Table of Contents

List of Tables

List of Figures

Truth and oil always come to the surface.

Spanish proverb

Introduction

Russia is considered to be an emerging market, a fact always connected to creating an economy from scratch. Therefore, after going through a complete restructuring in the Post-Soviet era, the country for the first time encountered the topic of contemporary corporate structure.

Russia is known for its natural resources, which are its main capital. The most valuable asset for the country, oil, determines both political and economic developments of Russia. The oil sector is the most Western-oriented and progressive sector of Russian economy. Its companies serve as role models for other Russian enterprises. Thus, the oil sector can be viewed as an indicator of the future path of the country.

This paper intends to analyze the development of the corporate governance in the Russian oil industry by describing the board of directors' structure and comparing board's influence to that of the CEO.

The paper is divided into four sections. The first section focuses on corporate governance in Russia: its origins and current structure. In the second section, the model of power of CEO and Board of Directors is introduced and four different types of boards are described. Then, in the third part, the oil sector is portrayed: its history, development and current major companies. Additionally, ownership structure and political involvement are discussed. In the fourth section, companies' boards of directors are analyzed. The analysis includes board composition and main board duties and activities, as well as their interaction with the main counterparts, specifically, management and CEO. Finally, a conclusion about the board type is drawn, and limitations of the study and suggestions for further research are discussed.

Corporate Governance in Russia

This section describes the development of corporate governance in Russia.

Tsarist Era

To understand which path is the suitable one for the Russian corporate world, it is necessary to track the development of corporate governance in this country over the ages.

The history of collective management goes back to Peter the Great. He was a pioneer in his attempts to adapt Western culture, science and, of course, economic strategies into Russia. Peter the Great advised Russian merchants to set up companies similar in structure to colonial Western companies. Additionally, he encouraged them to engage in foreign trade, and not to rely fully on foreign merchants. From a legal perspective, he had ruled already in 1699 to allow the establishing of commercial and industrial companies and monopolies (Conte, 1994, p. 68). His attempts brought little success – although, the domestic trade system was established, only few companies on a global scale around the country were set up. In addition, these companies failed after a short period, and only one Russian merchant managed to trade abroad - not as many as Peter had expected. Furthermore, Peter's contemporaries thought that the reforms were too revolutionary and preferred to stick to their old-fashioned and familiar ways of doing business (Platonov, 2003).

Fifty years later, Catherine the Second continued Peter's ideas in her own way. 1767 was the year that the first company with a free circulation of shares, 'Nizhniy Novgorod', was founded. A *Decree of the Status of Corporations*, issued in 1799, gave additional push for establishing another public company, which was supported by royal family (Conte, 1994, p. 93). This company, the Russian-American Company, which dealt in expensive furs, has fully copied the corporate model of the East and West Indian Companies and had received a 20-year monopoly on commerce with the new Russian Pacific colonies, the Kuril and Aleutian Islands and Alaska (Kolomiets, 2001). The royal patronage of aristocracy and the state became the norm in companies for next two centuries. Despite early attempts to restructure the Russian business system, Russia was not dominated by companies with property-based structure, like the Western world, but rather by private ownership structure until Stolypin's reforms of 1906. These reforms included a land reform and a corporate reform that would have led to the landlord’s loss of their land and the change of the corporation structure of the Russian companies, respectively (Brown, Kaser & Smith, 1994, p. 98). Being a very agrarian country even this attempt to restructure the Russian economy could not be clearly called a transition toward a market economy, but rather just one step out of feudalism. The steps were small, and the Bolshevik Revolution of 1917 reversed these reforms.

Communist Regime and Its Influence

Taking over the country, Lenin’s supporters conducted one of the longest running experiments in history, a seventy-year long effort called Communism. Communism needed to prove itself. Despite volumes of theoretical essays, Karl Marx did not leave instructions for communistic governments as to how the communist state should be run politically and, of course, economically. A simple decision was made: the nation had to choose an anti-capitalistic path (Considine & Kerr, 2002). Whatever fit the capitalist society should be avoided in the communist one. Such notions as private sector, profit-maximization firms and financial instruments were eliminated from the socialist lexicon.

The state introduced a new concept to the world, which was not then, and never after, considered to be effective for firms in particular and an economy in general. Natural business cycles, instability and booms and busts were replaced by artificial scientific planning, which was thought to be appropriate for the communist society. In this way, the state expected all industrial entities to be able to execute five-year plans through orders given by bureaucrats. The ruling communist party made decisions simultaneously for all industries, independent of their unique features. Soviet economy was characterized by a command structure, one in which industrial units were just fulfilling directives and not an active part of the thinking process.

Partly because of aforementioned reasons, an average Soviet enterprise used to be considerably bigger in terms of industrial capacity and employment than an average firm in the West. Managers in such enterprises had essentially paternalistic relationships with employees. In other words, managers acted as representatives of workers, satisfying not only their economic, but also their social and organizational needs. This strategy was used to stimulate the production efficiency of the individual (Kuznetsov & Kuznetsova, 1996, p. 1174-1176). Moreover, in the absence of both transparent and known ownership of the companies in communistic society, managers were easily able to implement Russian managerialism, which placed the executives in the core of the company. In this scheme the full control over the enterprise belonged to managers, more concretely, to *general directors* (CEO – Russian style) (Bim, 1996, p. 485).

The collapse of the USSR accompanied by Gorbachev's reform program brought the corporate governance issue in Russia to a new dimension (Considine & Kerr, 2002, p. 226). It was reflected by the access to Western corporate practice and a new willingness of companies to be similar to their Western prototypes. Specifically, what really changed the system was the privatization program launched by Chubais and Yeltsin in 1992 (Blasi, Kroumova & Kruse, 1997, p. 39). One of the main intentions of their plan was to develop an appropriate system of corporate governance for Russia that 'would stimulate an increase in efficiency and an improvement in performance in the newly privatized businesses' (Aukutsionek, Filotchev, Kapelyushnikov & Zhukov, 1998, p. 495). During the first years of privatization, over 100,000 small, medium and large economic units changed their type of ownership, becoming joint-stock companies (JSCs). Thus began the transformation of a socialistic economy into a market economy. The state offered three different methods for implementing privatization. The second method, in which employees were allowed to purchase 51 percent or more of their firm's shares, was the preferred one amongst the process participants (Table 1).

Table 1. *Methods of Privatization in Russia*

<table>
<tr><td colspan="2">Variant I. Minority employee ownership 25%</td></tr>
<tr><td>Workers</td><td>General public</td></tr>
<tr><td>25% for free to workers + option to buy 10% at 30% discount + 5% to buy at nominal price</td><td>60% of shares to be sold at auctions or held by the state for later sale</td></tr>
<tr><td colspan="2">Variant II. Minority employee ownership 73%</td></tr>
<tr><td>Workers</td><td>General public</td></tr>
<tr><td>51% to buy at 1.7 times the book value price</td><td>49% of shares to be sold at auctions or held by the state for later sale</td></tr>
<tr><td colspan="2">Variant III. Management Buyout 2%</td></tr>
<tr><td>Workers</td><td>General public</td></tr>
<tr><td>30% to workers + 20% to managing group</td><td>50%</td></tr>
</table>

Note. From Blasi, J., Kroumova, M. & Kruse, D. (1997). *Kremlin Capitalism.*

The program included most industrial enterprises but excluded those that were in any way controversial, such as military industries, oil companies, and medical facilities.
The interim step of privatization, incorporation, was the critical stage. In this step, a state-owned enterprise, which earlier had no separate legal identity as a business unit, was incorporated, an economic value was assigned to its assets, and it acquired a stock, a senior management, and a board of directors. The board of directors played the most crucial role in this entire scheme. The workers selected both the board, which consisted of four members (Table 2), and the management of each newly incorporated company.

Table 2. *Proposed members of the board in privatization plan*

• General director	➢ 2 votes
• Representative of top-management	➢ 1 vote
• Representative of local government	➢ 1 vote
• Representative of federal government	➢ 1 vote

Note. From Blasi, J., Kroumova, M. & Kruse, D. (1997). *Kremlin Capitalism.*

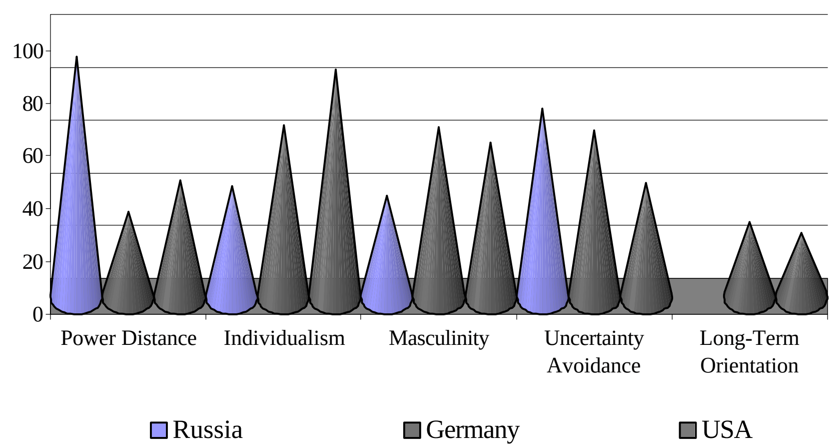
After being completely incorporated, the company could start privatization. The state legislators in favor of privatization made significant but ineffective efforts to prevent the opportunistic actions of both former communistic party members and Soviet top-managers, who were attempting to take over the company during its transition period (Blasi, Kroumova & Kruse, 1997, p. 40).

It is arguable whether the decentralizing of ownership, considered the best way to increase competition and improve performance in the Western world, worked well in Russia (Gurkov, 1998, p. 260). According to Kuznetsov and Kuznetsova (1998), the companies, which were established on the ashes of their counterparts, have not totally reformed their economic behavior. The privatization of the company was completed, in most cases, to the benefit of the incumbent managers and administrators. Thus, these top-managers often ended up controlling the company (Kuznetsov & Muravyev, 2001-2002, p. 469).

Culture

Each country has its own cultural characteristics, which in turn affect the development of companies (Figure 1). Due to this variation, companies dealing in the same business often differ from country to country. Russian businesses, as well, are influenced by Russia's culture in terms of their business ethics in general and corporate governance in particular. Therefore, even if a country chooses certain system of corporate governance, cultural and historical backgrounds prevent companies from having similar features as their foreign copies.

Figure 1. *Geert Hofstede Analysis for Russia, Germany and USA*



Note. From http://www.cyborlink.com/besite, no data available for *Long-Term Orientation* in Russia

Recognition of the importance of corporate governance hit this developing country recently. The Russian corporate governance system is just beginning to form, and its development will continue in its unique way over the course of next decade.

Current Corporate Governance System

Russia is still in transition. Although two decades have passed from the initial restructuring of the Russian economy, it is, so far, difficult to determine the corporate system of Russia. This system emerged in unique circumstances and possesses features found in both Anglo-Saxon and German corporate governance systems (Radygin, 1997, p. 14).

The current corporate system utilizes all necessary elements of corporate governance. However, practically speaking, these elements are scarcely in their intended form and, even in cases, where they do adhere to form, they have not proven to be efficient.

As an internal source of control, the board often fails to guard the shareholders' interests. Instead, the board often acts on behalf of the top-management and contrary to the shareholders' interests. Thus, an additional body, which oversees the board, is needed in order to assure board's efficiency. Another option is for the unsatisfied shareholders to step in and manage the company (Evenko et al, 2002, p. 22-27).

More often than not, separation between ownership and control is not practiced at all. This lack of separation occurs when the managers accumulate stock in their company (Aukutsionek et al, 1998, p. 505) or financial institutions are interested in acquiring large amounts of the company stock with the intention of controlling the company (Fortescue, 1996, p. 5). In this scenario, ownership and control become concentrated in the hands of just one group. This friendly alliance, built from interested owners, board of directors and management, is motivated in reaping profits at the expense of others. The interests of debtholders, other shareholders, and employees are disregarded and their rights are harshly abused. This alliance can imply share dilution[1], transfer pricing[2] and other various techniques for diminishing power and control of the less involved shareholders (Metzger, Dean, Bloom & Ratnikov, 2002, p. 22). But even large shareholders, who can directly monitor the board in the absence of this alliance (Radygin, 2002, p.110), seem to be absolutely unprotected once it exists.

In fact, hostile takeovers are almost impossible because of the strong controlling position of private owners in the company (Aukutsionek, 1998, p. 513). Moreover, mergers and acquisitions are usually ineffective in adding value to the firm. Managers often create alliances with a second company in which both parties hold shares of each other's companies (cross-holdings relationship). It helps to avoid outsiders' attempts to take over the company by covering and protecting each others' interests (Fortescue, 1996,

[1] The process when the new shares by the subsidiary are issued proceeded, if necessary, by an increase in its authorized capital. The new shares are then placed with favored shareholders.
[2] The exploitation by the holding its subsidiaries as 'cost centers'. The output of the subsidiaries is sold to the holding or its affiliates at below-market prices, while operating costs and debts are left with the subsidiaries

p. 5). A friendly investor, a so-called white knight, is another tool for preventing any enemy invasion (Kuznetsov & Kuznetsova, 1996, p. 1179).

Furthermore, the state still cannot assure stable economic development of the country and its industries. Political and economical decisions are made in chaotic and unsystematic ways. Despite the fact that from a legislative perspective the corporate law has improved, the regional and federal authorities are freely able to make legal decisions on behalf of certain financial groups, whose priorities are in line with their own economic interests. This factor is considered to be a major systematic defect of the Russian corporate system. (Radygin, 2002, p.107)

The Russian legal institutions are so poorly developed, that it leads to managers' and investors' avoidance of involving these institutions in solving the company's legal problems (Ryterman & Weber, 1996 cited in Aukutsionek et al, 1998; Fortescue. 1998, p. 9). They prefer other methods, including such illegal ones as bribery and corruption. That is why the personal relationships of managers with legislative and political bodies are important and unique characteristics of the new Russian business ethics. These contacts make it possible to consummate certain projects that would have been considered illegal in other circumstances (Evenko et al, 2002).

The financial markets hardly serve their role as external control mechanisms, as they are poorly developed as well. The performance of firm's shares does not reflect the firm's real value, as it is usually undervalued. Lack of information precludes analytic agencies from correctly evaluating companies.

The corporate governance is a completely new issue in Russian law (Fortescue, 1996, p. 16). Nevertheless, recent corporate and securities laws, created to protect shareholders' rights, were effectively introduced (Metzger, Dean, Bloom & Ratnikov, 2002, p. 21). Further in this vein, a Russian corporate governance code was recommended in 2002 by FCSM[3]. These measures, protecting shareholders' interests and thus attracting foreign investors to Russia, may be an indicator of future improvement in the external control roles played by both the financial markets and the state through the mechanisms of the legal system.

[3] Federal Commission for Securities Markets

The dominance of financial institutions, a unique characteristic of the German corporate system, has also a place in Russia in form of financial industrial groups (FIGs). According to Radygin (1997, p. 15), financial institutions (banks) created holdings through which they control enterprises. However, the Russian variant is different, as many financial institutions are either owned or controlled by the top-management of the enterprise itself.

Therefore, Kuznetsov & Kuznetsova (1996) suggest that there is “a stable and fundamental contradiction in the emerging corporate governance system” (p. 1180). This contradiction could be described by a co-existence of the minimum legal small shareholders’ protection and the maximum legal large shareholders’ protection.

The current transitional corporate governance seems to be improving dramatically and has evolved to the extent that it is already possible to see certain characteristics of the Western corporate governance systems.

Model of Power of CEO and Board of Directors[4]

In this section I introduce a model of board and CEO powers and explain its importance in the case of Russian oil industry.

Board of Directors Typology

Management often possesses an unrestricted power within a company. Not only is this power implemented on the management level, but the management’s representatives also participate in the board activities. The main and most influential body of the management team is the Chief Executive Officer. His veto power concerning current company’s decisions is rarely challengeable. The CEO always sits on the board and sometimes plays a very active role (Fama & Jensen, 1983). In lots of cases, he is the one, who is in charge of selecting and hiring board members and determining their compensations. Besides that, the CEO is able to screen the information flow, which will get to the board (Aram & Cowan, 1983). In extreme cases, the board can be fully controlled by the CEO and only

[4] My study is based on a model developed by Pearce & Zahra. (1991, February). The Relative Power of CEOs and Boards of Directors: Associations with Corporate Performance. *Strategic Management Journal,* 12/1, p. 137.

acts on his behalf. In such a case the board will only be willing to intervene in extreme situations and, therefore, will not be influential at all (Almazan & Suarez, 2000).

It is theorized in the economic literature that the optimal balance of board and CEO powers is necessary to improve company's performance (Pearce & Robinson, 1987). Only then, both of them are actively involved in company's corporate life and serve their duties.

There are four main types of board, which are defined by the level of power of the CEO and the board: *Caretaker, Statutory, Proactive and Participative* (Pearce & Zahra, 1991). The belonging of a board to a specific type is determined based on composition, characteristics, internal process, and decision-making styles of this board.

The first type, *Caretaker board*, is considered to be the most unproductive type. This board is characterized by low power of both, board and CEO. It has no responsibility to make corporate decisions (Molz, 1985). Thus, the senior management together with the CEO have an unlimited decision authority and are highly represented on the board. In such a scenario, the board is no more than a requirement of the current corporate governance guidelines (Table 3).

Table 3. *Board of director typology*

CEO POWER / BOARD POWER	low	high
high	***Statutory*** • Advisory • Managerial Control • Ratifying	***Participative*** • Collegial • Shared Leadership • Normative/Strategic
low	***Caretaker*** • Third Party • Review & Approve	***Proactive*** • Strategic/Shareholders' control

Note. From "The Relative Power of CEOs and Boards of Directors: Associations with Corporate Performance." Pearce, J. and Zahra, S., 1991, February. *Strategic Management Journal*, 12/1, p. 137.

The second type of board is a *Statutory board*. Here, the CEO has a strong say on the board. He fully controls the situation by dictating the decisions made by the board.

The board members usually have neither enough experience nor interest to fulfill their duties. Often they are even chosen by they CEO and act only on his behalf.

The third type is a *Proactive board*. The board is aware of its roles and legal responsibilities to shareholders. It usually consists of experienced individuals, who are familiar with the firm's industry. The board members of the *Proactive board* are involved in establishing board committees and working on them. They have sufficient information to make effective decisions. These established committees, on their part, facilitate the control, monitoring and review of manager's and CEO's behaviors. Thus, with the Proactive board the company's performance might be improved. For a further improvement, however, the board should try not only to rely on its formal power, but rather to cooperate closely with the CEO on an informal level as well.

The fourth type of board, *Participative board*, represents an optimal configuration. It features effective interaction between the CEO and the board members. The board is provided with a sufficient authority, so that it can prevent any non-beneficial activities of CEO. Thus, they serve as good counterparts to a dominant CEO. In this way, the board directors can fulfill their duties of protecting company's shareholders and ground a foundation for effective corporate governance.

Case of Russian Oil Companies

In the Russian oil companies, the CEOs are actively involved in the board's work. Furthermore, in the majority of these companies the CEOs are not only representing management on the board, but also the core shareholders[5] (Table 4). CEOs' influence appears even more critical, when considered the fact that in 2002 the Russian oil majors were employers of about 606,000 people. Considering that the average family consists of four-five people, it can be said, that members of oil companies' boards and management are responsible for the well-being of more than 2.7 million people. For these reasons, the relationship between the CEO and the board of directors requires a detailed analysis.

[5] The terms *core shareholders* and *blockholders* are used interchangeably.

Table 4. *CEOs of Russian Oil Companies, as of 2003*

Company	CEO	Core Shareholder?
Tatneft	Shafagat Takhautdinov	**Yes**
TNK oil Co.	Simon Kukes	No
Sibneft	Evgeny Shvidler	**Yes**
Surgutneftegaz	Vladimir Bogdanov	**Yes**
YuKOS	Mikhail Khodorkovsky	**Yes**
LUKoil	Vagit Alekperov	**Yes**
Slavneft	Yuri Sukhanov	No
Rosneft	Sergei Bogdanchikov	No

Note. From companies' data.

Russian Oil Sector

In this section I depict the history and structure of Russian oil sector.

History of Russian Oil Sector

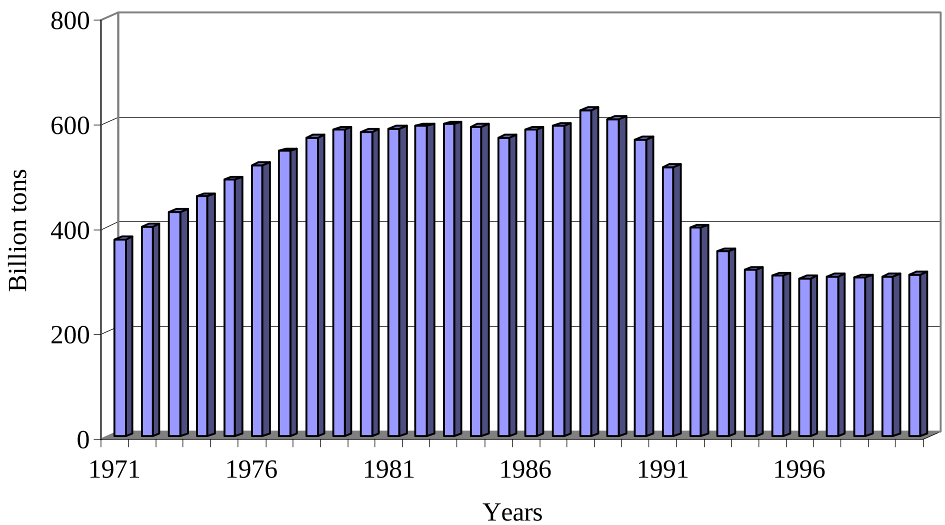
At the turn of the last century, the Russian oil industry was considered to be competitive on the global oil market and characterized by both, a strong direct foreign participation and minor state involvement (Reinsch, Lavrovsky & Considine, 1992). The only disadvantage at that time appeared to be the complete reliance on a sole drilling region, Baku (Azerbaijan), without additional oil exploration elsewhere in the country.

The Bolshevik government, which took over the country in 1917, realized the importance of the industry. Thus, the oil sector was nationalized in 1922 (White, 1991). The Communists strived to bring the oil sector to an industrial level of production. This plan succeeded in 1950, when the commercial exploitation of Volga-Urals oil facilities commenced. The second accomplishment of the Soviets was the exploration of the West Siberian Plain. This plain, with its 113 oil fields, produced over 200 million tons of crude oil by 1973, representing 50 percent of the annual crude oil production of that time. (Considine & Kerr, 2002)

The next two decades were characterized by the further development of the oil industry, reaching a peak production of 624 million tons in 1988 (Stern, 1987 cited in

Considine & Kerr, 2002, p. 154). The collapse of the USSR, followed by the cancellation of centrally planned economy, caused the Soviet crude oil flows to experience a significant recession of 15 percent from the 607 million tons reported in 1989 to 515.53 million tones in 1991 (Ebel, 1994 cited in Considine & Kerr, 2002, p. 231). The after-privatization process in Russia resulted in a decade-long period of a relatively fixed production level of about 300 million tons annually (Figure 2).

Figure 2. *Crude oil production of former USSR and Russian Federation, 1971-2001*

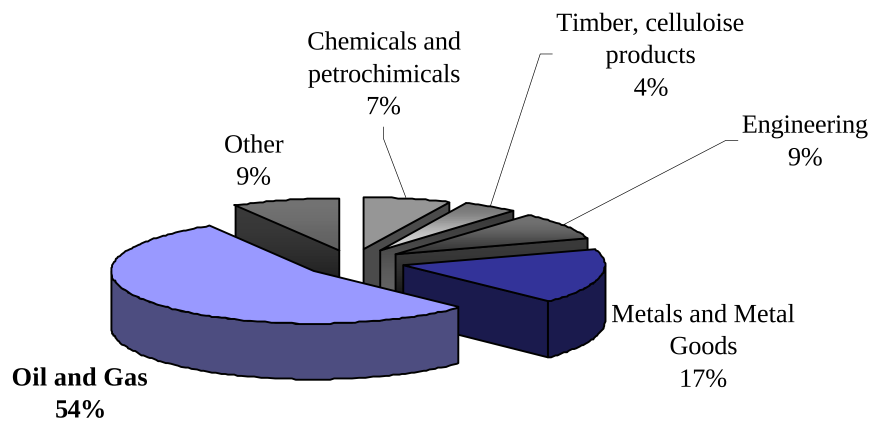


Note. From Considine, J. I. & Kerr, W. A. (2002). *The Russian Oil Economy*. Cheltenham: Edward Elgar.

Besides for the chaotic state of the transition economy, there are several explanations for the post-Soviet reduction in crude oil flows. The government policy of cutting back its investments in the oil sector because of the budget deficits was one of the primary causes (Considine & Kerr, 2002, p. 219). The scarce foreign investments, stemming from the high level of uncertainty in the Russian petroleum industry, were not sufficient to support massive oil complexes. High costs of production, facilities repairs, and pipelines maintenance costs demanded a tremendous and steady cash flow (Considine & Kerr, 2002, p. 232). Additionally, the exploration of the new drilling locations within the Western Siberian Region was prevented because of climatic and geologic reasons.

Nevertheless, the oil sector remains one of the most important in Russian economics. The *Expert* (2002) lists several explanations for this fact. First of all, the oil industry is considered to be the major Russian exporter (Figure 3), bringing "hard" currency (dollars) into the country. Furthermore, the industry is the primary taxpayer in the country and, through that, ensures a stable domestic currency exchange rate. Additionally, local oil prices influence rates of inflation and growth. Finally, despite the fact that the oil industry is mostly privatized, the state can still cash out the rest of its stock, thus, filling the government budget deficit. The recent sale of one of the fully state-owned oil companies, Slavneft, to private investors (TNK and Sibneft) is just the latest example of such a strategy.

Figure 3. *Structure of Russian Export, as of 2002*



Not*e.* From Ivashov, A. & Kravchenko, Y. (2001). Dangerous Games. *Business in Russia,* 118, 12-13.

Structure of the Oil Industry

The main characteristics of the Russian economy for over seven decades were central planning and command economics. The economy was based on the processes of administrative governance; enterprise managers could not follow their entrepreneurial initiatives, but had to execute the plan through orders (commands) given by bureaucrats (Krjukov, 2002).

Perestroika and the Law of Enterprises in 1988 could clearly be viewed as the first attempt to change the system. However, “it had disastrous implication for the ill-fated Soviet oil economy” (Considine & Kerr, 2003, p. 217). Thus, the sector was completely reorganized and the inter-industry state companies were established in a fashion, such that, control over the industry still remained in the hands of the Oil and Gas Ministries. These industrial organizations served as a major resource for filling the government deficit and repaying debts.

The state mismanagement and unsuccessful regulation of the oil sector resulted in the loss of state’s control over the oil companies and became a precondition for establishing management control. Thus, already in 1992 there was a further need for simultaneous restructuring, incorporation, and price reform in Russia. The oil sector was the last industry to undergo privatization. Initially, the holding company, Rosneftegaz, was created. It was responsible for the entire oil and gas sectors. From this enterprise, the vertical integrated enterprises were later established (finally 18), which were in turn then legalized by the *President Edict*, in 1992. Those groupings managed the whole process of the oil business within their regions: from exploration to extraction, refining and marketing (Gorst, 1996, p. 3). These companies, initially wholly state-owned, were supposed to be fully privatized later (Considine & Kerr, 2003, p. 232). However, according to the president edict, the government was still able to keep a controlling stack, up to 51 percent of their equity, for the next three years (Krjukov, 2002, p. 3). The rest of the company’s stock was distributed among both managers and employees of the company as well as sold through cash auctions and investment tenders (Khartukov, 1997, p. 6). Despite this privatization plan, some insiders (top-managers and their coalition) have retained the full control over their companies and, thus, have retained authority for all decisions regarding the companies. The situation offered these managers the opportunity to accumulate enough financing, usually in an illegal way, for the future managerial buyout (Krjukov, 2002, p. 3).

The second stage of privatization in the Russian Oil Sector occurred in 1995 and was followed by a turnover of control in this industry (Table 5). The equity, previously reserved as federal property, was collateralized by the state, and then was subsequently sold off to the commercial banks and affiliated financial institutions (Krjukov, 2002, p.

6). In some cases did insiders succeed in retaining control over the company and becoming the owners-managers of the firm (LUKoil, Surgutneftegaz and Tatneft).

Table 5. *Dynamics of oil privatization, 1994-2003*

		Government stake (%) as of:									
Company	Formed	1/1/94	1/1/95	1/1/96	1/1/97	1/1/98	1/1/99	1/1/00	1/1/01	1/1/02	1/1/03
Sidanco	05/94	-	100	85	51	0	0	0	0	0	0
Sibneft	09/95	-	-	100	51.1	0	0	0	0	0	0
TNK	08/95	-	-	100	91	51	49.8	0	0	0	0
SNG	03/93	100	40.1	40.1	40.1	0.8	0.8	0.8	0	0	0
Onaco	06/94	-	100	85	85	85	85	85	0	0	0
KomiTEK	06/94	-	100	100	92	1.1	1.1	1.1	1.1	0	0
YuKOS	04/93	100	86	53	0.1	0.1	0.1	0.1	0.1	0.1	0.1
VSNK	04/94	-	100	85	38	1	1	1	1	1	1
LUKoil	01/94	90.8	80	54.9	33.1	26.9	26.6	23.7	14.1	7.8	7.8
Tatneft	05/94	-	46.6	46.6	30.3	30.3	30.3	30.3	30.3	30.3	30.3
VNK	05/94	-	100	85	85	36.8	36.8	36.8	36.8	36.8	36.8
Slavneft	06/94	-	93.5	92	90	85.8	85.8	85.8	85.8	85.8	0
Rosneft	09/95	-	100	100	100	100	100	100	100	100	100

Note. From Khartukov, E. (2002, May 27). Russia's oil majors: engine for radical change. *Oil & Gas Journal*, 20-33. Sidanco is actually controlld by TNK since mid-2001. Onaco is controlled by TNK since September 2000. KomiTEK is controlled by LUKoil since mid-1999. VSNK is controlled by Sibneft (since March 1997 until November 1999) and by YUKOS (since February 2001). VNK is controlled by YUKOS since December 1997. Slavneft was privatized in 2003.

In August 1998, a financial crisis initiated the final stage of the restructuring of the Russian oil industry. The state had virtually lost control over this mostly privatized sector, and several Russian financial groups that had previously owned oil companies decided to divest or sell their oil enterprises because of the disappointing performance of this sector (decline in oil price, expected large investments).

According to Khartukov (2002, p. 20), the Russian oil companies are divided into three categories: private majors, federal state entities and regional players (Table 6).

Table 6. *Status of Russian Oil Companies in 2001*

Company	Oil reserves, billion bbl	Oil output, 1000 b/d	Refinery runs, 1000 b/d	Oil exports, 1000 b/d	Retail stations	Employees, 1000	Capital expenditures billion $
LUKoil	14.24	1263.5	443.1	440.2	850	128	1.12
YUKOS	12.18	1167	577.6	455.8	1280	86.3	0.59
SNG	9.1	884.2	317.2	325.4	470	86.4	1.37
TNK	11.47	998.9	392.2	349.1	370	60.9	0.8
Sibneft	4.64	413.5	266.3	144.3	860	38.3	0.14
Slavneft	1.67	299.8	229.8	107.1	200	33.6	0.25
Total private majors	**51.63**	**4727.1**	**1996.4**	**1714.8**	**3830**	**399.9**	**4.02**
Rosneft	5.16	300.1	154.7	111.1	1100	54.6	0.42
Total Federal majors	**6.83**	**599.9**	**384.5**	**218.2**	**1300**	**88.2**	**0.67**
Tatneft	6.65	494.3	6.2	182.2	100	60.2	0.61
BTK	1.74	238.3	407.6	79.3	90	57.9	0.33
Total regional mojors	**8.39**	**732.6**	**413.8**	**261.5**	**190**	**118.1**	**0.94**
Total majors	66.85	6059.6	2794.7	2194.5	5320	606.2	5.63
% of Russia's Total	72.7	86.7	78	86.8	23.2	90.3	84.4

Note. From Khartukov, E. (2002, May 27). Russia's oil majors: engine for radical change. *Oil & Gas Journal*, 20-33

The group of private majors includes 6 dominant players on the oil market: LUKoil (**L**angepas**U**rai**K**ogalym **O**il), YuKOS, SNG (Surgutneftegaz), TNK (Tyumen Oil Co.), Sibneft and Slavneft. Four of them (YuKOS, TNK, Sibneft and Slavneft) are controlled and personally run by financial tycoons and the two others (LUKoil and SNG) remained in the hands of the first post-perestroika wave top-management team. Recently, Sibneft and YuKOS announced their consolidation. Slavneft, which recently still was a federal state company, was privatized and now is included in this group.

The importance of the next group, the federal state companies, has decreased during the privatization period. Rosneft is still wholly owned by state and used as a political tool in government games.

The last group is the regional majors, BTK (Bashkir Fuel Co.) and Tatneft, which are partly owned and fully controlled by regional government of the republics of Bashkortostan and Tatarstan, respectively.

Other relatively big oil companies, such as Sidanco, VNK (Eastern Oil Co.), VSNK (East Siberian Oil Co.), KomiTEK, and ONACO (Orenburg Oil Co.), have been taken over by the oil industry giants (LUKoil, TNK and YuKOS) and, therefore, cannot be considered dominant players anymore.

There are two additional features of the Russian oil sector, which are worth to be analyzed to gain a fuller understanding of its corporate governance. One feature is the interest of foreign oil companies and investors in this area. Initially the foreign investors were prohibited to participate directly in the more than fifteen percent of companies' stock. However, they managed to acquire blocks of federal shares in exchange for loans to the government (Gorst, 1996, p. 4). However, the domestic unbearable taxation, the export-quotas, and the unpredictable political situation have cooled down most foreign companies' eagerness to be involved in the oil business and drew many of them out of Russia (Considine & Kerr, 2002, p. 290). Nevertheless, some comeback stories exist, as for example the recent merger between TNK and BP-Russia. The foreign companies, to their right, worry not only about the improvement of investment climate and country's potential, but also about its corporate management quality and financial performance (Khartukov, 2002, p. 32). This fact will, hopefully, result in the future improvement of corporate governance. A second feature is the companies' tendency to go West and expand their business outside of Russia, where the political and economic climates are much more predictable. The downstream expansion of LUKoil by acquiring American Getty Petroleum serves as a perfect case.

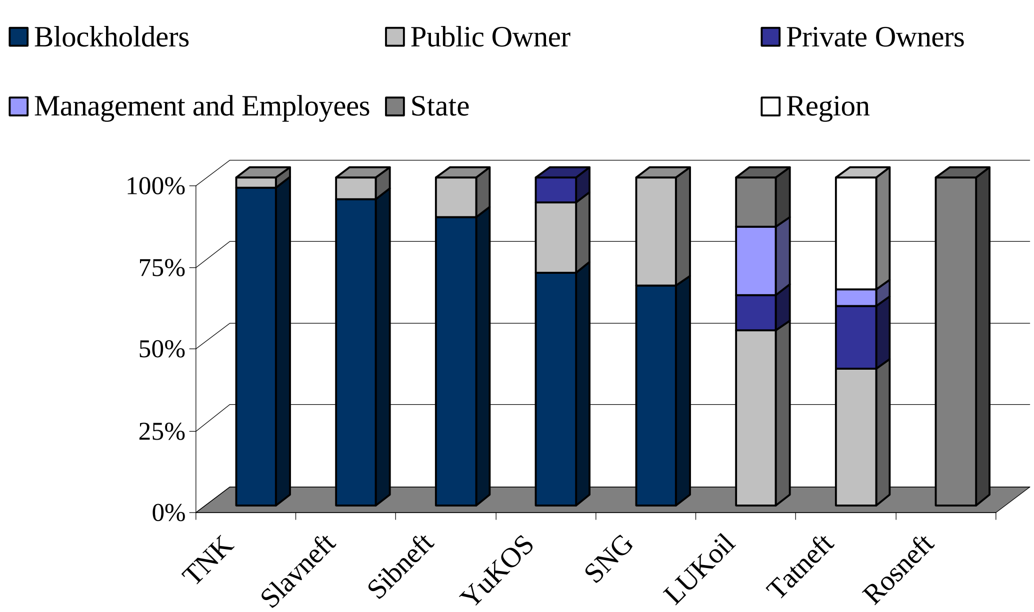
Russian Oil Majors[6]

LUKoil – Langepasneftegaz, Uraineftegaz, Kogalymneftegaz Oil Co.

The vertically integrated oil company LUKoil is a certain leader on the Russian oil market in terms of oil production and export. The company was established in 1991. Shortly after, in 1993, it already possessed three original production associations and several oil related companies. Between 1998 and 2000 LUKoil made a few important domestic acquisitions (Komi Region based KomiTEK, Norsi-Oil and other various oil enterprises) and some foreign ones. (Lane & Seifulmulukov, 1997).

Soon after the privatization process ended, the company consolidated the ownership of its subsidiaries “to improve co-ordination and to allow the company to reduce its effective tax burden”, as the company claimed (company’s official website, 2003). However, it is more likely that the real reason was the company’s attempt to reduce ownership of subsidiaries’ shareholders by diluting their shares. As result, the management team and the affiliated financial structures have conquered full control over the company and now own more than one-fifth of all shares (Figure 4).

Figure 4. *Ownership Structure, as of 2002*



Note. From companies’ data.

[6] For companies’ profiles the annual reports and official websites of companies were used. Additionally, Troika-Dialog Research (2001) gave an overview of the companies’ development.

In the last few years the company has heavily increased its investments in exploration of oil regions and made efforts to create the largest Russian retail networks. LUKoil is an export-oriented company, whose export share is about 70 percent of its entire production. Due to the fact, that the company did not own enough refineries, it has decided to acquire a few in Eastern Europe (Liuhto, 2001).

Concerned about the protection of its interests in the political arena, the company is very active on the federal level. It is worth mentioning, that two ministers of fuel and gas have previously worked for this corporation. The Russian Minister of Fuel and Gas, Kaluzhnyi, has his origins in LUKoil. The president and co-founder of LUKoil, Vagit Alekperov, held a post of a Fuel and Gas Minister in the Communist time. Despite this fact, LUKoil tries to minimize its political risk by lobbying several political parties simultaneously. The government is not always fond of this behavior.

The company has an aggressive foreign policy. It focuses on acquisition of as many foreign oil reserves as possible in order to alleviate the high level of uncertainty in Russia. Thus, one third of all company's reserves is located outside of Russia at this time.

Sibneft

Sibneft was created in August 1995 in the last stage of the Russian oil sector restructuring. The holding encompasses oil production and refining enterprises in Western Siberia.

The company's proven oil reserves are relatively small compared to those of leading oil companies, such as LUKoil or YuKOS. However, Sibneft applies an aggressive expansive policy on the local level including the development of retail networks and the acquisition of further oil enterprises.

The political power of the company is relatively unstable. Since the present owner, Abramovich, is strongly politically involved, the government's attitude towards him affects the company's lobbying power.

Sibneft managed to complete its shares consolidation program successfully without any conflict of interests between minor shareholders and controlling private owners and without government pressure. During the privatization process, a financial group, led by SBS-Agro Bank, obtained control over the company. The Bank of New

York acts as the underwriter for company's ADRs, which totally resume in 4.2 percent of company's stock (Table 7). The issuing of ADRs and Eurobonds might eventually lead to a greater transparency of the company.

Table 7. *Effective and expected Eurobonds Issues/ Oil and Gas Sector, as of 2003*

DR issue	Issuing date	Maturity date	Coupon	Yield on placement	Volume issued, mln	Corporate ratings (S&P)
Russia						BB+
Sibneft	26-Nov-2002	15-Jan-2009	10.75	10.75	$500	B+
LUKoil	21-Nov-2002	29-Nov-2007	3.5	7	$350	BB-
TNK	6-Nov-2002	6-Nov-2007	11	11	$400	B+
Sibneft	4-Mar-2002	13-Feb-2007	11.5	10.96	$150	B+
Sibneft	30-Jan-2002	13-Feb-2007	11.5	11.5	$250	B+
Rosneft	13-Nov-2001	20-Nov-2006	12.75	13	$100	B
Slavneft	2003	2008-2010	-	-	$200 (*)	-
Tatneft	2003	2008	-	-	$200 (*)	B-

Note. From Troika Dialog Research. (2002, December). Corporate Bonds. Moscow: Kudrin, A; and annual reports of the companies; (*) – expected.

The company expects advantages from its recent merger with YuKOS, which created YuKSI, the largest private sector company in the world in terms of proven oil reserves and the third largest in terms of oil production (company's data). This recent merger has no precedents in Russian oil history.

Slavneft

The Russian-Belarusian oil company Slavneft was founded in August 1994. It is a fully vertically integrated company, whose activities encompass the entire spectrum of oil production from exploration to retailing and marketing.

Due to decline of oil prices and budget deficits, the company's performance is relatively low at the moment. The company has several large foreign credits and is currently not able to maintain all oil enterprise facilities. It certainly also lacks a strong management team.

Until November 2002 the governments of Belarus and Russia fully owned the company. Then, the company was privatized and is now owned, to equal part, by TNK and Sibneft.

SNG - Surgutneftegaz

Surgutneftegaz was established in 1993 as a vertically integrated company with activities concentrated in the Tyumen region. It possesses two refineries in the St Petersburg region and retail enterprises in the northern part of Russia. Being located closely to Russian northern border, the company's refineries have a competitive advantage by minimizing transportation costs when exporting to Western Europe (mainly to Germany). The company is not only one of the biggest in Russia, but it is also one of the most dynamically developing Russian companies.

According to company's reports, it controls about 13 percent of the domestic market shares (company's data). The company has relatively large proven oil reserves, about 1.5 billion tons. Surgutneftegaz has a credible financial history. The company managed to avoid bank credits, to finance itself through revenue and not to engage in expensive foreign projects. Thus, this company was always able to pay dividends and taxes on yearly basis.

The company's long-term strategy is focused on both the internal Russian oil market and development of owned oil fields. The company does not get involved, contrary to others oil conglomerates, in an aggressive outside expansion (Lane and Seifulmulukov, 1999).

The company-state relationship remained unchanged during the entire period of company's existence since the company has not been participating in any lobbying activities.

Recently, Surgutneftegaz developed a more international orientation. The company issued ADRs (level I) on foreign stock exchanges (Table 8) and allowed foreign investors to hold more than 5 percent of stock. Surprisingly, Surgutneftegaz even launched a few joint ventures with foreign oil enterprises (with Neste, Elf Aquitaine and so on).

Table 8. *Effective ADR Programs, as of 2002*

ADR issue	Level	Symbol	Exchange	ADR:ORD	Since	Last issue
YuKOS	Level I	YUKOY	OTC	1:15	22-Dec-2000	28-Feb-2002
Sibneft	Level I	SBKYY	OTC	1:10	20-Apr-1999	
Tatneft	Level II	TNT	NYSE	1:20	25-Mar-1998	
Surgutneftegaz	Level I	SGTZY	OTC	1:50	30-Dec-1996	19-Mar-1998
LUKoil	Level I	LUKOY	LSE	1:04	1-Dec-1995	3-Nov-1997

Note. From Troika Dialog Research. (2002, December). *Corporate Bonds.* Moscow: Kudrin, A; annual reports of the companies.

During the privatization period the management team has retained control over the company. As a result of the non-involvement policy of the state and the strong financial power of the company, the managerial buyout could easily occur. Thus, the management holds about 67 percent of the company's stock (Figure 4).

Surgutneftegaz has a dominant position on the Russian oil market and, in terms of financial performance and foreign investment potential it can easily compete with LUKoil and YuKOS. (Troika-Dialog Research, 2001)

Tatneft

Tatneft is the fourth largest oil company in terms of oil production and was established in 1950. In 1994, it was incorporated and restructured. The company is situated in Tatarstan, where the entire oil production of the holding is located.

One third of Tatneft's oil production goes to export. The company has a decent reputation on the international arena. The company issued ADRs (level II) on foreign stock exchanges (Table 8), one of the requirements of which is a high level of company's transparency (Troika-Dialog Research, 2001).

Regarding the production process, since the company lacks its own refining facilities, its long-term growth could suffer. Thus, additional investments will be required in order to acquire the needed refining enterprises. Therefore, the company is planning to issue Eurobonds this year (Table 7).

The ownership of the company is equally divided between the regional government, the managers/employees, and foreign investors. Being partially owned and fully controlled by the Tatarstan administration, Tatneft is an instrument of political economics in the region. It subsidizes other industries in the area, investing in the social and financial development of the republic.

TNK - Tyumen Oil Co.

Tyumen Oil Co. (TNK) was founded in 1995. At that time the company consisted of two oil production associations, only one refinery and few retail enterprises. Till the end of 1997, the company was still not vertically integrated. During the privatization process and under the new management team, the company succeeded in taking over the previously state-owned company ONACO, to incorporate other oil enterprises (such as TNK-Nyagan) and to enormously expand its retail structures (370 gas stations, see Table 6).

TNK is considered to be the second largest company in terms of proven oil reserves and the fourth largest oil producer among Russian oil companies. TNK is strongly export-oriented.

The long-term strategy of the company involves reduction of production and refining costs, investments in the nearer abroad (Ukraine, Kazakhstan) and increase in number of its gas stations.

Due to company's lively investment activities and its high credit ranking (B+), TNK was able to receive large credits from foreign and local financial institutions and markets (Table 8).

Alfa-Bank, the main owner of the company, actively lobbies its interests in the state policy. The bank is highly involved in company's management (it is represented on the board of directors). The bank's recent acquisition of in the former large oil holding Sidanco gave TNK the additional resources for further development of oil exploration and extraction.

The management team of the company appears to be perfect in the eyes of the public. All managers are highly educated and some of them (like Simon Kukes and Len Blavatnik) have valuable foreign working experiences. These managers' characteristics play an important role in establishing relationships with potential international investors and shareholders.

Rosneft

The history of Rosneft goes back to the 1993, when the state took its first steps in the restructuring of the Russian oil industry. In 1995, the state-owned oil company, Rosneft, was transformed into a vertically integrated enterprise. The main reason for establishing this company was the desire to consolidate all those companies, which had not yet been included in the three recently established vertically integrated oil companies (LUKoil, SNG and YuKOS), and to be a fair competitor to them. The first after-privatization years were particularly hard for the state's giant. All private companies were willing to acquire enterprises of Rosneft, which at that time lacked a professional management team and suffered from budget deficits. As a result, the shares of some of its enterprises were diluted and the state lost its share in these companies. Others were collateralized with state's approval (loans-for-shares scheme[7]) and, afterwards swallowed by financial institutions.

In this way, Rosneft lost a large number of its subsidiaries (19 out of 30). The current management team, led by *director-general* Bogdanchikov, eventually was able to prevent further hostile takeover bids and even to return some of the oil production associations back to Rosneft (including one of the most important, Purneftegaz). Thus, company's financial situation has finally improved.

Being entirely owned by the state, the company is clearly an instrument of economic regulation. One of its main responsibilities is, of course, the regulation of the Russian oil sector. It is difficult to say, however, how this regulation actually takes place because there are a lot of strong players in the sector. The government's ownership of the company makes it less attractive to foreign and local investors. On the other hand, the company received the access to the most profitable oil regions (Sakhalin and Kuril islands), which do draw attention of foreign investors. Furthermore, the government lifted export-quotas for Rosneft, so that, they are now significantly higher than those of private companies.

The company has a clear long-term strategy, which includes further expansion of its gas production while keeping the oil production on the current level. Additionally, the

[7] This scheme implied filling of government deficit with loans from financial institutions. This approach later resulted in banks' acquisition of the companies because of the government's inability to buy the shares back.

company is attempting to create its own retail networks of gas stations. It is also strongly involved in attempts to revive the Chechnya's oil industry.

Regarding corporate structure, the company is looking to centralize the company's management and to improve employee's working conditions.

YuKOS – Yuganskneftegaz, KuibyshevnefteOrgSintez

YuKOS, fully vertically integrated oil company, was established in 1993. It is one of the largest and most internationally oriented Russian companies. Almost all company's oil exploration enterprises are located in the Western Siberia region. The distribution companies are mostly located in Central Russia. YuKOS's proven oil and gas reserves totals in 13.3 billion BOE (Table 6). YuKOS exports more than half of its crude oil production. (Lane & Seifulmulukov, 1999, p. 114).

Being the first privatized oil enterprise in Russia, the company was severely affected by the Russian banking crisis of 1998. It suffered from harsh budget deficits and was on the edge of bankruptcy. Because of high debts to federal and local authorities and the inability to pay salary to its employees, the company could only avoid bankruptcy or hostile takeover by making itself more attractive to domestic and foreign investors. However, the passive strategy of the former management, which did not foresee and prevent hostile bids, finally led to a change in the controlling power. A group of outsiders headed by Mikhail Khodorkovsky acquired the major stake of the company (about 82 percent), brought in a new management team and restructured the company.

YuKOS, having many subsidiaries, consolidated their shares in 1999. This move made the company more attractive to potential investors. Furthermore, joint ventures with the large foreign oil companies were established.

YUKOS clearly has an expanding strategy. It consists of the development of new oil regions and building of the Russia-China oil pipeline. Those projects require billions of dollars of investments and are not expected to be profitable in the near future. Additionally, the company emphasizes ownership of distribution channels. YuKOS also bought oil refineries abroad, which facilitate an increase in export numbers. In 1998 YuKOS announced its merger with Sibneft. This was finally realized in 2003, establishing a new company, YuKSi.

YuKOS has sufficient political influence to lobby its interests in the Russian parliament.

As all Russian vertically integrated companies, YuKOS is publicly traded. Its stock is traded on Russian, European and American stock exchanges (Table 8).

Board of Directors in Russian Oil Majors

In this section, a theoretical definition of board is given and various characteristics of board are discussed. Companies' data, collected for this study, are presented and analyzed.

The Role of Board in Corporate Governance

Generally speaking, corporate governance is defined as the interaction of the company with the key corporate players.

In a more narrow sense, the corporate governance refers to the integrated set of both internal and external regulations that harmonize manager-shareholder (principal-agent) conflict of interests resulting from the separation of ownership and control (study of Berle & Jensen, 1968; Williamson, 1984; cited in Baysinger & Hoskisson, 1990, p. 72; Jensen & Senbet, 1998, p. 372).

Russian corporate development has not followed a regular corporate path. Usually, in the beginning stage, companies tend to be private enterprises, but with time, additional financing is needed for future business expansion. The investors are usually willing to participate in the enterprise, but in exchange they want to obtain a part in the companies and their profits. Thus, "owners are forced to share their control and attract new shareholders: first from a narrow group, then, on an anonymous basis, in open markets" ("Role", 2001). Simultaneously, the company's corporate relationships are shaped.

The Russian corporate world has only existed for the past twenty years. Its developmental process was rather short and sudden: the existing companies basically skipped all aforementioned phases and have become public by privatization immediately.

Therefore, there are still many Russian publicly traded companies, which have features of the private ones such as full manager control and no disclosure of ownership.

Thus, the improvement of corporate governance system in general, and particularly the solution for the principal-agent problem, should be the main concern of the Western-oriented Russian oil companies in their pursuit of additional financing. The strengthening of the position of the board, a more effective organizational structure can be developed (Table 9).

Table 9. *Reasons for a powerful board in an organization*

Reasons
• Creates useful business contacts in order to strengthen the link between corporations and their environments
• Develops the organization's mission and goals in a more effective way
• Improves the CEO's and company's performance evaluations
• Is necessary for effective 'checks and balances' in corporate governance
• Plays a crucial role in creating corporate identity
• Establishes and monitors compliance with codes of ethics
• Sets a tone for definition of expectations of executives and employees
• Guides development of policies throughout the firm
• Has pervasive influence throughout many aspects of organizational life

Note. From "The Relative Power of CEOs and Boards of Directors: Associations with Corporate Performance." Pearce II, J. and Zahra, S., 1991, February. *Strategic Management Journal*, 12/1, p. 137.

Mission of Board

In a typical corporate structure the board of directors serves as a connecting link between managers of the company and its shareholders. The board, elected directly by the shareholders of the company, selects the top management team. Thus, the board of directors has the unique job of securing the shareholders' power by representing their interests and protecting these interests before the management. Furthermore, the board not only protects the shareholders, but also, by being involved in the company's business, is able to act as a mediator between the management and the shareholders.

However, sometimes, the opposite occurs, when the top management itself chooses the candidates for the board of directors, who will serve its needs (John & Senbet, 1998. p. 373). In this case, the only responsibility of the board remains to review and approve managerial decisions, which puts it into the *caretaker* board category. Drucker (1965) claims that the management only executes this power because the shareholders have not insisted on their rights and obligations. In such a scenario, the mission of the shareholders is reduced to cash flow providers. Corporate governance, therefore, should provide a model, which allows shareholders to be fully aware of their rights and to step up to their obligations. This model will also allow for minimization of agency costs, which are incurred by investors on account of separation of ownership and control (Meckling & Jensen, 1976).

Duties of Board

When reviewing the literature on board of directors, an agreement among scientists can be observed regarding the duties of the board of the company.

Bowen (1994, p. 18) believes that there are six important functions of the board. According to his opinion CEO's support, monitoring, selection, advising, replacing in the case of dissatisfaction, and reviewing/adopting long-term strategic directions are critical. Also Bacon (1993) agrees that the main duty of the board is the effective monitoring of the company's and the management's performance. Anderson and Anthony (1986) add CEO's compensation policy decisions to the list. The board has to provide all necessary resources, including human resources, in order to make sure that company's strategies will be implemented and its objectives reached.

Additionally, Bowen (1994) as well as Anderson & Anthony (1986), propose concerns about ethical and public standards as another function of the board. Bowen offers 'nomination of suitable candidates for election to the board, and establishing and carrying out an effective system of governance at the board level' to be a category of board's activity, too (Bowen, 1994, p. 22). Anderson & Anthony claim that providing shareholders with the adequate financial information and transparency should be also a board's responsibility.

In summary, the board acts as an internal control guard of the corporation. Despite the fact that companies complying to the descriptions of board duties are mentioned in many IPO prospects and annual reports, one can argue whether board members actually fulfill all of them.

In the modern corporate environment, the duties and other responsibilities of the board are usually described in a *Corporate Governance Charter*. This charter serves as a corporate governance code for the company. The existence of this charter shows a company's awareness of the importance of corporate governance. In Russian companies, a development of an own charter is still quite uncommon. The majority of companies rely on the *Corporate Governance Code*, developed by the FCSM. This code was compiled according to Western corporate governance standards, but as it is written in a recommendation form, it has no significant influence on Russian companies' behavior. The convenience of relying on a non-obligatory code, and the high costs of creating an own charter might be two reasons for lack of excitement in the introduction of the charters in corporations.

Nevertheless, the Russian oil sector is at the avant-garde of the corporate governance development in the region. YuKOS and Sibneft have published their charters in 2001 and 2002, respectively. Tatneft is expected to introduce a charter shortly. LUKoil considers issuing its charter in a near future as well. In their charters, companies describe the corporate governance structure and future goals. Like a corporate governance code developed by FCSM, these charters also resemble their Western prototypes: in content, as well as in structure. It can be expected that other oil conglomerates will also be eager to define more precisely the board of directors' role and to depict it in corporate governance charter.

Board and Shareholders

As previously mentioned, the board intends to solve a principle-agent problem. The principle in this problem, the shareholder, appoints the board to oversee the agent's (management's) activities. This means precisely that by exercising its controlling power a board tries to minimize agency-costs as much as possible and to protect shareholders' interests by being an intermediary between senior executives and shareholders (Li, 1994). The main reason for this being necessary is that the dispersed shareholders are unable to exercise control over the management by themselves (John & Senbet, 1998. p. 373). That is why the role of board of directors is extremely important in current Western corporations, where companies are usually publicly traded and have not just a few large stockholders but rather a lot of atomistic ones. Strong shareholders' control is seen as a sign of a *proactive* board. However, the situation is different in Russia, where large shareholders own and manage companies at the same time. Especially, this is true in the Russian oil sector, where privatization was affordable only for big players. In this way, the role of the board of directors has partially lost its importance.

Board and Management

To analyze the role of the board, it is important to understand the relationship between the board and the senior management. Managers are both main counterparts and main collaborators of the board. Their behavior is essential for the company and, theoretically, it is supposed to have a positive effect on the company's growth. However, managerial control is also the main characteristic of a *statutory* board, representing lack of board power. If managers are deviating from their duties as agents of shareholders and are focusing on their own needs, their actions might endanger both the financial and the corporate situations of the company. Efforts to build empires and willingness to sacrifice shareholders' returns for personal security are only some of the many possible malpractices of the top-management.

To solve the problem of managerial misconduct, disciplinary measures can be implemented to such managers. For this purpose, four various mechanisms exist: blockholders[8], the market for partial control[9], a debt policy[10], and the board

[8] Holding companies, industrial companies, families and institutions mitigate the problem of free riding in corporate control.
[9] If a company underperforms, able monitors can increase their voting rights to reach a control level allowing them to nominate a new management team.
[10] Creditor monitoring will be intensified in case of low interest coverage and low liquidity.

composition[11] (Renneboog, 2002). Thus, the board composition measure, which is one of the aspects of the board of directors' structure, is considered to be essential for an internal monitoring of the management. Moreover, this mechanism certainly plays a crucial role, when other tools are absent. In the circumstances of the Russian corporate environment, the blockholders mechanism is certainly relevant as well, since the Russian oil sector is featured by blockholders ownership. Accordingly, it can be argued that the board composition and the blockholders' involvement are two dominant disciplinary measures to be used. In some cases, when these measures are used on a continuing basis, the managers could even be suppressed by the dominant owners involvement. An example could be the TNK oil company, which is controlled by two dominant groups, Alfa-Bank and Access-Renova. These blockholders have strong representation on the board (31 percent for each) and thus make the management fully owner-dependent.

Sometimes, it is hard to draw a line between the board of directors' and the management's roles in a company; as Bowen (1994, p. 37) puts it: 'Boards always tend to fill management voids'. Although he describes a clear distinction between the board's concern ('policy and oversight functions') and the staff's concern ('responsibility for management and administration'), in practice, it is not easy to observe. Furthermore, Linowitz in the Handbook for Corporate Directors (1985) finds the additional ultimate similarity between directors and managers of the corporation. He claims that both groups possess a similar ability to respond correctly to the corporation's problems by producing right-time solutions.

One can distinguish between three different types of executive body systems (Table 10). As can be seen, the cooperation between a director (CEO) and an executive board is the dominant structure in the surveyed companies. The Surgutneftegaz is an exception, where the general director (simultaneously, a dominant owner) acts on behalf of the whole company representing its interests, concluding deals and issuing orders.

[11] A high-fraction of non-executives on the board and the separation of the functions of CEO and (non-executive) chairman increases the turnover of executive directors of under-performing companies.

Table 10. *Executive Body of a Public Company, as of 2002*

Management of the current activity of a public company is effected by:	Companies
General director	Surgutneftegaz
General director and Executive Board	LUKOIL, Sibneft, Tatneft, YUKOS, Rosneft
Management Organization or Manager	TNK

Note. From companies' data.

Board Committees

In order to understand whether the board has a say in the company's activities, it is worth to look at the board's work. The crucial controlling function, fulfilled by the board, is maintained through committees. These committees are constituted by the CEO and the board members, but managed by the board exclusively. Board directors have to be members of one or more of those committees in order to better execute their tasks. High number and efficiency of committees serve as an indicator of a *proactive* board.
The committees are a very recent development in Russian oil companies (Table 11). Therefore, they are not yet globally introduced and their importance is often underestimated.

Table 11. *Number of Committees per Board, as of 2002*

Average	2
Median	1
Range	1 to 4

Note. From companies' data

Audit Committee

To be traded on the New York Stock exchange is a dream of all companies, large and small. Russian oil companies, which were privatized or established just recently, have this dream, too (Brancato, 1996). Therefore, they need to be careful with their financial methods and need to follow the requirements of foreign stock exchanges. One of these requirements is the existence of an audit committee in the company.

The audit committee is the most effective of committees. Its main responsibility is to oversee both inside and outside auditors and the management, and to review the company's financial reports and filings. It has also a written charter as one of its functions.

Audit committees are established on the boards of all Russian oil companies. They are probably the most active among committees, because all public companies are obligated to provide accurate financial reports (according to GAAP and IAS)[12], in order to be traded on the foreign stock exchanges. Therefore, this committee usually consists of specialists in this area.

Nominating Committee

Ward (1996, p. 226) refers to a nominating committee as to one, which selects candidates for the board.

There are only two companies, which established this kind of committee for their boards (YuKOS and Sibneft). However, even in these companies, it is doubtful whether their committees are influential, because the controlling private owners and the CEO actively recruit and select candidates. A similar pattern can be observed in many Western companies as well (Foster, 1982).

Compensation Committee

One of the board responsibilities is to fix an executive stock compensation, salary, and benefits for top-managers. This task is usually executed by the compensation committee. Because of the nature of the task, the main decisive body of this committee should consist of outsiders.

Most companies do not disclose their compensation policy. Despite the fact that the FCSM obligates companies to publish this information, companies prefer not to do so since the fines are very low. According to Troika-Dialog (2002), most companies either reveal the compensation details only to shareholders at the annual meetings or simply ask

[12] GAAP – General Accepted Accounting Principles; IAS – International Accounting Standards

them to approve a lump sum. The goal of a compensation committee, therefore, is to achieve higher transparency of the salary policy.

Besides for the need for transparency, the compensation committee is responsible for developing a stock option compensation system. This system is still not implemented in the majority of Russian companies. As Russian financial markets will gradually become indicators of companies' performance, stock options will start to play a more important role as a compensation mechanism. For these two reasons a strong compensation committee is or will be required for every Russian company. In the Russian oil sector, YuKOS and Sibneft have already introduced these committees as a part of regular board activities.

Corporate Governance Committee

Currently, when competition between companies is intense, parameters for judging company's performance include not only financial measures, but also level of corporate governance. The introduction of a corporate governance committee is necessary to further improve and refine the corporate culture of a company.

According to Johnson et al (1993, p. 3) the corporate governance committee has three main functions. First of all, it is responsible for the organization and structure of the board. Second, the committee is in charge of setting qualifications for director candidates. Finally, it has to analyze whether the board and its committees are effective in implementing firm's corporate governance. Additionally, Ward (1996, p. 234) claims that 'shareholder liaison decisions and succession planning' should be functions of this committee as well.

In emerging corporations, to which the Russian oil firms belong, this committee is a necessity of each board. However, only the Russian oil giant YuKOS possesses a corporate governance committee. Even in the case of YuKOS it is questionable whether the committee really makes decisions concerning corporate governance of the firm or whether all requirements are simply dictated by local and foreign stock exchanges.

The presence of a corporate governance committee is still rare not only in Russian companies, but in the US companies as well, where according to 2001 Korn/Ferry's board study only about 46 percent had this committee.

Minority Shareholders Committee

The main task of this committee is the protection of minority shareholders' rights. The role of this committee in Russian business environment is extremely important, because companies usually belong to large shareholders, and so, the rights of minority shareholders are being abused. Although only one company, Sibneft, has introduced the minority shareholders' committee on its board so far, this can be seen optimistically as the first sign of concern with minority shareholders' rights (Table 12).

Table 12. *Board Committees*

	Audit	Compensation/Human Resources	Corporate Governance	Nominating	Minority Shareholders	Strategic Planning
2002	100%	29%	29%	29%	14%	0%
1998	43%	0%	0%	0%	0%	0%
1993	0%	0%	0%	0%	0%	0%
LUKoil	x					
Sibneft	x	x	x	x	x	
Surgutneftegaz	x					
Tatneft	x					
TNK	x					
Rosneft	x					
YuKOS	x	x	x	x		

Note. From companies' data.

Strategic Planning Committee

The strategic planning committee defines the strategic goals and objectives of the company and also determines its operational priorities. Also members of strategic planning committee develop recommendations on the dividend payment policy and evaluate the long-term productivity of the company's operations. This type of board committee has not been yet introduced in the Russian oil sector, despite the fact that it is recommended by the Russian Code on Corporate Governance (2002, p.35).

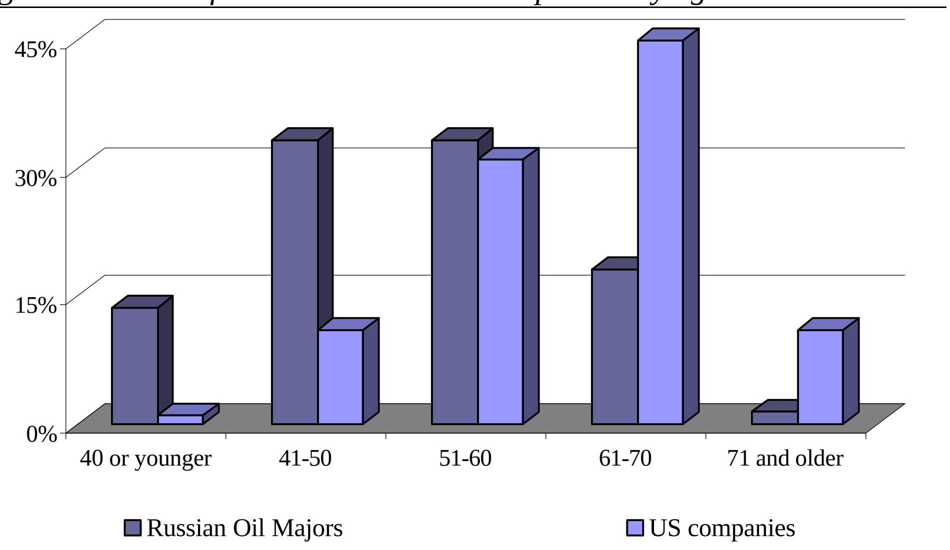
Board Members

Director Age Distribution

The age distribution in the Russian oil companies' boards provides interesting findings. First of all, it elucidates how the young outside managers-owners replaced the *oil generals*, the senior managers from the Soviet time.

I was able to determine the age of 72% of the directors of the 7 companies studied, where the average and median age is 51 and 52, respectively. There is a remarkable difference in the age distribution between the Russian oil companies and the Western companies. According to the 2001 Korn/Ferry study, in the United States the board members tend to be much older so that the age group of 40 and younger is almost not represented (Figure 5). An explanation for the age distribution could be the fact that Russian oil companies' boards are elected by a small group of blockholders who are relatively young themselves (Table 1), whereas in the United States the boards' members usually represent certain groups of shareholders who elect them based on expertise.

Figure 5. *Boards of US and Russian oil companies/ by age distribution*



Note. From Korn/Ferry Boards Study, 2001; and companies' data.

Place of birth

Here, the data show some interesting results as well. About 45 percent of all board' members were born in villages (Table 13). In my opinion, the logic behind this data is, that those villages were located in main oil regions of Russia, like Western Siberia and the Republic of Tatarstan, so that the oil sector offered an almost sole career opportunity.

Table 13. *Place of Birth, as of 2002*

Location	Percentage
Village	45%
Small Town	14%
Midsize Town	16%
Large city	5%
Capital City	5%
Abroad	16%

Note. Amirov, A. (1999). *Kto est' kto v mire nefti I gaza Rossii*, 1999 [Who is who in the World of Oil and Gas of Russia, 1999]. 2nd Edition, Moscow: Panorama.

Education

A further distinctive characteristic of the board members is the high level of education. A high percentage of the board members earned a PhD or a similar academic degree. Some board members have not only specialized in the chosen professions, but also have achieved a complementary degree in *Business Administration* during the post-Soviet period (Table 14).

Table 14. *Education of Board Members, as of 2002*

Education	Percentage
Mining/Geology engineer	44%
Engineer	32%
Lawyer	3%
Economist/Management	24%
Liberal Arts	3%
Other sciences	3%

Note. Amirov, A. (1999). *Kto est' kto v mire nefti I gaza Rossii*, 1999 [Who is who in the World of Oil and Gas of Russia, 1999]. 2nd Edition, Moscow: Panorama. The total percentage is more than 100 due to two or more degrees earned by some board members.

It is interesting to mention that more than half of the board members earned their degrees in Moscow universities (Table 15). Apparently, this facilitated the establishing of first business contacts, which have led to an active involvement in oil companies during the privatization time[13].

Table 15. *Location during Professional Education, as of 2002*

Location	Percentage
Moscow	53%
Other Russia	18%
Other Reps	22%
Abroad	16%

Note. Total is more than 100% because few members studied in different places.

The high level of education is especially remarkable when the career paths of average members are observed. The oil industry is a rather complicated field, where expertise plays a crucial role. Thus, it is no wonder that the majority of board members are experienced employees of the oil sector, who have climbed the hierarchical ladder all the way from the bottom to the top. Some of them bought out the company, which they have worked for (Alekperov from LUKoil and Bogdanov from Surgutneftegaz), and some earned the privilege to be among the senior management of the company (like Golubev from YuKOS and Poltorak from Sibneft). This state of things reminds strongly of the Japanese corporate governance system, where each employee is committed to work hard for his/her company with the expectation to be eventually promoted to managerial positions.

Director Residency

The majority of board members (92 percent) are residents of Russia. Most of the members live in Moscow. The number of board members who are Moscow residents has significantly risen compared to the first post-privatization years (Table 16). This could be explained by the re-dislocation of the main companies' offices from the production regions, mainly in Siberia, to the state capital, Moscow. Board's members of two companies build exceptions: Surgutneftegaz (SNG) and Tatneft. The first, Surgutneftegaz, claims that the reason is its political non-involvement symbolized by the

[13] The focus is on the managers/owners of the oil companies

distant location from the political epicenter. The second, Tatneft, is a regional major and is strongly tied to the government of the Republic Tatarstan whose representatives sit on the board (33 percent of all board members).

Table 16. *Breakdown of Director's Area of Residence*

Location	Percentage of Directors
Moscow	60%
Siberia and other Russia	16%
Other Republics (mainly, Tatarstan)	16%
United States	5%
Europe	3%
Russian residents	92.5%

Note. From companies' data.

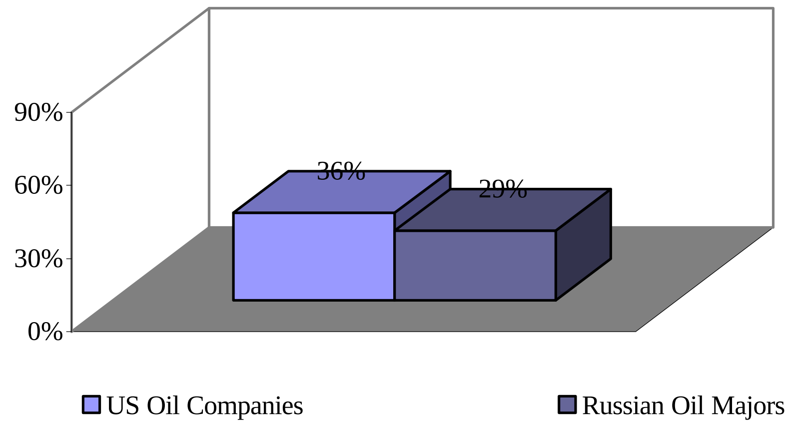
Further increase in the number of Moscow residents can be expected since the majority of company's shareholders reside in the capital as well. Also the headquarters of main customers and investors are located in Moscow (Lavrentieva, 2001, p. 13).

Gender

It is worth to note on the gender composition of the board. There are only two female boards members out of 79 members surveyed (2.5 percent). YuKOS, always more Western-oriented, hired a foreign independent female director. Sibneft's female board member, on the contrary, is an insider, an auditing expert. A few years ago Sibneft had two female board members, which was the first and only time in the Russian business practice.

The gender issue is an alarming one in the Russian companies. Women still hold significantly less high-ranking positions than men do, and their salaries are lower (Expert, 2002). However, the gender composition of Russian oil companies' boards is only slightly different from that of the American ones (Figure 6). This shows that the gender issue has not been overcome even in more developed countries.

Figure 6. *Companies with at Least One Female Director, as of 2002*



Note. From companies' data and Korn/Ferry 2001 Study.

Board Size

The average number of directors of Russian oil companies is 11 (Table 17). The US oil companies' average board consists of only 8 members, which is considered to be the optimum for the oil sector. Some companies, however, consistently disregard the Western tendency for a smaller board and, sometimes, even increased the board size. The TNK board, which grew from 9 to 13 members, serves as a perfect example.

Table 17. *Number of Directors on a Board, as of 2002*

Average	11
Median	10
Range	9 to 15

Note. From companies' data.

Director Share Ownership

A usual practice in developed countries is that board members possess a stock of their companies. Stock options and other stock-based compensations seem to be an appropriate incentive for a better performance of board members.

The Russian situation is quite different. First of all, there is no tendency to motivate board members by monetary compensations. Second, the real owners of the companies prefer not to proclaim that they own the company's stock because of political or other considerations, such as the public opinion. Thus, Russian companies' blockholders generally hide behind nominees or trustees, aided by regulations which do not require disclosure beyond direct owners (Troika-Dialog, 2002). These core shareholders often have seats on the boards. For these two reasons, the percentage of the boards' members, who own shares, is officially very low (Table 18) compared to an average American company with 90 percent of directors owning or controlling shares of the company. However, it can be assumed that the numbers will be different, when the owners disclose their identities. Additionally, an understanding of the importance of the stock-based compensation will positively affect the situation. There are already exceptions in the ownership disclosure policy. YuKOS and LUKoil have recently announced their beneficiary owners[14].

Table 18. *Percentage of Directors who own and control shares*

2002	18%
1993	0%

Note. From companies' data

The Role of the Board Chair

The board chairman plays an essential role in the creating and leading of an effective board. He represents the board before the state authorities, the management and shareholders of the company. It is, therefore, important that the elected chairman is a person, who can align the interests of all aforementioned parties.

Because of its financial credibility the Russian oil sector is strongly politically involved. Therefore, it makes sense that three out of seven boards surveyed have state representatives as chairmen of their boards, since it helps the enterprises to avoid unnecessary conflicts with the state. It is worth mentioning, that the only company, that has the non-executive director acting as board chairman, is the company with the most undeveloped corporate governance structure, Surgutneftegaz (Table 19). Despite the fact that it is a common practice in the West, that the board chairman is not a CEO of the

[14] Six individuals control 58.3% of YUKOS and seven senior executives of the LUKoil group own 21% of the company.

company, in the two oil giants YuKOS and Sibneft chairmen of the boards are the ex-SEO and the SEO of the companies, respectively.

Table 19. *Who are the Board Chairs? as of 2002*

Position	
Outside Director	14%
Major/significant shareholder	14%
Former/Current SEO of the company	29%
Representative of Federal/Regional Administration	43%

Note. From companies' data.

Director Compensation

The directors' compensation is still a taboo issue among most Russian companies. Three Russian oil companies, however, have recently improved on their corporate governance policies by revealing the related information (LUKoil, YuKOS, Sibneft). It showed that board members' compensation plays only a symbolic role and provides no incentive for a better member performance. The directors' cash compensation is equal to $10,000 in case of YuKOS and to zero for the outside non-executive directors in the case of LUKoil[15]. Stock-based compensation is still not introduced.

Board Sponsors

Board composition serves as one of the internal control mechanisms for monitoring the company's management. Thus, it is extremely important to analyze the board composition in order to determine whether the control mechanism is effective in the case of the Russian oil companies and to see the degree of insiders' influence on the corporate policy (Troika-Dialog Research, 2002, p.33).

Various distinctions exist in the board structure. First of all, one can distinguish between the firm's top managers and the outside directors who sit on the board (Table 20). The roles of insiders (employees) and outsiders depend on their participation in the

[15] According to Troika-Dialog (2002) these directors are exempted from any 'losses incurred as a result of any action that relates to the performance of their duties as directors'.

firm ownership. This distinction makes them behave differently and have different incentives.

Table 20. *Board members' classification*

➢ Insiders:	➢ Managers ➢ Managers/blockholders	
➢ Outsiders:	➢ Independent ➢ Interested:	 ➢ Blockholders ➢ Affiliated

Second, the outsider group could be divided into two subgroups: interested directors (independent from management, but have ties with a controlling owner) and independent non-executive directors (outside directors which have no relationship with management or controlling owners). The independent directors are the most valuable members of the board, since their independent power will be used for protection of shareholders' interests (Alonso, Pelenzuela and Itturiaga, 2000).

Third, the group of interested directors consists of the affiliated directors (non-employee directors with personal or business relationship with the company) and the blockholders (those with special status because of their ownership proportion). Thus, there is an opinion that the board member who received his/her post because of a significant amount of shares possessed by him/her or his/her boss has interests "closely aligned with those of outside investors and different from the professional management's" ones (Demsetz & Villalonga, 2001, p. 214).

It is common in the economically developed countries that insiders have a minor presence on the boards of big corporations since one of the board's duties is to monitor their (insiders') performance. Nevertheless, the management's presence on the board is necessary, because they add efficiency to the board's work by explaining the top management's rationale. Having insiders on the board probably also solves the information asymmetry problem[16], and consequently improves the decision process (Baysinger & Hoskisson, 1990, p. 77). But in some cases board's members-managers are

[16] The main idea behind the information asymmetry theory, that some participants of the market usually lack information, which is needed for making correct decisions.

not willing to share information with other members of the board and, thus, outsiders lack information needed to be truly effective in controlling decisions.

The results of the board composition in Russian oil companies are quite interesting. The average percentage of inside directors on a board is four, which is twice as many as in the US companies (2001 Korn/Ferry Board Survey). Most of these managers are core shareholders of the companies as well so that they represent not only interests of the management, but also interests of large shareholders. The absolute leader with minimum insider members on the board is YuKOS, whose CEO solely represents its management team (Table 21). Only three companies have two independent board members each (LUKoil, Sibneft and Sibneft). All outside members of other companies are blockholders, including regional and federal governments, and persons affiliated with them.

Table 21. *Percentage of Inside Directors*

Company and its board size	Insiders	Blockholders among insiders:
Lukoil (11)	27%	100%
Sibneft (9)	67%	17%
SNG (11)	89%	13%
Tatneft (15)	33%	60%
TNK (13)	8%	0%
YUKOS (11)	9%	100%

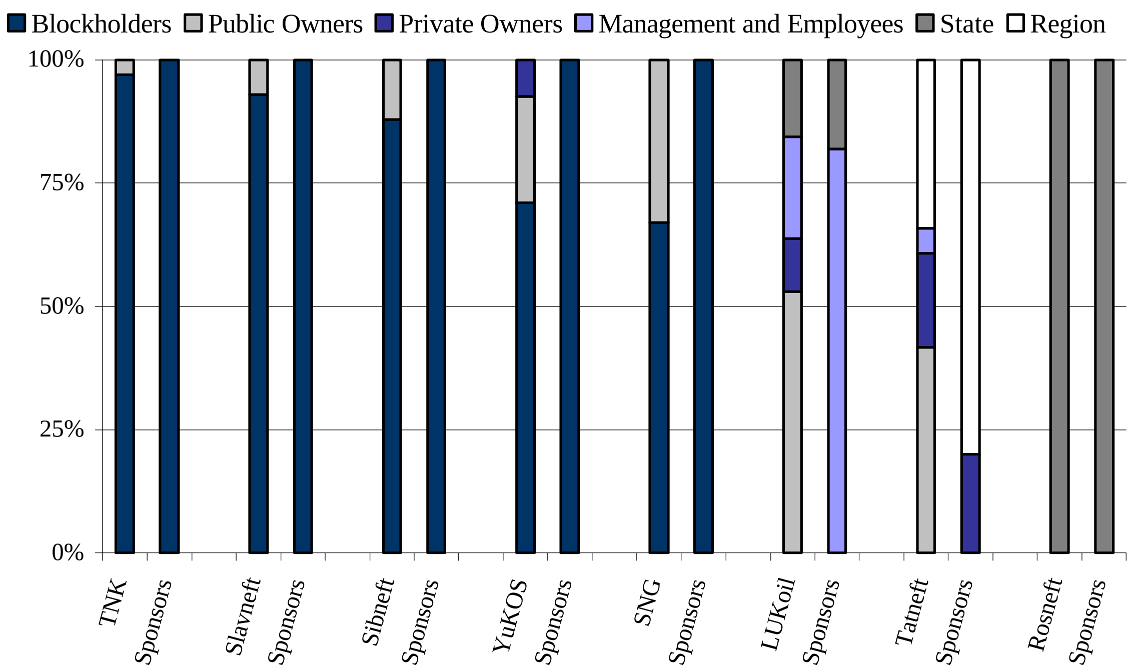
Note. Companies' data & www.plink.ru/togis

This fact can be proven by investigation of the distribution of sponsor groups. These groups, which are core shareholders of companies, are basically controlling the nomination of board members. Therefore, it can be expected that their nominees will represent sponsors' interests on the board. Being dependent on their sponsors, the elected board members are not able to eliminate the negative effects caused by managers-owners (Cowen, 1993, p. 3). From Figure 7 one can infer that the core shareholders[17] closely monitor the board activities and that interests of public owners are often ignored. Especially large groups of shareholders are disregarded in LUKoil and Tatneft, where

[17] For this analysis it is expected to relate regional and federal governments in the core shareholders' group

managers and the regional government elect almost all board members. In such a situation, the main duty of the board, the protection of the rights of all stockholders, becomes an extremely complicated and almost impossible task.

Figure 7. Ownership structure and board members' sponsors, as of 2002



Note. From companies' data and Troika-Dialog Research (2002).

Conclusion

After an exhaustive analysis of the board features a conclusion can be drawn about the board of directors' and CEO's powers in the discussed companies. Consequently, each board is classified in terms of the Model of Power of Board of Directors and CEO.

Caretaker board

Sibneft's board of directors consists mostly of top-management (one of which is the CEO of the company) so that it has no power to make independent decisions without its agreement. Additionally, board's outsiders have close relationships with the controlling private owners. Thus, they always follow their will. Despite the fact that the corporate governance charter was recently introduced and several committees were established, the board's role is ultimately insignificant and its contribution not critical. The existence of a minority shareholders' committee might be the only advantage of Sibneft's board. However, its ability to protect the rights of the 12 percent minority shareholders remains questionable. Therefore, the board is classified under the *caretaker* category (Figure 8).

Statutory board

Surgutneftegaz (SNG) with all but one insiders on the board certainly possesses a *statutory* board type (Figure 8). The autocratic management structure gives the CEO unrestricted control. He is clearly the owner and the manager of this company, and he solely dictates company's development pattern. The CEO has successfully retained his power since the Soviet time and is not expected to give up this power in near future. Thus, the rights of a large group of public shareholders are totally disregarded while no internal or external controlling mechanisms for protecting them exist. To mollify public opinion, an outsider was chosen to be the chairman of the board of directors.

The managers and employees of LUKoil, led by the owner-CEO, have a strong influence on all board's activities. As a result, the board does not fulfill its role as the management's monitor. Although two foreign independent directors participate in the board and enrich its expertise, their zero compensation might point to a high level of affiliation with blockholders. Therefore, the public shareholders' rights are constantly ignored. The unique feature of LUKoil is the partial state's ownership of the company which somewhat reduces the influence of the CEO on the board. Thus, the Russian giant LUKoil has also a *statutory* type of board.

Table 22. *Russian oil barons, as of 2002*

Rank	Name	Net Worth ($bil)	Company	Age	Board Member?
26	**Mikhail Khodorkovsky**	8.0	YUKOS (**CEO**)	39	Yes
49	Roman Abramovich	5.7	Sibneft/RusAl	36	No
68	**Mikhail Friedman**	4.3	Alfa-Group/TNK	38	Yes
147	**Viktor Vekselberg**	2.5	TNK	45	Yes
329	**Vagit Alekperov**	1.3	LUKoil (**CEO**)	52	Yes
386	Leonid Nevzlin	1.1	YUKOS	43	No[18]
386	**Evgeny Schvidler**	1.1	Sibneft (**CEO**)	38	Yes
427	Mikhail Brudno	1.0	YUKOS	43	No
427	Vladimir Dubov	1.0	YUKOS	45	No
427	Platon Lebedev	1.0	YUKOS	46	No
427	Vasily Shakhnovsky	1.0	YUKOS	45	No
427	**Vladimir Bogdanov**	1.0	SNG (**CEO**)	51	Yes

Note. Adapted from The World's Billionaires. (2003, March 17). *Forbes*, 122-140.

The CEO of YuKOS, Mikhail Khodorkovsky, is the absolute leader among Russian billionaires and one of the most influential people in Russia (Table 22). His authority is unchallengeable to a degree that he can afford to be the only insider on the board of the company. Although this structure superficially satisfies the standard requirements of an optimal board, the CEO remains the one nominating board members so that the so-called outsiders are strongly affiliated with owners-managers. Therefore, YuKOS' board is included in the *statutory* type of board. However, several positive developments should be mentioned, such as the existence of a corporate governance committee in the list of the board's activities and company's participation in the WEF[19], which demonstrate awareness of the importance of corporate governance. The willingness of the CEO and other shareholders to partially give up control in exchange

[18] Mr Nevzlin is former member of the board of director.
[19] WEF - World Economic Forum, whose members follow its developed corporate governance principles.

for additional investments into the company is also worth mentioning. If the CEO's attempts to align his interests with those of outside shareholders continue, YUKOS' board has a tangible perspective to rise up to a more sophisticated type of board.

Proactive board

Since the board of Rosneft consists of a mix of top-managers and state representatives with veto right in all management decisions, the board possesses unlimited power, so that the management of the company is practically not involved in the planning of long-term strategies and can only partially serve as a counterpart to the board. Thus, Rosneft, the last state-owned Russian oil major, certainly has a *proactive* board.

A similar situation can be found on the board of Slavneft, which was recently acquired by two Russian oil companies, Sibneft and TNK, so that the board is totally controlled by them. Despite the fact, that the board has an unlimited control over the company, which makes it *proactive*, it only acts on behalf of core shareholders. As a result, the minority shareholders' rights are disregarded.

TNK has a relatively strong CEO, whose expertise is highly valued among Russian oil managers[20]. He plays a significant role on the board and strongly influences its activities. Otherwise, the board consists of representatives of two groups of core shareholders, Alfa-Bank and Access-Renova. These blockholders come to protect their rights by activating the board as an internal mechanism of control. Thus, TNK possesses a *proactive* type of board. Unfortunately, the board is only concerned with those two groups, so that a small group of minority shareholders remains with no protection.

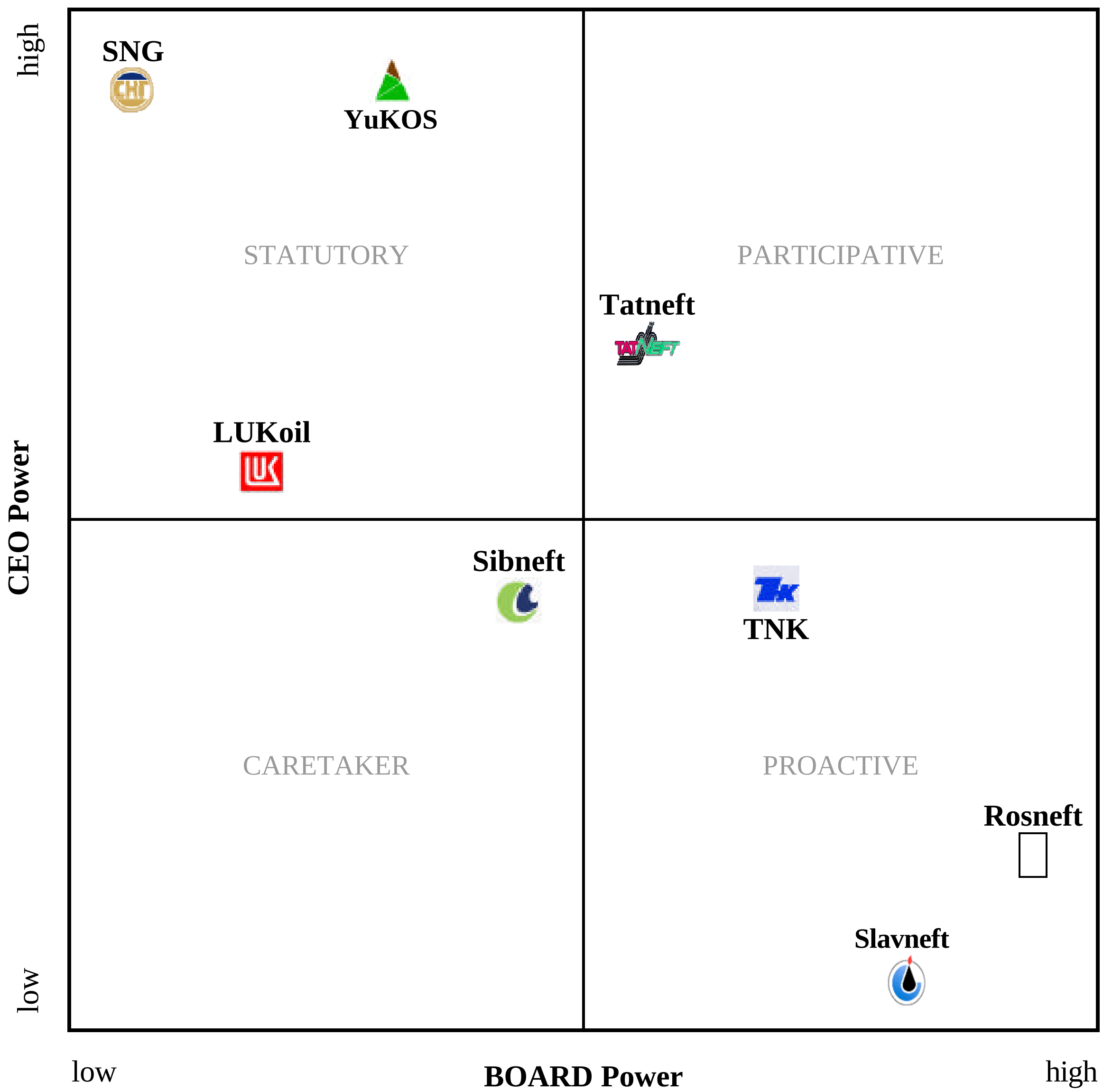
Participative Board

Being partly controlled by the Republic Tatarstan, the board of Tatneft has a strong impact on the management's behavior. The CEO, who is a controlling private owner of the company as well, shares common interests with the regional government in

[20] Simon Kukes, CEO of TNK, was elected to the YuKOS new board of directors.

the further development of the company and the region. The outsiders' presence on the board is relatively strong. The company's stock is actively traded abroad, and Tatneft developed the *Corporate Governance Charter*. Although for aforementioned reasons, the regional major Tatneft belongs to the *participative* boards' group, there are still serious shortcomings in the board's activities. Since public shareholders are not represented on the board, they have no say in the company's decisions and are in no way protected against management's malpractices.

Figure 8. *Typology of boards of Russian oil companies*



Only Tatneft managed to develop its corporate governance structure to the level, where it would be considered to have a participative board. However, some of the aforementioned developments let hope that several companies stand on the right path (especially, YuKOS and LUKoil), that will set an example for oil companies, in particular, and for other Russian enterprises, in general.

Additional Observations

It is necessary to say, that the companies' assignment to board categories is somewhat artificial, since many companies are located on the border of categories (especially Sibneft) and, therefore, could undergo a transition at any moment. The companies' positions should not be seen as static and permanent, but rather easily changeable and changing.

Generally, an interesting trend can be observed in companies' clustering with respect to board and CEO powers. Most of the companies either possess an extremely strong board (TNK, Rosneft and Slavneft) or an influential CEO (SNG, YuKOS and LUKoil). Only in few companies the powers are balanced (Tatneft and Sibneft). The difficulty with finding the optimal balance goes back to the initial point that the Russian corporate governance is still in its developmental stage. The trial and error will with a bit of luck eventually lead to collegiality and shared leadership between board and CEO.

Discussion

Limitations of the Current Study and Suggestions for Future Research

I would like to mention some limitations of the current study. The first obstacle is the extreme scarcity of data available for the analysis of Russian oil companies. This fact goes back to the generally low transparency of the companies and their unawareness of the common practice in publicizing company's activities and performance. The second and more severe obstacle is the unwillingness of companies' managers and core shareholders to make certain information public. This restrictive disclosure policy is due to the objectionable nature of the information, as was mentioned earlier regarding ownership structure and compensation policies. Therefore, even when contacted for information, companies often react with suspicion and give negative responses. Additionally, I found a theoretical limitation of the model of Power of CEOs and Boards of Directors for application in the Russian economic reality. As mentioned in the analysis, all companies consistently disregard the interests of public shareholders. However, protection of those interests is not built into the model as a measure of corporate performance. Since the model ignores this important feature, it lets some companies appear more successful in managing their corporate governance. Others, on the contrary (for example, Sibneft), which are trying to protect the minority shareholders, only received a comparatively low ranking.

For further research on this topic, a field research would be required. Board members could be surveyed about characteristics and structure of their boards. The survey should include following board characteristics: independence, expertise, role involvement and ethical standards of board members. For aforementioned reasons, such a survey might not be realizable in near future.

Future Prognosis

At the moment the Russian boards seem to be similar to those of Western companies. Two explanations can be given. New Russian oil companies with only 10-15 years of existence have chosen not to develop a completely new board of directors' structure, because its quality and functioning would be questionable. Rather, they decided to take an example on developed countries and to adapt their corporate governance structure, including the role of the board of directors. As a result, the Russian boards strongly resemble their Western prototypes in terms of created committees and duties assigned to board members. However, a different explanation exists as well. Russian oil companies pursue a deliberate goal by imitating the Western corporate governance structure, in general, and the board's structure, in particular. This goal is to receive additional investments from foreign capital markets, whose participants are extremely sensitive to fulfillment of corporate governance requirements. This approach is called "capitalization on the benefits of good corporate governance" (Troika-Dialog Research, 2002, p. 9). The success of the approach is demonstrated by several examples, when Russian oil companies were able to issue the ADRs and Eurobond programs (Tables 7 and 8) after changing their corporate governance structure. In this way, it becomes questionable, whether the improved corporate governance structure will be retained, or will be changed back to the old one, once foreign capital has already been granted.

Therefore, two different predictions for the future are possible. If Russian oil companies can completely affiliate themselves with the Western world and adopt its corporate culture within a short period of time, their boards will eventually become identical with their Western prototypes. However, the opposite could occur as well if Russian companies are not able to rise above their historical background and the unique 'owners-managers' structure. In this case, the board members would entirely dependent on the top-management so that their role will be decreased to simple paid employees. I think I was able to demonstrate with my data that the first scenario is more likely to take place because the appearance of board committees in Russian companies could be seen as a sign for the managers' final realization of the use of board members' expertise and knowledge. Therefore, managers seem to be willing to give over tasks to the board members and, in that manner, to involve them in the companies' activities. This new tendency can be explained by the managers' acceptance of the new board's role. Certainly, the international interdependence and the process of globalization will also support this development.

References

Almazan, A., and Suarez, J. (2000, February). Optimal Corporate Governance Structures. *CEPR Discussion Paper*, 2391.

Alonso, P., Pelenzuela, V. and Itturiaga, F. (2000). *Corporate boards in some OECD countries: size, composition, committee structure and effectiveness.* Research Paper, University of Valladolid, Spain.

Amirov, A. (1999). *Naibolee Vlijatel'nye predprinimateli Rossii, 1999 [The most influential businessmen of Russia, 1999].* Moscow: Panorama.

Amirov, A. (2002). *Kto est' kto v mire nefti i gaza Rossii, 2002 [Who is who in the World of Oil and Gas of Russia, 2002].* 3rd Edition, Moscow: Panorama.

Anderson, C. A. & Anthony, R. N. (1986). *The New Corporate Board.* New York: Wiley.

Aukutsionek, S. (1997). Surveys of Industrial Enterprises in 1996: Results and Forecasts. *The Russian Economic Barometer*, 6(1), 3-7.

Aukutsionek, S., Filatchov, I., Kopelyushkov, R., & Zhukov, V. (1998, December). Dominant Shareholders, Restructuring and Performance of Privatized Companies in Russia: An Analysis and Some Policy Implications. *Communist Economies & Economic Transformation*, 10(4), 495-519.

Baysinger, B. and Hoskisson, R. E. (1990, January). The Composition of Boards of Directors and Strategic Control: Effects on Corporate Strategy. *The Academy of Management Journal*, 1(2), 72-87.

Bim, A. S. (1996, December). Ownership and Control of Russian Enterprises and Strategies of Shareholders. *Communist Economies & Economic Transformation*, 8(4), 471-501.

Blasi, J., Kroumova, M. & Kruse, D. (1997). *Kremlin Capitalism.Privatising Russian Economy.* Ithaca and London: Cornell University Press.

Bowen, W. G. (1994). *Inside the Boardroom: Governance by Directors and Trustees.* New York: Wiley.

Brancato, C. K. (1996). *Getting listed on Wall Street: The Irwin guide to financial reporting standards in the U.S.* Irwing: Professional Publishing.

Brown, A., Kaiser, M. and Smith, G. B. (1994). *The Cambridge Encyclopedia of Russia and the former Soviet Union.* Cambridge University Press.

Considine, J. I. & Kerr, W. A. (2002). *The Russian Oil Economy*. Cheltenham: Edward Elgar.

Conte, F. (1994). *Great Dates in Russian and Soviet History.* New York: Facts on File.

Corporate Board and Corporate Governance. (1993).*The Conference Board* (Report Nr. 1036). New York: Bacon, J.

Cowen, S. S. (1993). Board of directors as strategy. *Journal of general management,* 19(2), 1-13.

Demsetz, H. & Villalonga, B. (2001, September). Ownesrship structure and corporate performance. *Journal of Corporate Finance,* 7(3), 209-233.

Evenko, L. I., Konstantinov, G. N. & Filonovich, S. R. (2000, September). Corporate Governance: International Experience and Russian Realities. *Working Paper Nr. 1,* Russia-Canada Corporate Governance Program, Shulich School of Business, York University, Toronto, Canada.

FCSM. (2001). *Corporate Governance Code*. Retrieved May 21, 2003 from: www.ricd.ru

Fortescue, S. (1998, May). Privatization, corporate governance and enterprise performance in Russia. *Bulletin*. CERC: University of Melbourne. 15 pp., from www.cerc.unimelb.edu.au/bulletin/bulmay98.htm

Gorst, I. (1996, February). Oil Industry Provatisation, Russian Style. *Petroleum Economist*, 52/2, 3-4.

Gurkov, Igor. (1998, June). Ownership and Control in Russian Privatised Companies: New Evidence from a Repeated Survey. *Communist Economies & Economic Transformation*, 10(2), 259-271.

Investor Protection Association, Managers Association and Center for International Private Enterprise. (2001). *The Role of Independent Directors in Russian Enterprises.* Moscow: Russia.

Ivashov, A. & Kravchenko, Y. (2001, November-December). Dangerous Games. *Business in Russia,* 118, 12-13.

John, K. and Senbet, L.W. (1998, May). Corporate Governance and Board Effectiveness. *Journal of Banking and Finance,* 22(4), 371-403.

Johnson, R., Hoskisson, R. and Hitt, M. (1993, summer). Board of Director Involvement in Restructuring: The Effects of Board versus Managerial Controls and Characteristics. *Strategic Management Journal,* 14(Special Issue), Corporate Restructuring, 33-50.

Khairullin, I. (2000). *Kto est kto v Respublike Tatarstan [Who is who in the Republic of Tatarstan]*. Kazan: Tatarskoe gazetno-zhurnalnoe izd-vo.

Khartukov, E. (1997, February). Bankers becoming new masters of oil companies. *Petroleum Economist*, 64/2, 6-9.

Khartukov, E. (2002, May 27). Russia's oil majors: engine for radical change. *Oil & Gas Journal*, 20-33.

Kolomiets, A. (2001). Finansovye Reformy Russkih Tsarei. Moscow: Zhurnal Vorposy Ekonomiki.

Korn/Ferry International. (2002). *28th Annual Board of Directors Study 2002.*

Krjukov, V. (2002). Kto v Neftjannom dome khozyain? [Who is an owner in oil business]. *EKO,* 5-20. Moscow.

Kuznetsov, A. & Kuznetsova, O. (1996, November). Privatisation, Shareholding and the Efficiency Argument: Russian Experience. *Europe-Asia Studies*, 48/7, 1173-1185.

Kuznetsov, P., and Muraveyev, A. (2000-2001). Ownership Concentration and Firm Performance in Russia: The Case of Blue Chips of the Stock Market. *Acta Oeconomica,* 51(4), 469-88.

Lane, D. & Seifulmulukov, I. (1997). *The Transition from State Socialism in Russia: The Case of LuKOIL*. Judge Institute of Management Sc., WP 24/97, Cambridge: England.

Lane, D. & Seifulmulukov, I. Structure and Ownership. In Lane, D.S. (1999). *The Political Economy of Russian Oil (ed. by Lane, D.).* Maryland: Rowman and Littlefield Publishers.

Lavrentieva, V. (2001, December 10). Big Fish in Small Pond. *The Moscow Times,* 12-20. Retrieved June 15, 2003, from: http:/matov.narod.ru/eng/references/mt101201.html

Li, J. (1994, July/August). Ownership Structure and Board Composition: A Multi-country Test of Agency Theory Predictions. *Managerial and Decision Economics,* 15(4), 359-68.

Linowitz, S. M. (1985). The Corporate Governance and the Corporate Director. In Mattar, E. P & Ball, M. R. (Ed.), *the Handbook for Corporate Directors* (Ch. 2.2). New York: McGraw-Hill.

Liuhto, K. (2001). Russian gas and Oil Giants Conquer Markets in the West: Evidence on the Internationalization of Gazprom and LUKoil. *Journal of East-West Business,* 7(3), 31-72.

Metzger, B., Dean, R. N., Bloom, D. & Ratnikov, K. (2002). A new Russian revolutioin: Corporate governance reform. *International Financial Law Review.* London.

Misamore, B. (2003, February 5). *CSFB Global Energy Conference: YuKOS.* Retrieved June 1, 2003, from: www.yukos.com

Patrick O'Callaghan & Associates in partnership with Korn/Ferry International. *Corporate Board Governance and Director Compensation in Canada: A Review of 2001*. (2001, December). Vancouver, Canada.

Pearce, J. and Zahra, S. (1991, February). The Relative Power of CEOs and Boards of Directors: Associations with Corporate Performance. *Strategic Management Journal,* 12(2), 135-153.

Platonov, I. (2003). *History of Russia*. Retrieved June 10, 2003, from: www.magister.msk.ru/library/history/platonov/13peter2.html

Radygin, A. (1997, September 18-19). Corporate Governance through the banks: the experience in Russia. *Eleventh Plenary Meeting "Banks and Privatization"*. Rome. Retrieved May 1, 2003, from: http://www.iet.ru/special/oecd/Agp97en.html

Radygin, A. (2002, January). Corporate Governance in Russia: Constraints and Prospects. *Voprosy Ekonomiki*. 1, 101-25.

Reinsch, A. E., Lavrovsky, I. & Considine, J. I. (1992). *Oil in the Former Soviet Union.* Study No. 48, Calgary: Canadian Energy Research Institute.

Renneboog, L. (2002). Ownership, managerial control and the governance of companies listed on the Brussels Stock Exchange. CentER, Tilburg University. *Working Paper,* 93.

RICD, FCSM, ISMM and INVAS. (n.d.). *Structure and Activities of Boards of Directors of Russian Joint-Stock Companies.* Retrieved June 1, 2003, from http://www.ricd.ru

Seifulmulkov, I., and Lande, D. (1997). The Transition from State Socialism: The Case of LUKoil. *Working Paper 24/97*, Judge Institute, University of Cambridge, Cambridge. Business Strategies in Transition Economies.

Stern, J.P. (1987). *Soviet Oil and Gas Exports to the West: Commercial Transaction or Security Threat?* Energy Papers, 21. London: Royal Institute for International Affairs.

The World's Billionaires. (2003, March 17). *Forbes*, 122-140.

Troika Dialog Research. (2001, May). *Oil Sector*. Moscow: Mazalov, I.

Troika Dialog Research. (2002). *The Corporate Governance Initiative of the World Economic Forum: Changing Corporate Governance in Russia.* Moscow.

Troika Dialog Research. (2002, December). *Corporate Bonds.* Moscow: Kudrin, A.

Troika Dialog Research. (2002, October). *Corporate Governance Profiles – Long Crawl West.* Moscow: Krasnitskaya, E.

Ward, R. D. (1996). *21st century corporate board*. Wiley: New York.

White, S. (ed.), (1991). *Political Encyclopedia for the Soviet Union and Eastern Europe.* London: Longman.

(n.d.). (n.d.). *Neftegazovij kompleks Rossii: tekuschee sostojanie, rol' I interesy v Rossijskoi politike [Oil and Gas Russian complex: current situation, role and interests in Russian politics]*. (2002). Analytic report. Retrived June 20, 2003, from www.expert.ru

Following websites have been used:

www.corp-gov.org, www.LUKoil.ru, www.ricd.com, www.rosneft.ru, www.securities.com, www.sibneft.ru, www.slavweb.com, www.surgutneftegaz.ru, www.tatneft.ru, www.tnk.ru, www.yukos.ru, www.expert.ru, www.public.ru www.mars.acnet.wnec.edu/~grempel/courses/wc2/lectures/petersrussia.html