required. As a result, company operations requiring approval at general shareholder meetings, such as the adoption of long-term strategies, the creation of joint ventures or dividend payments, could not take place. Accordingly, attempts by the new management to develop a long-term business strategy could not be realised. The stalemate also prevented any improvements in corporate governance.

Table 3. Ukrnafta economic performance 1997–2004

	1997	1998	1999	2000	2001	2002	2003	2004
Oil production (mt)	3.0	3.0	3.0	2.9	2.8	2.8	2.9	3.0
Gas production (bcm)	2.2	2.6	2.7	2.7	2.6	3.3	3.3	3.4
Net sales (US\$m)	560	538	344	538	486	384	556	822
Net profit (US\$m)	163	57	56	182	182	84	167	254

Sources: Ukrnafta (www.ukrnafta.com); Dragon Capital (www.dragon-capital.com); InvestGazeta (www.investgazeta.ua); MFK Investment Bank (www.mfkgroup.com).

An attempt by the government to resolve the conflict by reducing the legally required quorum for a general shareholder meeting from 60% to 50% was rejected by parliament. At the extraordinary general meeting of Ukrnafta shareholders in March 2003, an agreement between the two shareholders was finally reached. Privatbank received four out of eleven seats on the supervisory board, and its candidate, Ihor Palytsya, was appointed as head of the management.

In spring 2005, the new Ukrainian leadership, which saw Privatbank as an ally of the former regime, started legal investigations into Privatbank's acquisitions. It again attempted to neutralise the influence of Privatbank in Ukrnafta. However, an initiative to reduce the legally required quorum for a general shareholder meeting from 60% to 50% was again rejected by parliament in October 2005.

In summary, Ukrnafta was characterised by bad corporate governance in the late 1990s, when the largely uncontrolled management engaged in asset stripping. As in the Yukos' case, the conflict with minority shareholders did not help to improve the company's corporate governance performance (or its economic performance for that matter). Contrary to Menatep Bank, however, the Ukrainian state as majority owner did not revert to illegal means to get rid of the unwanted minority shareholder. When legal means failed, a stalemate was the result. Nevertheless, when a compromise was finally reached in 2003, corporate governance improved remarkably (see Table 4) as transparency measures and fair participation in decision-making were now being demanded by both sides in order to protect their own interests.

Table 4. Ukrnafta corporate governance index 1997–2004

	1997	1998	1999	2000	2001	2002	2003	2004
Index value	0.2	0.2	0.6	0.6	0.4	0.4	1.0	1.0

3.3. PKN Orlen — The power of laws

PKN Orlen is Poland's largest oil and petrochemical company. It was established in 1999 through the merger of Centrala Produktów Naftowych and Petrochemia Plock. In 1999 and 2000, altogether 72% of PKN Orlen was sold on the Warsaw Stock Exchange in the form of Global Depository Receipts (GDRs) on the London Stock Exchange. The state retained a blocking stake of more than 25%. In 2002 and 2003 two bigger minority shareholders emerged, the Kulczyk Holding and the Commercial Union obtaining stakes of 5.69% and 5.04%, respectively⁷.

Table 5. PKN Orlen economic performance 1999–2004

	1999	2000	2001	2002	2003	2004
Total crude oil processing (mt)	12,5	13,1	12,9	12,5	11,7	12,2
Net sales (US\$m)	3,347	4,285	4,156	4,540	6,917	7,958
Net profit (US\$m)	237,9	207,7	91,8	113,1	266,0	651,9

Source: PKN Orlen company data.

⁷ All ownership figures are from PKN Orlen's annual reports.

Jan Kulczyk, Poland's most influential «oligarch» according to the mass media, acquired important assets in Poland's privatisation auctions and promoted his business through contacts with leading politicians on both the regional and national levels (Grzeszak 2004; Schoenman 2005).

When Kulczyk became a minority shareholder in PKN Orlen, the company was still reeling from political scandals. In 2004, a parliamentary commission was established to examine possible irregularities at PKN Orlen. The allegations included donations by the company to foundations headed by the wife of the Polish president. Another parliamentary commission was set up to investigate allegations that Kulczyk had been in negotiations with the Russian secret service to promote Russian business interests in the Polish oil industry. In the Czech Republic, it was alleged that the Czech prime minister had been bribed to favour PKN in the Unipetrol privatisation.

In 2004, the president of the Kulczyk Holding was appointed head of the supervisory board of PKN Orlen. However, after criticism from the Polish prime minister, he was replaced by the government's candidate after just 20 days in office. Since then the government has used its blocking share in PKN Orlen to determine the head of the company management. In September 2004, a deputy finance minister was appointed to this position (Heinrich et al. 2005).

Although scandals have spoiled the company's image and have hampered the realisation of an ambitious strategy to create a regional, vertically integrated oil company in central eastern Europe, PKN Orlen's corporate governance has been on a consistently high level. The firm published its financial information in international accounting standards, disclosed its ownership structure and paid dividends. No violations of shareholders' rights have surfaced. In 2004, a representative of the minority shareholder (Kulczyk Holding) was elected to the company board. In summary, PKN Orlen has been characterised by a good corporate governance performance, particularly in its disclosure standards, as indicated by the index values presented in Table 6.

Table 6. PKN Orlen corporate governance index 1999–2004

	1999	2000	2001	2002	2003	2004
Index value	1,2	1,2	1,2	1,2	1,2	1,4

This can be seen as a result of a stricter enforcement of legal regulations related to corporate governance (Hashi 2003). First, this forced the company to ensure a rather high level of transparency in financial reporting and ownership disclosure (Patel et al. 2002; Brody et al. 2005). Second, this forced state organs

to investigate allegations of manipulations and violations. Though the parliamentary committees established to examine PKN Orlen are unlikely to clarify all issues, public attention and pressure helps to ensure certain minimum standards of conduct on the part of politicians and businesspeople alike (Federowicz/Sitek 2006).

4. Causal relations

If all four factors (pressure from majority shareholders, pressure from outside minority shareholders, pressure resulting from internationalisation/globalisation and pressure coming from the state in the form of legal regulation) have an impact on corporate governance performance, their interaction deserves explanation. On the basis of research conducted so far, the following causal mechanisms can be suggested (for details see Heinrich et al. 2005):

The strategy of majority shareholders is positively correlated with corporate governance performance. However, there are intervening variables. First, the strategy of majority shareholders has an impact on corporate governance only above a lower limit set by legal regulation. In addition, if the position of minority shareholders is strong, they have the potential to neutralise the strategy of majority shareholders; depending on the strategy of the majority owner, this may be positive or negative for the company's corporate governance performance. If the strategy of majority shareholders is oriented towards long-term profitability, its positive impact on corporate governance performance is strengthened if the degree of internationalisation is high.

This leads to the following working hypothesis:

A company's corporate governance is good if

(1) the legal regulations are good, i.e. the quality of related laws and the degree of their enforcement are high, or

(2) the strategy of majority shareholders is oriented towards long-term profitability and there is no conflict with strong minority shareholders. The impact of this constellation on corporate governance is strongest when internationalisation is high.

Condition (1) describes the situation in central east European countries like Poland. Big or established companies are unlikely to risk legal proceedings. Although illegal manipulations take place, they are an exception rather than the rule. Still, there is considerable room for improvement. Whether companies just fulfil the legally required minimum standards or aim for higher standards depends on the other three factors.

Condition (2) describes the situation in former Soviet republics like Russia and Ukraine. As the minimum standard set by legal regulations is very low, mainly due to lack of enforcement, the actual corporate governance performance of companies in these countries can differ dramatically. The main explaining factor for these differences seems to be the strategy of majority shareholders. In the case of the oil industry, which is covered in this study, a strategy of long-term profitability automatically leads to internationalisation. Accordingly, there is a strong link between strategy and internationalisation, which both promote better corporate governance. Conflicts with minority shareholders, however, have in most cases led to a deterioration in corporate governance.

5. Conclusion — How to improve corporate governance performance?

As the current experience of Russia demonstrates, a remarkable improvement in corporate governance is possible under condition (2) (see e.g., Kochetygova et al. 2004; Judge/Naumova 2004; Heinrich 2005). However, this improvement does not cover all companies and as it depends on the will of the majority shareholders, it can be reversed at any time. Moreover, the state has only very limited control over these factors and therefore cannot really influence corporate governance. As the example of Ukraine indicates, where corporate governance performance has not improved, economic growth alone is not enough to ensure better corporate governance (Sidenko/Kuziakiv 2003).

Condition (1), on the contrary, offers the state direct control over corporate governance and has the potential to ensure general and lasting improvements, as the Polish case demonstrates. In Russia, however, legislation which makes high corporate governance standards compulsory has not been effectively enforced. This lack of enforcement is at the core of the discussion about Russia's corporate governance problem, and three major explanations for it have been offered. First, it has been argued that the laws regulating corporate governance are not adequate for the Russian situation. Second, attention has also been drawn to the limited enforcement capabilities of the Russian state. Third and finally, it has been maintained that western corporate governance concepts are alien to Russian business culture, which is therefore unable to understand or accept them.

The first argument is based on the fact that Russia's corporate governance regulation, especially as formulated in the Law on Joint-Stock Companies⁸, is

⁸ Federal Law No. 208-FZ «Ob akcionerных obščestvach» of 26 December 1995.

an import of related US regulation, which does not take Russian specifics into consideration. As Pistor et al. (2000, p. 340) put it, «where new laws were forced upon a judicial system unfamiliar with the underlying legal tradition and were not adapted to fit the specific local context, the effectiveness of the law suffered». Accordingly, such legislation sets wrong incentives and addresses problems not pressing in Russia, while ignoring Russian practices that can be employed to circumvent legal regulation. The focus on small individual shareholders, for example, is inadequate in Russia, because in spite of the aims of mass privatisation they are actually non-existent. Instead, major blockholders dominate most companies, but their interests related to ensuring effective control are ignored in the legislation (Roth/Kostova 2003; Yakovlev 2003 and 2004).

In order to allow for effective enforcement, corporate governance regulation should be adapted to the Russian environment. In this context, Wright et al. (2003) support the co-existence of two different governance systems based on sectoral differences. Yakovlev (2003) also suggests that the regulations should become more differentiated (e.g., through the introduction of different rules for closed, i.e. legitimately insider-dominated, and open joint-stock companies), that the interests of other stakeholders should be included, that specific loopholes (as, for instance, the use of bankruptcy proceedings for unfriendly take-overs) should be fixed. At the same time, he notes that today the threat of ownership rights' violations in Russia come from the state machinery pursuing its bureaucratic or political goals rather than from company insiders (Yakovlev 2004). Accordingly, a reform of the state's economic policy is a precondition for the development of enforceable corporate governance regulation.

The second argument is based on the assumption that «enforcement more than regulations, laws-on-the-books or voluntary codes is key to effective corporate governance, at least in transition and developing countries» (Berglöf/Claessens 2004, p. 1). In this context it has been argued that «Russia's core problem today is less the lack of decent laws than the lack of the infrastructure and political will to enforce them» (Black et al. 2000, p. 1755). Such enforcement problems are explained with missing capacities, incompetence and corruption in government agencies and the judiciary (e.g., Solomon 2002; Burger 2004).

Numerous strategies have been developed to tackle enforcement problems. In relation to corporate governance regulation, these range from anti-corruption campaigns to greater involvement of private agencies (for an overview see Berglöf/Claessens 2004). However, those strategies are focusing on the longer term. In this context Pistor/Xu (2005) argue that «[R]ecipes for legal governance mechanisms that have worked elsewhere, including reactive law enforcement by courts and proactive law enforcement by regulators, may not help in the

short to medium term». As a short-term solution they suggest administrative governance, based on refined pre-existing governance mechanisms, which set incentive structures motivating bureaucrats to promote specific corporate governance standards. Such mechanisms can include IPOs of state companies, the success of which is linked to regional budget income or to personal career perspectives. State subsidies or other forms of preferential treatment for regions or state-owned enterprises can be linked to specific elements of corporate governance performance.

Whereas the two approaches presented above focus on the institutional environment and accordingly suggest institutional changes as a short-term solution to Russia's corporate governance problem, the third approach is more pessimistic about the possibility of short-term change, as it sees Russia's corporate governance problem as a consequence of its deeply-rooted business culture.

«Russia's cultural and institutional mechanisms may call for the rejection of many market-based reforms, since Russian history demonstrates that relational corporate governance has generally been the Russian 'default mode', with enterprise incumbents like banks, and especially the State, but generally not outsider investors, enjoying a significant voice in the control of enterprises. [...] Doubts remain concerning whether such uniquely Russian corporate governance in the early 21st century is capable of enhancing industrial performance. [...] Relations between the enterprise and the state may always be characterised by simultaneous opportunistic behaviour at the centre and at the periphery. This opportunism gives Russia the high country risks that have prevailed for centuries, discouraging high-commitment foreign investments, and reinforcing incumbents' views of foreign investors as speculators and asset-strippers. [...] If US-style capital markets are to make a substantial contribution to Russia's global competitiveness, it seems that this will be the result of the inexorable grind of marketisation in the very long term in the face of opposition from Russia's culture and institutions and/ or of acute and sustained national emergency» (Buck 2003, p. 311–312).

These three approaches, which try to explain why Russian corporate governance is generally poor, focus on different factors; they therefore present different solutions and different degrees of pessimism. However, they are not contradictory. This is especially true for the first and second approaches. Obviously improved laws would benefit from improved enforcement mechanisms and vice versa. Accordingly, as many of the authors quoted above at least implicitly state, the difference is one of priorities and not of principle.

Whereas proponents of the importance of business culture are very sceptical about the short-term effects of improved laws as well as of improved enforcement,

they do not deny that long-term changes occur and are linked to the institutional environment, which in turn is influenced by legal regulation and enforcement patterns. In this context, McCarthy/ Puffer (2002) explicitly treat culture as one factor of influence among several.

Accordingly, the reference to business culture can be interpreted more as an argument of caution to those believing in institutional engineering and institutional revolutions. In this perspective the business culture approach assesses the obstacles faced by those who want to improve laws and enforcement. How big these obstacles are and how difficult it will be to overcome them is a question which can only be answered by integrating all three approaches. Moreover, the external factors mentioned in the hypothesis above, namely the motives of majority and minority shareholders and the degree of internationalisation, are important intervening variables equally worth of consideration.

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