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The Russian Corporation: Patterns of Behavior during the Crisis

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Abstract

This paper considers the behavior patterns of Russian firms before and during the financial crisis of 2008-2009. To facilitate comparison, we define three main groups of actors at the firm level in the Russian economy – large, politically connected companies; mid-size firms that expanded in the 2000s with the help of administrative support, and successful mid-size firms driven by market factors. Many of the large companies practiced highly risky financial policy and experienced a decrease in efficiency before the crisis, and the managers and owners of some Russian firms have been engaging in opportunistic behavior during the crisis; the forms and causes of this behavior are analyzed here. We conclude by proposing some policy implications with emphasis on supporting successful mid-size firms driven by market factors.

Keywords: *Patterns of firm behavior, the Russian economy, the economic crisis, large companies, mid-size firms, opportunistic behavior*

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Despite official attempts to designate Russia as a safe-haven in the stormy sea of the global financial crisis, the crisis has deeply affected the Russian economy. Until mid-2008, Russia's economic growth rates remained high, following the trend of the preceding nine years (the average annual GDP growth rate between 1999 and 2007 was 7%; in 2007 the rate was 8.1%). The crisis first manifested itself in August 2008, when stock indexes fell sharply, culminating in a market crash in September. As a result, the leading RTS stock market indicator plunged four times (from almost 2,500 points in the beginning of May to less than 600 points in late October 2008, however in June 2009 it was about 1,000 points). This steep decline posed problems for the financial sector because banks extensively borrowed foreign money on share packages. A number of big banks teetered on the brink of bankruptcy, and a panic erupted among their depositors.

Nevertheless, prompt assistance from the government and the Central Bank helped stabilize the situation in the financial sector by November, despite increasing inflationary pressure on the rouble. As a result, by the end of autumn 2008, the probable economic slowdown and the need to settle the external debts of Russian corporations, along with rising inflation, were believed to be the major challenges for the Russian economy. Meanwhile, economic growth forecasts for 2009 were generally positive. For instance, Sergei Aleksashenko, a well-known Russian expert and former Deputy Governor of the Bank of Russia, believed in November that GDP growth in 2009 would be no higher than 2.5% (Aleksashenko, 2008, p.34); the World Bank estimated GDP growth at 3% based on unchanged oil prices of around 75 US dollars a barrel (World Bank, 2008, p. 17), and the November outlook issued by the European Commission for Russia predicted even growth rates of 6% in 2009 and 6.5% in 2010 (DG ECFIN, 2008, p. 137).

However, in reality, the ramifications of the crisis were much more severe. As stated in the Russia Economic Report released by the World Bank in June 2009, the overall decline in global demand, falling commodity prices, and the tightening of credit have accelerated Russia's economic slowdown since the fourth quarter of 2008 (Table 1).

Table 1. Main indicators of Russian economic development, 2006-9

	2006	2007	2008	Q4 2008	Q1 2009
GDP growth, %	7.7	8.1	5.6	1.1	-9.8
Industrial production growth, year on year, %	6.3	6.3	2.1	-6.1	-14.3
Fixed capital investment growth, %, year on	16.7	21.1	9.8	-2.3	-15.6

year					
Federal government balance, % GDP	7.4	5.5	4.0	4.0	-0.6
Inflation (CPI), % change, end of period	9.0	11.9	13.3	13.3	5.4
Current account, in billions of dollars	95.6	76.6	98.9	8.1	11.1
Unemployment, % (ILO definition)	7.2	6.1	6.3	7.1	9.4
Memo: Oil prices, Urals (\$/barrel)	61.2	69.5	95.1	54.9	44.1
Reserves (including gold), in billions of dollars, end of period	303.7	478.8	427.1	427.1	383.9

Source: (World Bank, 2009a, 2009b) on the databases of Rosstat, CBR, Ministry of Finance, Bloomberg data.

The economy deteriorated dramatically in early 2009. The estimated contraction in real GDP in the first quarter of 2009 was 9.8 percent, down from 8.7 percent growth during the same period in 2008. Based on the most recent April-May data in the second quarter, real GDP is estimated to contract even further, driven by continued decline in industrial production.

All major sectors reported a contraction in the first quarter of 2009 as a result of weak demand, low investment levels and collapsed industrial output. Adjustments in tradables are especially large due to deteriorating external environment and consumer confidence. Contractions in the tradable sector, estimated at 14.4 percent in the first quarter of 2009, were driven by a sharp fall in industrial production, 14.3 percent, especially in transport equipment and other sectors in manufacturing. Non-tradables continued to defy the trend of tradables by registering growth in the last quarter of 2008 but contracted 6.2 percent in the first quarter of 2009. Driven largely by demand- and finance-sensitive retail and construction sectors, these contractions reflect an impact of economic shocks that are gradually filtering through labor and financial markets by higher unemployment, lower household incomes and tighter credit conditions. Construction sector, for example, reported a 20.9 percent decline in Q1-2009 relative to 2008, while transport contracted by 7.4 percent and retail trade by 4.9 percent in the first quarter of 2009.

According to World Bank estimates aggregate unemployment in Russia could reach 13 percent in 2009. This estimate reflects both a contraction in employment as well as changes in the sectoral structure of employment. The sectors most affected will likely be manufacturing, construction and retail trade. “Monocities” with large spatial concentration of these sectors are being particularly hard hit.

In mid-March 2009 the government started to use the Reserve Fund to cover its fiscal gap as it was planned in the amended 2009 Budget. In the March-May 2009 period, the Reserve Fund has lost \$35.4 billion and currently stands at \$101 billion. The share already spent by the government constitutes 3 percent of GDP out of 7 percent planned for 2009.

As a result, according to World Bank estimations, due to the much bleaker global financial outlook and oil prices in the 45 US dollars per barrel range, the Russian economy is likely to contract by 7.9% in 2009 (World Bank, 2009b, p. 12). Recent forecast of the Ministry of Economic Development of the Russian Federation predicts that GDP will decline by 8% in 2009.

Judging by visible trends, Russia is merely on the threshold of the crisis; the worst is still to come. In any case, the time has come to think about the outcome of this crisis and about the range of factors that could help to curtail it.

One of such factors is prudent macroeconomic policy that will lower the incentives for economic agents to engage in opportunistic behavior and rent-seeking. At the same time, companies also have to make efforts to overcome the crisis. The firms that continue to modernize their production processes and businesses to boost productivity will define the post-crisis trajectory of the Russian economy. In the realm of industrial policy, the government's duty is not to bail everyone out but to provide incentives and opportunities for these kinds of firms. . In order to formulate an effective, coherent anti-crisis industrial policy that contains a vision for the future, it is essential to understand the models of behavior guiding present-day Russian firms, how these models have been distorted by the crisis, and how they are expected to evolve. We will try to address these issues in this paper.

1. The pre-crisis situation or the Russian corporate sector in the early and mid-2000s.

Recent studies (Puffer & McCarthy, 2003; Yakovlev, 2004; Andreff, 2005; Yakovlev & Danilov, 2007) suggest that although the quality of corporate governance in Russia was improving in the 2000s (in terms of formal indicators), certain features of Russian corporations were preserved, such as their:

- Highly concentrated ownership and control;
- Rapid pace of corporate integration (with integrated business groups dominating the Russian economy);
- Tendency to 'personify' Russian business.

The more detailed studies (Dolgopyatova et al., 2009) have also furnished evidence of the emergence of new tendencies in the Russian corporate sector. One of these tendencies is *the separation of ownership and management*. This tendency has manifested itself most explicitly in holding company groups (business groups), which often include several scores of *independent* juridical persons. Because the final owners are incapable of managing the entire complex of assets in their possession, they are hiring managers to run their enterprises instead.

Another tendency is the increase in the *real usage of instruments of modern corporate governance*. In the first half of the 2000s, measures such as establishing greater transparency, hiring outside directors, paying regular dividends, and launching domestic and international IPOs were largely cosmetic; they were primarily taken to improve the corporate reputation of Russian companies in global markets rather than to effect real decision-making. However, a survey of 822 joint-stock companies conducted in the framework of a joint Russian-Japanese project in 2005 (Dolgopyatova et al., 2009) demonstrated that the firms had not introduced these best practices of corporate governance merely to boost their image or appease minority shareholders (whose role was nonetheless still weak). Russian companies are instead increasingly using the instruments of corporate governance to resolve the agency problem between owners and managers. They are focusing on internal instruments, such as granting a bigger role to boards of directors, introducing incentives for managers based on company returns, etc. The *substantial renewal of management teams* in large and mid-size enterprises and the establishment of a link between personnel changes and company returns are some of the positive effects of this trend.

The above-mentioned tendencies are typical mostly of ordinary member companies of business groups. This is how Russian business groups, which were created largely to defend the property rights and interests of company owners in the imperfect institutional environment, have become advocates of best practices of corporate governance in recent years.

In general, recent studies present a picture of a *gradually changing Russian corporate model*. In the 1990s, “the transitional firm” became a standard fixture on the Russian business scene. Run by managers who were independent of shareholders, this entity was characterized by a very opaque ownership structure, crude violations of shareholder rights, hostility to outside investors, and blatant disregard for the standards and mechanisms of corporate governance (Blasi et al., 1997; Kraakman, Black & Tarassova, 2000). This peculiar corporate model is now becoming a thing of the past. As a result, although some elements of national corporate identity have remained intact, in the mid-2000s Russian joint-stock companies began edging toward the classical path of development in market-oriented economies. We can therefore speak about two different models, one for large-scale businesses and another for mid-size companies, each

playing an objectively different role in the economy. In the next section, we will discuss their criteria for distinction.

The perspective model for mid-size Russian companies can be defined as a closely held firm (as described by Berglöf & von Thadden, 2000) with a bias towards concentrated ownership, a limited presence on securities markets and distance from the state. On the contrary, due to the national features of public policy in Russia, the largest companies can be expected to model themselves after development firms, which rely on informal ties with investors and the government; this model is commonly found in South-East Asia.

2. What are large and mid-size businesses?

We would like to point out that there are different definitions of large and mid-size companies in the Russian academic and business environments. For instance, in the latest “Expert-400” rating computed in autumn 2008 from 2007 data (Expert magazine, 2008), the bottom rungs were occupied by companies with annual sales volumes of around \$400 million. However, Yakov Pappe, the leading Russian expert on the problems of big business, believes that large companies in Russia nowadays are those with annual sales volumes of \$1 billion in the oil and gas industry and \$500 million in the remaining industries (Pappe & Galukhina, 2009, p. 22).

In the paper (Yakovlev & Danilov, 2007), we classified companies with an annual turnover of more than \$1 billion as “large”. According to this criterion, as of 2007, 151 firms qualified as large-scale companies (based on the “Expert-400” rating). However, very few large-scale companies are public in real rather than juridical terms. Of the 151 large-scale companies, only 39 have a formal marker for their stock (enabling their market capitalization to be calculated). For this reason, using the single criterion of capitalization to estimate business scales in Russia is not fully accurate.

Estimating the share of large-scale corporations in the Russian economy is a task requiring many complex calculations. The existing data allow only a relatively accurate comparison between the pre-tax returns (losses subtracted) of the largest corporations, which can be calculated from the data presented by Expert magazine, and the profit and loss balances of large and mid-size enterprises, which can be computed from Rosstat data. This comparison gives the share of the largest corporations in the Russia economy (with sales exceeding \$1 billion) in 2007 as 49.5%.

Determining the characteristics of mid-size businesses in Russia is also a difficult task. For instance, according to the Federal Law No.209-FZ “On the Development of Small and Mid-

size Enterprises in Russia” (Section 4, point 1), mid-size enterprises include those with 100 to 250 employees. However, the relevant federal government guideline has set a limit of 100-400 million rubles in annual sales for mid-size enterprises (or no more than \$16-17 million for 2008). Contrary to this approach in its special “Mid-size Business” project (Vin’kov et al., 2008), Expert magazine included in this category companies with an annual turnover of more than \$10 million, with the exception of the enterprises listed in the “Expert-400” rating. In 2006, the number of such companies in Russia’s private sector was about 13,000, and their weight in total earnings relative to all Russian companies with a turnover of more than \$10 million was 44%.

We define large-scale companies as those with an annual turnover of over \$1 billion and mid-size companies (by international standards) as those with a turnover ranging from \$50 million to \$1 billion. According to this definition in 2006, there were more than 3,000 mid-size companies in Russia.

3. Patterns of firm behavior in the pre-crisis period (2006-2008).

We have observed the following tendencies to be typical of the entire corporate sector in Russia over the last three years:

- Expansion of the public sector with an increasing volume and variety of assets in state-owned companies, including the establishment of new joint-stock companies with government stakes (industrial holding companies based on the restructuring of state-owned assets, development institutions, and capitalization with the use of public funds);
- Expansion of public demand by means of government procurement of goods; public support for large-scale investment projects with the funds of The Investment Foundation of the Russian Federation and the state corporation “Bank for Development and Foreign Economic Affairs (VneshEconBank)”; organization of large-scale programs to develop infrastructure (e.g. the 2014 Winter Olympic games in Sochi, the 2012 APEC summit in Vladivostok); and the implementation of the National Housing Project. As a result, some corporations are seeking public resources and trying to acquire special foreign assets to achieve their goals;
- Increasing pressure of competition from global markets and a tendency to speed up mergers and acquisitions (“buy or you will be bought”);
- More foreign borrowing, heavier debt burden;
- Imposition of tough restrictions on foreign investors and shareholders (The Law on Investment in Strategic Enterprises; a conflict between the Russian government and the British Petroleum Co.).

At the same time, a number of these tendencies were limited to certain groups of companies in the corporate sector. For instance, large enterprises expanded their scale, complicated their organizational structures, decreased their internal efficiency, and undermined their owners' ability to exercise control over them. However, this tendency was typical of all large-scale corporations entering into global financial markets and seeking to establish a strong foothold. At the same time, some tendencies specific to Russia also took shape:

- Informal relationships with the government became closer (especially after the YUKOS affair). Practically no large enterprise could survive in the Russian market at that time unless it had the endorsement of the state (Puffer & McCarthy, 2007).
- For many companies, relationships with the government paved the way for receiving “administrative rents”, which in the short run were much higher than anything achievable by reliance on business streamlining and improvement of internal efficiency.
- At the same time, this proximity to the state produced an illusion of lower risks and created an incentive for active borrowing (mostly abroad, because the Russian financial system was underdeveloped) as well as for super-aggressive buy-ups of assets.

The remaining uncertainty about ownership rights could also be a factor behind the growing indebtedness of the corporate sector. For instance, according to Alexander Shokhin, the President of the Russian Union of Industrialists and Entrepreneurs (RSPP), despite high returns on domestic investment (which in 2006-2007 triggered substantial growth in foreign investment in Russia), many owners of private Russian companies preferred to funnel their profits into foreign off-shore accounts and invest in decidedly less rewarding projects. At the same time, their companies in Russia were financed by borrowing. For this reason, companies were burdened with excessive debts, and in the event of takeovers, the would-be acquirers had to assume liability for these debts.

It is therefore evident that the internal inefficiency of the largest Russian companies continued to deteriorate. The decline went undetected by external investors – and apparently by owners and top managers of these companies – due to the smokescreen created by high rates of economic growth and readily obtainable money.

However, mid-size businesses have been coming to the fore in recent years, neck and neck with their larger counterparts. Contrary to the conventional wisdom of the expert community, these companies grew quickly in the 2000s and were solely responsible for pushing the real diversification of the Russian economy forward (Vin'kov et al., 2008; Sementsov et al., 2008). As shown in a study conducted by Expert magazine, these companies were very diverse

in terms of their rates of development. In 2000-2006, about a quarter of these mid-size firms (defined by Expert magazine as earning more than 10 million dollars in sales) experienced a decline in real turnover at constant prices in spite of rapid overall economic growth in the country; on the other hand, 38.5% of these firms displayed an increase in turnover at annual rates of 20% and more (three times higher than the average GDP growth rates in that period).

These data conform to the results of the project on the competitiveness of the Russian economy conducted by the SU-HSE and the World Bank in 2005-2007. This study showed that Russian companies are characterized by a considerable diversity in productivity levels, with dispersion within each sector being considerably larger than among sectors (Golikova et al., 2007). In the group of the most competitive and effective firms, which make up to 20-25% of the total number, productivity is at least three times higher than the sectoral average. At the same time, a large percentage (30-40%) of all firms exhibits extremely low productivity. There are clusters of inefficient firms in every sector, even in the most competitive ones. The intersectoral dispersion between the best 20% and the worst 20% of Russian firms is as high as 20-25 times. These results prove that there are high entry and exit barriers, which have served to prolong the life of the ineffective, non-market sector of manufacturing.

Consequently, it is safe to say that before the current crisis, differences between Russian companies were usually very high. While some firms were highly efficient, in line with international standards of competitiveness, the others were utterly inefficient and should have died, but nevertheless managed to survive.

Meanwhile, a segment of successful medium-size firms has emerged in the economy, with greater mobility and internal efficiency than the companies belonging to the first echelon. Mid-size companies have generally had difficulty obtaining access to external financial resources, meaning that they have had lower indicators of debt-to-sales than large corporations. In recent years, mid-size companies have been actively trading on stock markets, especially on the Russian market (Box 1).

Box 1. The role of the stock market as the source of investment for large and mid-size Russian companies in 2007-2008

In 2007, nineteen corporations conducted IPOs and entered the securities market; another ten conducted secondary offerings at the market; and another five corporations with Russian assets conducted public offerings at foreign stock exchanges. In 2008, another seven corporations conducted IPOs; ten corporations conducted SPOs; and two foreign companies with Russian assets publicly floated their shares (Danilov & Yakushin, 2008). This large

inflow of corporations to the equity market enables us to present a fairly representative evaluation of this market in terms of percentage distribution of large and mid-size corporations (see table below).

Number of IPOs in 2007-2008

Corporations	Large	Mid-size	Not included in the “Expert-400” (non-classifiable)	All corporations
Conducted IPOs	7	6	13	26
Conducted secondary public offerings of shares	7	7	6	20
Foreign corporations with Russian assets	3	0	4	7
Total	17	13	23	53

The above data suggest that although the stock market is more accessible to the largest corporations, a substantial number of mid-size Russian corporations are heavily relying on it as a source to fund their dynamic growth.

In our opinion, successful mid-size firms have a higher degree of internal efficiency than the firms in the first echelon because their businesses can be more easily observed by their owners. The mid-size firms are also less likely to rely on connections with the public administration; furthermore, they work in a more competitive environment and are more inclined to make innovations. Successful mid-size Russian firms, in comparison with their foreign counterparts, can quickly adapt to unfavorable external conditions, including “severe” business climates.⁴

At the same time, as shown by a more detailed examination of the most successful 217 mid-size companies in Expert magazine’s project, these companies’ ultra-high rates of growth were often due to their success in finding specific market niches with practically unlimited demand.

Generally speaking, on the eve of the current crisis, big businesses suffered from a relative decline in efficiency, which remained unnoticed by outside investors and unrecognized by their owners and top managers. At the same time, a segment of fast-growing companies came into being in Russia, accounting for 20-25% of the total number of mid-size businesses. Their

⁴ In this context, we would like to quote Lev Freinkman, who, in his description of Russian forms at a workshop in the SU-HSE, said that in contrast to its foreign counterparts, the successful Russian mid-size business lives in highly imperfect institutional environment and acts according to a regime of “subversive guerilla detachment”. In other words, this type of firm is extremely durable yet able to dissolve and vanish if necessary.

steady growth over seven years is evidence of their efficiency. However, mid-size companies with low and medium degrees of efficiency remained in the second echelon too.

These three segments – large companies, efficient mid-size firms and the rest of the mid-size firms – behaved quite differently in the crisis situation. This is the focus of our analysis in the next section.

4. Reaction to the crisis

At the outset of this section, we have to issue a certain methodological caveat. As we mentioned above, the Russian economy is only just starting to enter the crisis, which we believe will last a fairly long time. At this point, no one – including ourselves, other experts, and the government – has complex systematic information about the state and behavior of the enterprises at hand. Therefore, the “typical models” we have created here should be interpreted as hypotheses based on available cases and facts as well as on a certain logic; they will certainly require further empirical testing. Nevertheless, we believe that even in this hypothetical form, our models could serve as useful tools for analyzing what is going on in the real sector of the Russian economy as well as for designing more adequate instruments of economic policy.

We must also emphasize that models of firm behavior can be strongly influenced by the general situation in relevant sectoral markets. In cases of plunging demand, even efficient mid-size companies can fail, but if demand declines smoothly or remains stable, large and inefficient firms might opt to implement less opportunistic strategies.

With respect to the reaction of Russian enterprises to the crisis, we presume that on the way out, the decisive factor will be the behavior of the largest and fastest-growing (efficient) mid-size companies. The composition of efficient mid-size firms could change over the course of the crisis and in the post-crisis period, because the mid-size companies that focused heavily on the expansion of public demand will probably fall apart and new efficient mid-size companies will enter the market. (For instance, these new players might evolve from companies that manage to fulfill investment projects with imported equipment and orientation towards domestic consumer demand, which is expanding now via the replacement of imports due to the ruble devaluation.) At the same time, we must distinguish between two mid-size sub-groups that developed steadily and swiftly in the pre-crisis period. The first group includes the companies that have experienced rapid growth due to finding new market niches, realizing new business ideas, and introducing new technologies and products. The second group encompasses the firms whose success has been based on their decision to resort to so-called “administrative resources”. As we understand it, “administrative resources” consist of informal support from public

authorities, a practice that limits competition and gives preferential treatment to certain companies (the construction industry has frequently made use of these “resources”).

In reality, these two sub-groups can be hard to distinguish. In the 2000s, for example, many successful mid-size companies tried to simultaneously rely on market forces *and* seek out “administrative resources”. Nevertheless, we believe that the distinction is useful for analytical purposes. To illustrate this point, we will provide a stylized description of how three groups of firms – the largest companies, successful mid-size enterprises that have relied mostly on market factors, and successful mid-size enterprises that have mostly depended on “administrative resources” – are reacting to the crisis.

The largest companies:

- Have been hampered by excessively aggressive policies and the systematic underestimation of risks;
- Possess a more complicated management structure; they have the status of public companies. The owners do not have adequate information about the condition of their businesses, and it is difficult to prevent managers from engaging in opportunistic behavior. However, the main owners cannot take advantage of every possible measure for improving efficiency because they are obliged to disclose and explain all major actions to their shareholders and investors;
- Have close proximity to the state. This enables them to lobby for assistance, but upon receipt of this aid, they tend to become saddled with additional “social obligations” (support of employment), which impede their efforts to restructure and improve efficiency;
- Can take out public loans against shares. These loans are unlikely to be repaid, however, and pledges for them become the property of the state. But because the state has not yet announced its plans or intentions in such cases, this situation is going to produce further uncertainty about ownership rights. The relevant risks objectively give managers and current owners incentives to engage in opportunistic behavior and withdraw assets, which obviously does nothing whatsoever to promote restructuring;
- Can block the allocation of public support to more efficient companies in the “second echelon” by virtue of their close proximity to the state and common interests;
- Are more likely to lobby for public support. This is because government leaders, on the basis of contacts with representatives of large companies and in the absence of other reliable sources of information, tend to form a distorted picture of current events that is biased

towards negative trends, which gives big businesses additional impetus to lobby for public support.

Mid-size companies whose growth largely depends on market factors:

- Can obtain significant incentives to increase exports;
- Can demonstrate dynamic growth based on import substitution on the condition of having completed their investment projects;
- Will have limited access to foreign technologies and components due to the sharp devaluation of the ruble and thus have serious difficulty completing their innovation projects;
- Will collide with one another when competing for resources for expansion and development, with companies relying mostly on support from the public administration;
- Will be ready for severe restructuring under severe crisis conditions;
- Will speed up the implementation of projects to improve their efficiency, thus reducing their “time horizons” dramatically;
- Will try to keep a low profile vis-à-vis the expansion of their activities in order to avoid the imposition of additional “social obligations” and pressure to deal with inefficient partners.

Mid-size companies whose growth largely depends on administrative support:

- Will face a dramatic drop in competitive power;
- Might resort to opportunistic strategies in the face of drastic layoffs, hoping to provoke “social tension” on the side of authorities and create conditions for lobbying for public support;
- Will rely more actively on their connections with government, using up the resources that are intended to support entrepreneurial activity (e.g. funds for ensuring access for small and mid-size enterprises to federal and municipal procurement systems), and limiting the scope of competition;
- Will be able to rely on the regional and local authorities with whom they cooperate.

Although companies in the different groups behave in different ways, we expect the Russian market to undergo a substantial redistribution of property rights. The redistribution will primarily take place in the sectors that are most severely affected by the crisis (machinery, metals, chemicals, construction), as well as in the sectors that had stronger competition and lower profit rates before the crisis (retail trade, agriculture). This redistribution might also be

driven by the largest companies having to sell off some of their assets – among other reasons, to repay their debts to lenders.⁵

However, we believe that the redistribution will hardly change the structure of ownership in Russian companies: it will most likely remain highly concentrated. In this respect, the methods for settlement of defaults on corporate bonds are fairly informative (Box 2).

Box 2. Behavior of mid-size companies in case of default on the corporate bond market

Defaults on corporate bonds have become much more frequent.

There were 109 technical defaults during October 2008-March 2009. In the event of technical default of payment, issuer companies can choose one of the following strategies:

- They can mobilize all possibilities to avoid a full-fledged default. In this case, as a rule, a corporation can use the days remaining in the loan period to try to cover its liabilities in order to prevent its technical default from turning into a full-fledged one. Otherwise, the corporation can immediately open talks about restructuring to keep its creditors from suing for bankruptcy after a full-fledged default. This occurred in 21% of the technical defaults registered in the period of October 2008 to March 2009.
- They can try to avoid bankruptcy after the default has been declared. They can either attempt to restructure their liabilities in talks with the holders or to swap their debt for property (i.e. convert bonds into equities). This happened in 3% of the technical defaults registered in the period of October 2008 to March 2009.
- They can either do nothing or precede their bankruptcy with asset withdrawal in an attempt to swindle their creditors. This approach results in a full-fledged default followed by bankruptcy. Companies took this route in 76% of the technical defaults registered in the period of October 2008 to March 2009.

It should be noted that these figures became much worse in the first months of 2009 (as of the end of October, November, and December, these indicators were 31%, 22%, and 47%, respectively). We believe that the government's bailout policy was the main catalyst of the Russian corporations' skyrocketing defaults. Once the firms realized that the government would come to the rescue, they toned down their efforts to avoid bankruptcy by themselves. For this reason, the general rate of technical defaults went up from 5% in October 2008 to 16% in February 2009, but then down to 10% in March 2009.

⁵ According to (Aleksashenko, 2008), by the fall of 2008, the external debts of the Russian corporate sector were about \$500 billion, of which \$200 billion were slated to mature before the end of 2009.

It is worth noting that Russian corporations have never looked to the stock market for salvation from bankruptcy (the practice of conducting IPOs in order to dodge bankruptcy is widespread in international markets). Russian corporations instead tend to change their majority owner rather than appeal to the general public for aid.

5. Preliminary conclusion and policy implications

We believe that successful mid-size companies that relied mostly on market factors in their development during the 2000s could become the driving force for enhanced corporate efficiency and might lift the Russian economy out of the crisis. Of course, we cannot give a precise forecast of their future role. Nevertheless, relying on the data obtained from the project conducted by the SU-HSE and the World Bank as well as from Expert magazine's project on mid-size enterprises, we can suppose that before the outbreak of the crisis, the share of efficient, fast-growing enterprises ranged from a quarter to a third of the total number of mid-size firms. Their share was still higher in terms of total sales than that of small and mid-size enterprises

However, until recently, this type of enterprise was essentially ignored by federal policymakers; the main target of support during the initial phase of the financial crisis was the largest companies. For example, at the end of December 2008, the government approved a list of 295 "system-creating" enterprises⁶ and declared that these firms could expect to receive government credit guarantees, subsidies for interest rates, restructured tax debts, public procurements, and preferential export and import tariffs. The criteria for inclusion in this list were annual sales of over 15 billion rubles or half billion dollars and a workforce of no less than 4,000 employees; in addition, firms on the list were required to have the status of enterprises forming company towns and a certain amount of tax payments.

We believe that the government's policy of favoring the largest firms is risky because these companies are generally inefficient and their owners and managers lack sufficient incentives for restructuring. Their reluctance to restructure is partly due to the heavy reliance on customs instruments for protecting domestic producers; this protection limits domestic competition and hence offsets the urgency of restructuring efforts. Devaluing the ruble can have a similarly negative effect by virtue of limiting access to foreign technologies and lending. At the same time, devaluation increases uncertainty about property rights, for many of the companies

⁶ This list was approved on December 23, 2008 by the Government Commission for Higher Stability of Economic Development in the Russian Federation. On May 12, 2009, an additional nine companies were added to this list (so that it now consists of 304 enterprises). The complete list can be found at <http://www.government.ru/content/4be99bcb0e2341c4b6d8774f9a18a4c4.doc>

that relied on foreign lending for modernization will have serious problems paying off their debts.

A possible alternative to supporting the largest companies would be to create demand by launching public investment projects and programs (primarily directed at the development of infrastructure), which should be open to all economic agents that meet public quality-price ratio criteria vis-à-vis their goods and services. This approach will more likely provide public support for efficient firms that are able to enter new markets, ensure an increased supply of their goods and services in the crisis situation, and create new jobs.

Ultimately, the policy option will depend on the government's financial resources. The strong decrease in tax collection in the spring of 2009 could thereby become a precondition for a more sober and pragmatic fiscal policy on the federal and regional levels.

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