

## 8. State-owned enterprises in Russia – The origin, importance and principles of operation<sup>1</sup>

*Paweł Augustynowicz*

*The aim of this paper is to analyse the state enterprise sector in Russia in terms of its origin, economic significance, principles of operation and efficiency. State-owned enterprises (SOEs) and those dependent on the state – constituting about 30–40% of the full potential of the Russian economy – are particularly strongly represented within the largest Russian companies, in sectors defined as strategic. Therefore, the classification, legal basis and forms of the above-mentioned enterprises will be analysed. It appears that Russian state-owned enterprises operate according to an entirely different set of rules than companies in developed countries and this situation is likely to be intentional.*

*This study will be conducted on the basis of official statistics, a few empirical studies and the analysis of international literature (mainly contained in the various studies conducted by organisations such as the OECD and the World Bank). The following analyses will be carried out: the analysis of legal acts concerning SOEs in Russia, the presence of SOEs will be analysed across the ranking list of the largest Russian companies (including the Top 400 list). Studies of scientific papers in Russian and English will also be carried out.*

*Knowledge on the functioning of the Russian state-owned enterprises and information about the model of corporate governance used in this country (corporate governance of the country) are very limited. Moreover, in papers by various authors one can find ambiguous or even contradictory opinions. This results mostly from differences in the assumptions and definitions, or simply from the use of unreliable / incomplete data. The author expects that this paper will result in the creation of a clear, dependable and objective image of the Russian state-owned enterprise sector.*

*During the past twenty years of the Russian transformation there have been two opposite processes in the field of state property. The first one is privatisation and the second one is the process of strengthening the presence of the state in certain branches of the Russian economy. These two processes will be analyzed in this paper. This analysis will clearly show that despite a huge decline in the SOE sector after the transformation, this sector is still very significant to the Russian economy. Moreover, these enterprises play a crucial role, since they are concentrated in the most strategic sectors, and are more profitable and have other competitive advantages over private enterprises.*

---

<sup>1</sup> The project was financed by the National Science Centre pursuant to the decision number DEC-2012/05/N/HS4/00507.

*Keywords: State-owned enterprise, Russia, strategic sectors*

## 1. Introduction

Even after twenty years from the collapse of the socialist regime the state is still very strongly present in the Russian economy. This has a vast impact on both the regulatory and institutional, as well as ownership areas. State-owned enterprises (also dependent on the state) have a dominant share in some of the largest Russian companies. They also play a very crucial role in many strategic industries (see Table 1 below). The Russian economy and the Chinese one, are the only major economies in the world, in which state enterprises are so important.

*Table 1.* The structure of privatised enterprises by form of state ownership in the period 1993-2011

Year	Number of privatised enterprises - total	Including, by form of state ownership		
		Federal	Local	Municipal
1993	42924	7063	9521	26340
1994	21905	5685	5112	11108
1995	10152	1875	1317	6960
1996	4997	928	715	3354
1997	2743	374	548	1821
1998	2129	264	321	1544
1999	1536	104	298	1134
2000	2274	170	274	1830
2001	2287	125	231	1931
2002	2557	86	226	2245
2003	434	161	152	121
2004	502	121	246	135
2005	491	112	226	153
2006	444	98	254	92
2007	302	73	115	114
2008	260	26	135	99
2009	366	140	87	139
2010	217	97	56	64
2011	276	119	80	77

*Source:* Own calculation based on (Goskomstat 2004, 2005), Tables 13.10 and 13.11.

The role, scope and current way of functioning of SOEs in Russia is unique, not only among the largest economies in the world, but also among the group of post-socialist countries, where the dominance of state ownership was a natural feature of the previous economic system. Russia, because of its distinctiveness (that re-

sulted from its size and geographical location, wealth in natural resources and imperial ambitions), has always followed a specific economic policy. The tradition of the state as the main guardian of the economy, also in terms of ownership, has in Russia a long and established position.

After changing its political and economic systems in the early 1990s, the Russian economy, like other post-socialist economies, experienced a period of rapid and spontaneous privatisation. As a result, there was a rise of the whole new sector of formally private enterprises, that often had their majority stakes owned by the private capital and the minority stakes owned by the state capital. Nonetheless, these enterprises were still highly dependent on state policy. However, after a few years even these highly controversial privatisations were halted. Since 2005, Russia has increased the share of the state sector in the economy (EBRD 2009).

Both in the English and Russian literature there are only a few significant publications containing the analysis of the state enterprise sector in Russia and corporate governance issues of the state. Papers dated 2000–2005 (based mainly on the data from the 1990s) are now rather obsolete and outdated. Furthermore, they often contain contradictory results regarding both the scale and efficiency of state enterprises in Russia. Russian studies in general positively evaluate the process of change in ownership and the resulting efficiency of the private sector in the 1990s (Степашин 2004, Радыгин–Мальгинов 2001). The existence and functioning of the state enterprise sector in this period has been considered as having had a negative impact on the economy. These statements are not consistent with the conclusions of researchers from outside Russia, where the efficiency of both public and private sectors in the 1990s in the Russian economy has been severely criticised (Perevalov et al. 2000).

Recent studies on the functioning of state-owned enterprises also provide conflicting data. An econometric analysis shows a significant positive effect of state ownership on the quality of corporate governance in Russia in 2001–2004 (Yakovlev 2008). This can be explained by the change in government policy in the sphere of privatisation and state property management, which took place after 2000 (Yakovlev 2011). Other data indicate a positive impact of state capital on the quality of corporate governance in this period (Avdasheva 2007). A number of studies represent a distinct view, providing an extensive list of arguments that point to a lower efficiency and poor corporate-governance practices in Russian enterprises. Sprenger (2010) presents a review of literature in this area and a set of arguments about the unreliability of the state as an owner within the Russian economy.

These conclusions are confirmed by the recent Western publications concerning the analysis of the transformation processes. The state is generally considered as a poor owner in post-socialist economies (Estrin et al. 2009, pp. 699-728., Hanousek

et al. 2009, pp. 43-73.). Note, however, that these claims are based on data from smaller countries, with a slightly different history, such as the Czech Republic, Hungary and Poland. Therefore, one can doubt, whether it is possible to generalise the theory to cover this very special case of the Russian economy.

## 2. The definition and classification of SOEs in Russia

There is no unified definition of a state-owned enterprise in Russia, neither in official documents, nor in the scientific literature. This term can denote a whole spectrum of entities. It can be given to enterprises with 100 percent share of the state capital, as well as to entities with majority shareholdings, and to firms with minority state shareholding that still allows it to enjoy actual corporate-governance rights.

The legal basis for the functioning of state enterprises in the modern Russian economy is regulated by a number of different acts. The Civil Code of the Russian Federation lists three possible legal forms of enterprises:

1. The biggest enterprises from the public domain are mainly *joint-stock companies* (so-called open companies). This legal form provides the private capital with the opportunity to take a share in the ownership, as well as with the ability to conquer foreign stock-exchange markets.
2. *Unitary enterprise* is a specific form of organisation and operation of enterprises with 100 percent state ownership in Russia. Unitary enterprises do not own any property that still belongs to the state, as represented by the federal, regional (republics, oblasts, etc.) or local (in the case of municipal enterprises) entities. Unitary enterprises are liable for their obligations in respect of all the assets that cannot be divided into shares or equity – they always remain owned by the state. Business managers of unitary enterprises have to obtain approvals for most of their decisions. This often results in the emergence of allegations against “manual control” applied to these enterprises.
3. Another specific product of the Russian state property-management model are *state corporations*, which are partly business entities and partly state agencies (non-profit organisations). The legal basis for the creation of state corporations has existed since 1999. Each of these operates under a separate law. Therefore, they have very little in common. Generally, one can say that these companies:
  - are relatively independent from the state-owner;
  - are the sole owners of their assets;
  - have limited disclosure obligations to the state.

### **3. The size of SOE sector in Russia and it's change over time**

The SOE sector within the Russian economy was an object of significant and unprecedented changes during the transformation period. Russian policymakers decided to apply a fairly radical approach to change, which implied a rapid change in ownership within the economy. An in-depth analysis of these events in the most turbulent period of the privatisation process (in 1991–1994) is virtually impossible due to the fact, that there is almost no official statistics on the said period.

The first spontaneous processes of privatisation in the Russian economy could already be observed in 1991. However, at the end of that year, the structure of the economy still had a negligible share of the private property. By the end of 1991, the share of private ownership in the economy had reached 4.2% (Степашин 2004, p. 82.).

According to the Central Statistical Office of the Russian Federation, before the start of the rapid privatisation, the state of SOEs was as follows:

- 349.3 thousand of state-owned enterprises belonging to all levels of government (national, federal, and municipal) with total assets valued at 35.6 billion rubles;
- 80.1 thousand of non-business organisations with total assets valued at 24.1 billion rubles (Goskomstat 1992).

These data suggest that the value of the state property, that could hypothetically be privatised, amounted to 35.6 billion rubles. However, this approach is too simplified, since companies in the Soviet Union had a completely different nature, and even the definition of an enterprise was far from the definition accepted by today's market economy. Therefore, not all of the nearly 350 thousand companies could be called companies. In contrast, a number of organisations (among the above-mentioned 80 thousand that were categorised as non-enterprise entities) could have features specific to a typical enterprise. This applies to many holiday resorts and social facilities belonging to different types of departments of the state apparatus. In subsequent years, these units had been separated from their parent units and successfully became the subject of privatisation proceedings.

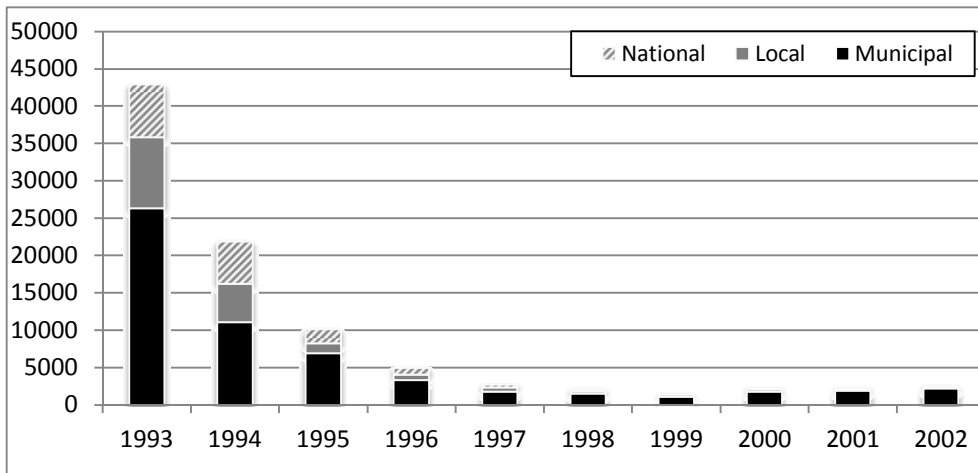
The acceleration of the privatisation process can be associated with the enactment of two documents important from the perspective of the process:

- The Ordinance on the introduction of the system of privatisation vouchers in the Russian Federation (dated 14 August 1992);
- The Ordinance on the expansion of the system of privatisation vouchers in the Russian Federation (of 14 October 1992).

The above-mentioned regulations allowed for non-monetary methods of privatisation. Namely, they introduced vouchers (also known as privatisation certificates) as a means of settlement in privatisation transactions. The moment of introduction of these laws could be considered as the beginning of mass privatisation and decline in the SOE sector in Russia.

The scarce data from the beginning of the privatisation period mentions about 36.8 thousand state-owned enterprises privatised in 1991–1992, while in 1993 this number amounted to 42.9 thousand and dropped to 21.9 thousand in 1994. As shown in Figure 1, the years 1993 and 1994 were particularly abundant in privatisation transactions, while in 1995–1997 the number of privatisations fell, and in subsequent years it remained at a relatively low level.

*Figure 1.* The structure of the privatised companies by form of state ownership, 1993–2002

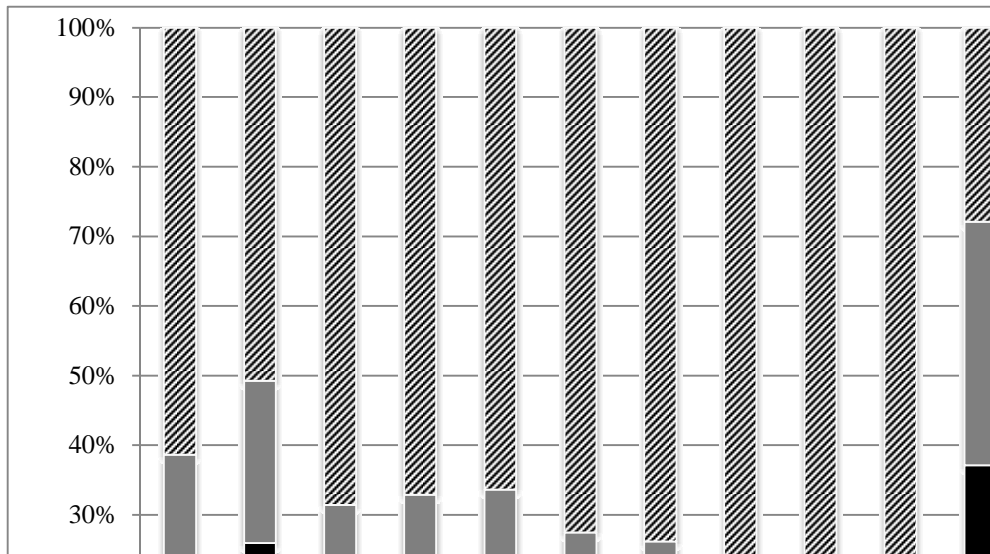


*Source:* Own calculation based on (Goskomstat 2004, 2005), Tables 13.10 and 13.11.

Table 1 shows the details of the number of enterprises privatised between 1993 and 2011, broken down by various forms of ownership before privatisation. A sharp decline in the number of enterprises privatised in 2003 may be noted. Data broken down by form of ownership show that this decline was associated with a shrinkage in the number of privatised enterprises owned by the Municipality (from 2,245 in 2002 to 121 in 2003).

Figure 2 shows the share of municipal, local and federal forms of ownership in the structure of enterprises privatised in selected years. In the period 1993–2002 municipal enterprises were by far the largest group, which accounted for more than half of all the privatised enterprises. In the years 2002–2011 the share of municipal enterprises was much smaller. In 2004–2008 companies owned by local governments took the lead, and in the years 2009–2011 the majority of privatisation transactions applied to federal enterprises. This division reflects the different strategies of privatisation across these years. Municipal enterprises definitely comprise the largest group, but they are very small entities. By contrast, federal companies were generally much larger units, most of which were sold out in 1992–1995 (see Table 1).

*Figure 2.* The share of the different forms of state ownership in the structure of privatised enterprises between 1993–2011



*Source:* Own calculation based on (Goskomstat 2004, 2005), Tables 13.10, 13.11; and (Goskomstat 2012), Table 13.10.

One of the natural consequences of changes in the ownership structure of the economy of Russia is the change in the employment structure. Table 2 contains data on the employment within the Russian economy (and in the case of the period 1970–1990 in the economy of the USSR). It is worth noting that – according to official Figures – certain activities in the USSR were treated as employment in the private sector.

*Table 2.* The structure of employment in the Russian and former Soviet Union economy in years 1970–2010 by type of ownership, in%

<b>Type of ownership</b>	<b>1970</b>	<b>1975</b>	<b>1980</b>	<b>1985</b>	<b>1990</b>	<b>1995</b>	<b>2000</b>	<b>2005</b>	<b>2010</b>
State	86	88.8	90.4	91.1	82.6	42.1	37.8	33.7	30.4
Private	14	11.2	9.6	8.9	12.5	34.4	46.1	54.1	58.6
Mixed Russian	...	...	...	...	4.0	22.2	12.6	7.8	5.7
NGOs and religious organisations	...	...	...	...	0.8	0.7	0.8	0.6	0.5
Foreign and mixed Russian-foreign	...	...	...	...	0.1	0.6	2.7	3.8	4.8
Total within the Russian economy	100	100	100	100	100	100	100	100	100

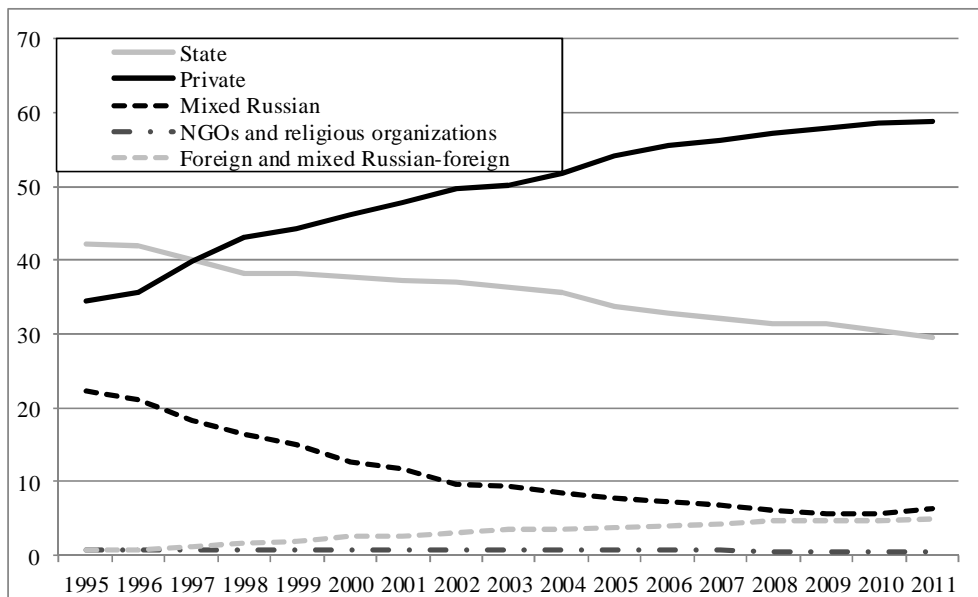
*Source:* Own calculations based on (Goskomstat 2003) Table 6.5; (Goskomstat 2007) Table 5.5; and (Goskomstat 2012) Table 5.4.

Figure 3 presents more detailed data on the structure of employment by type of ownership in recent years. Several important trends should be emphasized here. An increase in the share of employment in the private sector and the decline in employment in the state sector seem to be obvious. But the level of employment in the private sector, according to the latest data, still remains relatively small. Only 58.8% of the economically active population were employed in the private sector as at the end of 2011. The issue of employment in the sector known as a mixed state-private deserves an in-depth examination. These are of course nothing else than state-owned enterprises with the participation of private capital or private enterprises with the participation of state capital. However, as was already mentioned, these companies are still strictly controlled by the government, so they can be included into the domain of the SOEs. Therefore, state-owned enterprises and enterprises controlled by the state employed 35.7% of the economically active population, 5% were employed in enterprises with foreign capital, and 0.5% – in other organisations. Another noteworthy fact is the decline in the share of mixed ownership during the transition process. In 1995, the share of employment in this sector was 22.2%, but at the end of 2011 this share already declined to no more than 6.3%. This may be a consequence of the policy in the sphere of privatization, involving the so-called residual privatisation, i.e. the sale of shares in these companies in which the state has only partial participation.

Over the past 20 years, the Russian labour market has strongly changed its image. The share of employment in the public and mixed sectors fell from 86.6% in 1990 to 35.7% in 2011, and in late 2000 and early 2001, the share of employment in sectors dependent on the state fell below 50%.



Figure 3. The structure of employment in the Russian and former Soviet-Union economies in the years 1970–2010 by type of ownership, in%



Source: Own calculations based on (Goskomstat 2003) Table 6.5; (Goskomstat 2007) Table 5.5; and (Goskomstat 2012) Table 5.4.

In summary, the level of employment is one of the indirect measures to estimate the scope of the domination of the state within the economy. Of course, the use of this measure may lead to some distortion, because – in general – companies in the public sector have a higher level of employment compared to private companies. On the other hand, it can be assumed that the state sector in Russia – due to its concentration in highly profitable and monopolistic areas – plays even more important role than it seems at first glance.

#### 4. Other indirect measures of the SOE sector in Russia

Statistical data on the Russian economy, especially that regarding the state-owned enterprise sector, published by the National Bureau of Statistics (Goskomstat), can be considered as unreliable. Due to the fact that there are fundamental differences in the statistical methodology, and also because of the various accepted definitions of analysed companies, we can speak of a strong inconsistency in Russian statistics

compared to data from European countries, that are members of Eurostat. The difficulty in accessing these data follows from the fact that some Russian statistical publications are not distributed abroad. Moreover, until the end of the 1990s, the Russian statistical offices did not keep up in their studies with the turbulent changes in the real economic system. For this reason, there was often a problem that certain sets of data from this period did not have the continuity, definitions and classifications of the studied phenomena and processes were changing significantly over time. Russia does not belong to the OECD, and consequently many important issues are not included in OECD reports, or are included to a very limited extent. What is more, there is no unified database of SOEs (or at least none that would be accessible to the scientific community). Even commercial databases do not include information on the ownership structure of Russian companies.

Therefore, the share of the SOE sector within the Russian economy could only be estimated using various indirect measurements. Attempts to do this have been made by the European Bank of Reconstruction and Development. According to the EBRD report produced in 2009, the share of the public sector (which is of course a broader term than the SOE sector share) in the Russian GDP amounts to about 35%, although in 2004 it amounted to 30% (EBRD 2009). Unfortunately, the report does not disclose the underlying methodology for the calculations used to measure this.

Another estimation of the economic significance of the SOEs sector could be made by means of analysing the TOP400 list of Russian enterprises. This ranking provides i.a. information on revenues and profits across the largest Russian companies. Among them there is a considerable number of SOEs.

Table 3 shows a list of 25 largest enterprises in Russia. It is worth noting that, out of the total of 25 included in this list, there are 10 state-owned enterprises. Moreover, the revenues of state enterprises on this list exceed those of private companies by USD 81 billion. Compared with the total revenues of the 400 largest enterprises in Russia (TOP-400), the revenues of the first 10 state-owned enterprises account for almost 30% of the total. The advantage of SOEs is even more significant when it comes to comparing profits. The largest 10 state companies generate more than 53% of profits compared to the profits of enterprises from the whole TOP-400 list.

*Table 3. Revenues, net profits and ownership of the first 25 companies from the TOP400 list of the largest Russian enterprises*

<b>Rank in 2013</b>	<b>Company name</b>	<b>SOE/private property</b>	<b>Revenues in 2013, in USD billion</b>	<b>Net profit in 2013, in USD million</b>
1	"Gazprom"	SOE	153.3	38950
2	The oil company "Lukoil"	private	116.3	10925
3	The oil company "Rosneft"	SOE	67.5	11004
4	Railways	SOE	49.6	2518
5	Sberbank of Russia	SOE	43.3	11194
6	"TNK-BP Holding"	private	39.9	9009
7	AFK "System"	private	34.2	947
8	"Surgutneftegaz"	SOE	27.3	5796
9	"Transneft"	SOE	23.6	5933
10	"IDGC Holding"	SOE	20.0	1018
11	VTB Group	SOE	19.8	2915
12	The "Inter RAO"	private	17.9	-719
13	X5 Retail Group	private	15.8	-127
14	"Evraz"	private	14.7	-335
15	"Magnet"	private	14.4	808
16	"Tatneft"	SOE	14.3	2524
17	"Severstal"	private	14.1	762
18	"Stroygazkonsalting"	private	12.5	b.d
19	NLMK (NLMK)	private	12.2	596
20	MMC "Norilsk Nickel"	private	12.1	2143
21	"Mechel"	private	11.3	-1665
22	"VimpelCom"	private	10.9	2280
23	The combined company "Rusal"	private	10.9	-337
24	"SGM"	private	10.4	954
25	"Rostelecom"	SOE	10.3	1134
<b>TOTAL SOEs</b>			<b>429.1 (29.4%)</b>	<b>82986 (53.1%)</b>
<b>TOTAL private</b>			<b>347.7</b>	<b>25241</b>
<b>TOTAL for the TOP-400</b>			<b>1457.5</b>	<b>156214</b>

*Source:* Own calculation based on data from RA Expert, [www.raexpert.ru](http://www.raexpert.ru)

## 5. Conclusions

The research conducted within this paper reveals a whole list of methodological issues that hinder the proper examination of the state-owned enterprises sector within the Russian economy. The main limitation is the lack of reliable data on this subject. Another problem is connected with the term "state-owned enterprise" itself. This term applies to the whole list of different entities that have different parameters of

operation. Unitary enterprises are very widespread at the municipal level and represent mainly utility services. These companies have been partially privatised, since they are not very attractive for the government. When analysing privatisation data, SOEs from the local and municipal levels were the main targets for privatisation, especially during the first decade of the transformation.

In contrast, joint-stock companies that are owned by the Russian government are big and powerful enterprises that often operate within very profitable sectors of the economy and are considered as the “blue chips” of the Russian economy. The analysis of the TOP-400 list shows that the largest SOEs often surpass their private counterparts in terms of revenue and profits.

The scope of the research conducted within this paper has not covered the analysis of the SOEs that are organised in the form of state corporations, but many facts suggest that this form of state-owned enterprises is the least transparent one. Every single state corporation is established by a separate law. These legal acts often give some privileges to state corporations. This leads to numerous instances of unfair competition with the private sector, separate (preferential) procedures for access to capital and lower disclosure requirements (Sprenger 2010, pp. 90-110.).

All of the abovementioned facts suggest that the state-owned enterprises sector within the Russian economy is divided into two structurally different subsectors: small obsolete enterprises that often operate within the utilities sector and which are the remnants of the bygone era of communism, and big corporations that are very important for their owner (the Russian state). The first subgroup is a burden for the economy and must be eliminated as fast as possible. The second one plays a very important – if not the leading – role within the Russian economy.

### References:

- Avdasheva, S. B. (2007): Holding company groups and models of corporate governance in Russia. *Working papers* of State University – Higher School of Economics, WP13/2007/18.
- EBRD (2009): *Transition Report 2009: Transition in crisis?* London.
- EBRD (2009): *Transition Report 2009: Transition in crisis?* London.
- Estrin, S. et al. (2009): The Effects of Privatisation and Ownership in Transition Economies. *Journal of Economic Literature*, 47(3), pp. 1-30.
- Goskomstat (1992): *Итоги переоценки основных фондов на 1 июля 1992 года.*
- Goskomstat (2003): *Российский статистический ежегодник – 2003г.*
- Goskomstat (2004): *Россия в цифрах – 2004 г.*
- Goskomstat (2005): *Россия в цифрах – 2005.*
- Goskomstat (2007): *Российский статистический ежегодник – 2007г.*
- Goskomstat (2012): *Российский статистический ежегодник – 2012г.*

- Goskomstat (2012): *Россия в цифрах – 2012*.
- Hanousek, J. et al. (2009): Divestitures, privatisation and corporate performance in emerging markets. *Economics of Transition*, 17(1), pp. 43-73.
- Perevalov, Y. – Gimadii, I. – Dobrodei, V. (2000): Does Privatisation Improve Performance of Industrial Enterprises? Empirical Evidence From Russia. *Post-Communist Economies*, volume 12, No. 3.
- Sprenger, C. (2010): State Ownership in the Russian Economy. Part 2. Governance Problems and Performance Effects. *Journal of the New Economic Association*, 7, pp. 90-110.
- Yakovlev, A. (2008): State-business relations and improvement of corporate governance in Russia. *BOFIT Discussion Papers*, 26.
- Yakovlev, A. (2011): State-business relations in Russia in the 2000s: From the capture model to a variety of exchange models? *BOFIT Discussion Papers*, 10.
- Радыгин, А. Д. – Мальгинов, Г. Н. (2001): *Государственная собственность в российских корпорациях: Проблемы эффективности управления и задачи государственного регулирования*. Институт экономики переходного периода, Moscow.
- Степашин, С. В. (2004): *Анализ процессов приватизации государственной собственности в Российской Федерации за период 1993-2003 годы*. Издательство «Олита», Moscow.