

Russian Mass Privatization: What Has Been Achieved?

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In countries of the former Soviet bloc, the economic aims of industrial privatization beyond mere ownership change include shifts in managerial strategies to reflect market imperatives and ultimately to improve enterprise performance. New strategies involve business turnaround, at first through retrenchment, or reactive restructuring. When stability is achieved, second-stage strategies involve long term, deep restructuring in a recovery phase, involving investments in new products and processes. Extensive research on Russian privatization has so far yielded little evidence of progress in these respects, but ignores the important, counterfactual question, 'What would have happened without mass privatization?' For a realistic evaluation of Russian reforms and their consequences, comparisons are made with Belarus, another former republic of the USSR, with some political and economic reforms but hardly any privatization. This comparison indicates that privatization in Russia has been a relative success.

I. INTRODUCTION

The break-up of the USSR after 1991 was followed by extensive economic reforms in most republics and countries of the former Soviet bloc. In Russia itself, prices were substantially liberalised, more openness to international trade and capital flows was achieved, and the State gradually withdrew from playing a dominant role in the governance of industrial enterprises. In particular, the privatization of Russian industry gradually accelerated after 1992, with the exception of certain 'strategic' firms in the defence and natural resource sectors. By the beginning of 1997, 123,000 formerly State-owned enterprises had been privatized, and about 70% of Russia's GDP was accounted for by the private sector, according to the European Bank for Reconstruction and Development (EBRD), 1997, p195. Budget constraints have hardened somewhat with the withdrawal of the State as lender-of-last-resort, new private

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business start-ups have proliferated and a new breed of Russian entrepreneurs is emerging (McCarthy et al., 1997).

At the same time, however, many changes in Russia appear to have been superficial. Although the natural resource-based sectors have spawned over two hundred quoted companies on the Russian Trading System, and competition in many markets is fierce between new private companies, especially outside the manufacturing sector, in other areas progress has been slow. The EBRD (1997, p15) describes Russian State credit and subsidy policy towards industry as only 'moderately tight', and although bankruptcy legislation has been introduced, enforcement has been weak. The 'unofficial' economy still is estimated to be 41.6% of Gross Domestic Product (EBRD, 1997, p74), and shares in privatized firms, as the result of a 'giveaway' share distribution, mostly have fallen into the hands of incumbent enterprise managers and other employees rather than outside investors (Filatotchev et al., 1996). Although outsiders often can overcome barriers to share trades imposed by enterprise incumbents, a number of studies of Russian privatized firms have failed to identify any significant improvement in their performance that can be attributed to outside ownership and improved corporate governance (Filatotchev et al., 1996, Blasi et al., 1997, Earle & Estrin, 1996).

Although some reactive, short-term restructuring has been found in privatized firms as they have reduced employment and capacity (Filatotchev et al., 1996, Earle & Estrin, 1996), there has been no significant increase in investments in privatized firms to achieve deeper restructuring, and in particular, no significant inflow of foreign capital for direct investment (as opposed to portfolio investment).

For example, in the period 1989-95 Russia had cumulative inward foreign direct investment (FDI) of US\$3,900 million (mostly in the natural resource sectors) while China attracted \$121,700 million (International Bank for Reconstruction and Development, IBRD, 1996a, p64). Even in per capita terms, Russia in 1995 attracted FDI of \$1.10 per person compared with \$18.20 for China (United Nations Conference on Trade and Development, 1997, pp348-350). In terms of foreign trade, China's total 1995 exports were \$149,000 million of which 81% were manufactured goods (IBRD 1996b, p110), while Russia exported \$81,000 million, mostly raw materials and fuels, with machinery and manufactured goods providing only 8% (EBRD 1997, p65).

In other words, compared with China, Russia's economic reforms have failed to attract foreign investment and consequently have failed to produce a manufacturing sector that can compete significantly on world markets.

A gloomy outcome indeed at a national level for Russia, but what if privatization never had happened or had been more half-hearted, and what would have been the situation at the enterprise level?

These important, though hypothetical, questions imply the counterfactual analysis identified with Fogel (1964). It is impossible to answer them with any econometric authority, given the number of uncontrolled variables involved, but it is possible to make informed judgements by using comparisons between Russia and a country like Belarus. Belarus was also a republic of the USSR, sharing a rather similar economic, political and social environment. After 1991 however, Belarus introduced fewer economic reforms, and substantially omitted privatization from its policies.

In contrast with Russia, the European Bank (EBRD, 1997, p154) reported that in 1997 the private sector in Belarus accounted for only 15-25% of GDP. In 1993, about 8,500 State enterprises (10% of the total) were slated for privatization, but in early 1997 only 24% of this original target had been privatized. At this time, all privatizations were halted, and none have occurred since 1996. Indeed, some companies have even been renationalized. The International Monetary Fund (IMF) and World Bank (IBRD) have both withdrawn their support for the Belarusian economy, and the EBRD (1997, p155) reports continued extensive State intervention in the setting of industrial price and production targets. One third of industrial enterprises are loss-making but virtually none has been closed, and the State continues to give financial aid to priority enterprises through tax and import duty concessions and through directed credits (EBRD, 1997, p155). For example, budgetary subsidies in Belarus amounted to 3.4% of GDP in 1995 compared with only 1.3% in Russia (EBRD, 1997, p83). Thus, employment levels have been sustained above Russian levels, and some reactive restructuring avoided, but at the expense of deeper reform. Inward FDI has been low even by Russian standards, and indeed UNCTAD (1997, pp340-350) calculates that with the exception of Somalia and Sierra Leone (which both had negative inflows), Belarus had the lowest per capita FDI inflow in the world in 1995, at \$0.40 per person, compared with Russia's \$1.10. Current trends suggest that even the unfortunate records of Somalia and Sierra Leone may be under threat from Belarus. Given a comparable geographical location and sharing a common, recent, political and economic history, it is seriously suggested that Russia without a privatization programme could have followed the Belarusian path.

It appears therefore that comparative enquiries into managerial priorities and strategies in Russia and Belarus may be instructive in order to answer the counterfactual, 'what if...?' question for Russia. The next section discusses business turnaround as a result of short-run retrenchment and long-run recovery strategies, and then reviews survey responses from managers in

privatized firms in Russia and Belarus in this context, supplemented by one Russian and two Belarusian case-studies. It concludes with some comments on the merits of Russian mass privatization and implications for investors from the West.

II. BUSINESS RETRENCHMENT

Although the collapse in industrial and final consumer demand in the former USSR after 1991 was massive, individual firms in the West also have had to face up to similar disasters. For example, the 'peace dividend' of the 1990s has meant the cancellation of military orders and market collapse for many weapons manufacturers in the West; the demand for British coal virtually disappeared with the discovery of North Sea gas; and the birth of the PC has had enormous implications for typewriter builders and for the printing industry.

Faced with market collapse, the continued procurement of labour, capital and material supplies cannot be sustained without soft loans and/or grants. Western academics, for example Robbins & Pearce (1992) and Pearce & Robbins (1993), have observed that a successful transition to changed market circumstances can be achieved only in a sequence of steps after first 'stopping the bleeding' (Bibeault, 1982). Together, internal and external factors determine the severity of the enterprise crisis, and, unless soft credits are available, a retrenchment phase follows, when the main objective is to get control of cash flows and achieve a position of stability. Such retrenchment comprises current cost reduction (including reductions in the labour-force) and/or asset reductions (capacity reduction or plant closure), depending on the severity of the situation. This is analogous to the 'reactive' or 'shallow' restructuring in economic transition described by Earle and Estrin, (1996). Only if retrenchment policies achieve stability can the next decision-point be reached: whether to enter a recovery phase, which amounts to 'deep' restructuring, involving entrepreneurial decisions concerning new capital investments.

III. LONG-TERM RECOVERY

The direction of new strategies such as diversification, refocusing on core competencies, acquisitions, and the adoption of new technologies may vary from case to case, but they all have one thing in common: a need for new investment and for the funds to finance that investment. An enterprise in economic crisis is unlikely to be able to generate funds internally, though some diversified firms may be able to sell or spin-off activities to raise funds for new

projects. With these exceptions, recovery must involve shareholders and/or outside lenders.

In the former USSR, long-term loans are unlikely from a banking system that prefers, for pragmatic and legal reasons, to keep its assets liquid. Investment banks may be a source of long-term loans, but they will probably demand an equity stake, too, in order to protect their investments with a degree of control. Where States are themselves in budget crises, they cannot consider any loan finance for industrial investment, and this emphasises the conclusion that shareholders are the most feasible potential source of funds for recovery strategies.

Shareholders who are enterprise incumbents are unlikely sources of significant amounts of restructuring finance. In any case, existing managers and other employees are stakeholders in firms even before they obtain shares (Buck et al. 1998), and with dual roles as employees and shareholders they are likely to inhibit the very short-run cost and asset reduction policies that can achieve stability as a prerequisite for deeper restructuring. (Although employee ownership in the former Yugoslavia was associated with over-investment, this was a result of State loans being the dominant source of investment finance, see Buck, 1982, 77-123).

This leaves outside shareholders as the major potential source of new investable funds, including financial institutions, venture capitalists and strategic investors as well as individual outsiders. Besides looking at the underlying asset value of the enterprise and earnings prospects, the time-horizons of outside investors are crucially influenced by the tradability of shares. Freely tradable shares give outside investors infinitely long time-horizons, since the value of shares reflects the present value of all future expected dividend streams, but any attempts to limit the tradability of shares must increase the reluctance of outsider investors to finance long-term restructuring programmes. In the former USSR, stock trading restrictions can deter outside shareholders, thus placing a new emphasis on short-run turnaround and the internal generation of funds for recovery investments.

In order to provide estimates of the extent of turnaround responses in terms of retrenchment and recovery in privatized firms in two countries from the former USSR subjected to massive economic crisis, the authors carried out extensive surveys in Russia and Belarus, reported below.

IV. RETRENCHMENT AND RECOVERY IN RUSSIA AND BELARUS

Managerial attitudes and strategies in Russia and Belarus were estimated through direct questionnaire surveys of enterprise directors during the first half of 1997, after piloting a survey instrument in Moscow and Minsk. Useable responses were obtained from 106 privatized industrial firms in Russia and from 91 in Belarus. Rather than focus on the dynamic, new private start-up sector, and natural resource-based firms, a decision was made to study the industrial heartland of the former USSR: her manufacturing industry, where the need for business turnaround is most pressing. Although this sector has the reputation of being entrepreneurially inert, it employs a majority of the former USSR's workforce, and its future has enormous implications for political stability. To illustrate the current importance of this sector, the average employment of firms in the sample was 1,044 in Russia and 1,157 in Belarus. The surveys were conducted approximately 4.0 years and 2.5 years after privatization in the two countries, respectively. In each country, a random 5% of returns were checked by at least two of the authors personally visiting companies for face-to-face interviews with senior managers, to check the accuracy of questionnaire responses.

The contrasting economic policy stances of the two States surveyed are reflected in their different average industrial ownership structures in privatized firms (Table 1). In the few firms that have been privatized in Belarus, the State in 1997 still holds an average 12.1% of voting shares (versus 6.3% in Russia) and 'insiders' hold 67.9% (versus 55.4% in Russia). Within these dominant insider ownership groups, managers have a smaller average holding of 12.2% in Belarus (versus 17.1% in Russia), and other employees' shareholdings are correspondingly more significant. Importantly, private 'outsiders' now have 38.3% of Russian shares compared with only 20.0% in Belarus.

These shareholdings are reflected broadly in Board representation in both countries and have great significance in the determination of company strategies. The picture presented by Table 1 therefore suggests that in Russia weaker employee ownership, together with higher stakes for managers and outsiders, may be expected to produce short-term turnaround strategies that are not so favourable towards the immediate concerns of employees (current wages and employment). Eventually however, recovery strategies may be more realistic in Russian companies, where employees have smaller proportions of total shares.

Table 1

1997 distribution of voting shares (%) in sample of privatized firms, Russia and Belarus

	RUSSIA	BELARUS
Managers	17.1	12.2
Other Employees	38.3	55.7
<i>(Total 'insiders')</i>	<i>(55.4)</i>	<i>(67.9)</i>
Trading Partners	4.0	3.5
Investment Funds	3.5	1.7
Banks	1.8	0.5
Private Individuals	13.7	9.9
Holding Companies	1.9	1.2
Foreign Investors	0.6	1.7
Other Organisations	12.8	1.5
<i>(Total 'outsiders')</i>	<i>(38.3)</i>	<i>(20.0)</i>
The State	6.3	12.1
TOTAL	100.0	100.0

A. Business Retrenchment in Russia and Belarus

Although realistic measurement of the size of the collapse of sales was not possible in a period of hyper-inflation which affected sectors differentially, the overall predicament of Russian and Belarusian privatized firms is reflected in managers' responses to questions about the average competitiveness of their products. In these two countries that are increasingly open to competition from imports, fewer than 25% of managers estimated that their products were competitive on world markets in terms of product price, design, quality, packaging and after-sales service, with the last reckoned to be most deficient in both countries.

In such a situation of deep crisis, with over-manning and with large average debts to the State, suppliers and banks, and faced with the prospect of further sales decline in the face of import competition, business turnaround is required, with an early emphasis on 'stopping the bleeding' before reconstructive surgery is considered. In Belarus, with a higher proportion of shares held by employees with short-term needs and held by the State, and with relatively fewer outside investors, it could be expected that managers would be

generally less able to reduce costs in the short run than would managers in Russia.

This was found to be the case. Focussing on the 1995-97 period, the weighted average reduction in employment in Belarusian privatized firms was reported to be 14.8%, as opposed to 23.0% in Russia. In order to get some impression of the continuing extent of over-manning in 1997, we asked managers to estimate the **desired** level of employment compared with the current **actual** level. The average Belarusian response was 97%, as opposed to 85% in Russia, indicating that Belarusian managers were still relatively reluctant to concede the need for employment reduction in a situation requiring business retrenchment.

Table 2
Mean values of directors' strategic priorities

(Average responses on a seven-point Likert scale, where 1=unimportant, 7= very important, etc, to the question, 'What importance do directors give to the following strategies?')

	RUSSIA	BELARUS
Retrenchment Strategies:		
Monitor cash flows	6.1	5.9
Seek new domestic markets for existing products	5.7	5.3
Recovery Strategies:		
Marketing and Advertising	4.1	5.5
Seek new export markets for existing products	2.7	5.6
Develop new products for domestic markets	5.2	5.9
Develop new products for export markets	3.0	5.4
Monitor IRR on investments	3.7	5.4
Seek new investors	4.4	5.1

Managerial priorities in relation to different retrenchment and recovery strategies in 1997 are shown in Table 2. The first thing to notice is that Belarusian managers absolutely fail to distinguish short-term and long-term priorities: in the middle of a business crisis, they consider each of eight strategies to be worth at least an importance rating of five on a seven-point scale. The significance of this failure of senior managers to establish any priorities is emphasised by Peters and Waterman (1995, p307):

“The organization gets paralyzed because the structure not only does not make priorities clear, it automatically dilutes priorities. In effect, it says to people down the line: ‘Everything is important: pay equal attention to everything.’”

Conceding that Belarusian managers consider every strategy to be important, they fail to give retrenchment strategies the higher priority that Russian managers appropriately provided, instead giving each short-term variable related to current cash-flow a lower value than do Russian managers. Although Belarusian managers’ previous responses in relation to their products’ lack of a competitive edge on world markets revealed the infeasibility of expanding exports of existing products, the fourth row of Table 2 still shows that they still entertain dreams of expanding export sales for existing products, all in the middle of a short-term crisis requiring retrenchment actions.

Such dreams persist even in the dire circumstances of one privatized firm in Minsk, Belarus:

B. Case Example 1

***Ribocomplex** is one of the least fortunate privatized firms in Belarus, as a sea-fish processor in a country without access to the ocean. It is confronted not only with the break-up of the USSR and its main suppliers in the Baltic states but also with the exhaustion of Baltic Sea fish stocks. Although it had a workforce of 1,200 in 1993, since privatization in 1995, there has been no further reduction in its labor force of 296. The pre-privatization retrenchment occurred through attrition as a result of low wages, rather than from conscious company strategy. Wages are one-third lower than at Kommunarka, (Case 2, below). It sells its entire output to the Russian market.*

The factory was a depressing sight for the authors in April 1997, with workers huddled in about 10% of the total factory area, processing only a token quantity of fish. It would appear that with the breakdown in supplies of raw fish, the antiquated plant is doomed as a fish-processor, and in its existing

function can only be preserved as a large refrigeration facility, with even fewer jobs than at present

Still the managers dream that their premises and plant are an attractive target for foreigners. As a fish-processing plant, the managers estimate that they would require only \$0.7 million of new investment to achieve world standards, assuming raw fish supplies could be obtained.

After so-called privatization in 1995, the State had 84.5% of the voting shares, with employees holding the other 15.5%, but by January 1997, the State was left with 26%, employees 38%, managers 1.5% and 'friendly' outsiders 34.5%.

In 1995, there was a takeover raid. A brokerage company, 'Ramos', was hired by 'European Style', a joint venture operating in the fish industry that wished to acquire Ribocomplex's refrigeration capacity. It bought 36% of the shares, but was only able to register 22% before the company's General Director instructed the so-called 'independent' company operating the share-register to stop all transfers.

*Late in 1997, employees and managers at Ribocomplex were confident that a team of investigators from the President's office would recommend **renationalization** of the company to preserve the few jobs that have survived so far.*

This case emphasises the business crisis in the most unfortunate privatized firm in Belarus. The harsh conclusion is that fish-processing is no longer feasible at Ribocomplex. Even further retrenchment, with the focus on refrigeration services is the only practicable strategy, and any State 'rescue' can only be financed by taxes on more successful private businesses.

By comparison, post-privatization Russian managers are more commercially and entrepreneurially aware, recognising the high priority that should be given to realistic and urgently needed short-term strategies of monitoring cash flow and seeking to increase domestic sales. In this context, it may be that the weaker ownership position of non-managerial employees in Russia compared with those in Belarus may in the end enable managers themselves to acquire more shares and to implement turnaround strategies. 30% of Russian managers reported that they had already purchased or intended to purchase shares from employees, as opposed to only 13% in Belarus. There is a rather different privatization situation in Russia:

C. Case Example 2

GAZ (*Gorky Avtomobil Zavod, now the Nizhny Novgorod Automobile Company*) has faced a turnaround crisis less severe than most Russian privatized firms. It was founded in 1930 with the support of a then-friendly US government and the Ford Motor Company: its first product was a version of the Ford 'Model A' truck in 1932.

Upon privatization in 1993, it became an enormous employee-manager buy-out, and, in late-1996 when one of the authors visited, it had managed to maintain its workforce at 106,000, but this included workers in every kind of social infrastructure operated by GAZ, from fish farm to schools and hospitals. Incumbent managers and other employees were hostile to any outside investor who might impose a strategy of retrenchment in relation to direct production or infrastructure workers, and no foreign motor manufacturer was prepared to pay a price for GAZ control if these social liabilities were included.

Nevertheless, 20% of GAZ's shares had fallen into the hands of outsiders plus 13% with senior managers and 67% with other employees, and half of the outsiders' shares (i.e. 10%) could be traded reasonably freely on the Moscow capital market. The remaining 90% of shares (80% inside-held shares and 10% with so-called outsiders) could only be sold to a private company owned and controlled by the GAZ chairman.

Dominant incumbent ownership was reflected in control of the company's Board, though the State was also represented in the form of the Nizhny Regional Administration and the State Property Committee, which oversaw the privatization process. This State involvement evidently gave the company certain privileges such as the non-payment of taxes and access to State credits, which have enabled it to avoid employee retrenchment even though certain elements of the product range have been abandoned. Specifically, the production of medium trucks (401,500 in 1993) had been virtually abandoned by 1995 in favour of the Gazelle range of light trucks, probably financed out of plowback profits accumulated with the support of the State. The Gazelle trucks (73,000 produced in 1995) and the Volga saloons (157,000 in 1995) are currently the backbone of GAZ, but their design and build quality are not competitive internationally.

Although GAZ's Russian market is stable for the moment and no immediate retrenchment strategy is needed if the local authorities assume responsibility for social infrastructure, managers and other employees now seem to be aware of the need for outside investors and new products, and in 1998 are prepared to enter joint venture agreements in which foreign strategic partners do not assume a share of GAZ's infrastructural burden. In early 1998, an agreement for a \$1,450 million joint venture with Fiat was nearing completion for the assembly of Fiat models by GAZ.

Although GAZ is in a relatively favourable position of stability compared with other Russian privatized firms in manufacturing, it seems that, five years after privatization, GAZ senior managers have grasped the need to establish priorities and cut production and employment where products have poor trading prospects, to achieve short-term stability before embarking on recovery investments with foreign investors. Such business recovery is the subject of the next section.

D. Business Recovery in Russia and Belarus

Although the majority of managers in privatized firms in Russia and Belarus have faced a demand collapse and have recognised the uncompetitive nature of their existing products, probably few privatized firms in Russia and Belarus have restored business stability yet, or reached a decision-stage at which recovery strategies should have a high-priority, as at GAZ. Recognising the seriousness of their problems in regard to global competitiveness, Russian managers on average calculated that investment spending on new premises and re-equipment needed to achieve world standards was of the order of \$65.9million per enterprise: a totally infeasible amount in the short-term. Belarusian managers estimated a requirement of \$11.1million per firm. However, in these desperate circumstances, Russian managers have focused on short-term retrenchment strategies, while Belarusian managers unrealistically dream of new investors and investment (Table 2).

Outside investors arguably represent the only realistic long-term source of new funds for investment on a large scale. Although 56% of Russian and 68% of Belarusian managers consider that their firms are attractive investment targets for outside investors, Russian and Belarusian managers alike cited the State and retained enterprise earnings as their most likely actual sources of funds - clearly inconsistent with the sums quoted previously as necessary to achieve competitiveness. This disregard for outside investors is based on a fear that outsiders will urge drastic business retrenchment strategies.

The extent of this hostility to outsiders was slightly lower in Russia, in that 'only' (sic) about two-thirds of managers would try to prevent an outside accumulation of shares, while in Belarus the response was about three-quarters. The concrete effect of this hostility to outsiders is that privatized firms in Belarus (and to a lesser extent Russia) have adopted a strategy of **blocking the transfer of shares and strategic control to outsiders**, usually by administrative devices. Such actions have already been alluded to in relation to Ribocomplex, above. Since technically they are unlawful, it was not possible to conduct formal surveys into the phenomenon, but a third case is relevant

regarding recovery strategies and barriers to externally-imposed strategies, like Case 1 from Minsk in Belarus:

E. Case Example 3

*The **Kommunarka** confectionery company is one of the most fortunate and prosperous privatized companies in Belarus. Since privatization in 1993 it has managed to increase its sales, production capacity and labor-force, thanks to its products. These comprise sweets, chocolates and biscuits, which are still popular in Belarus and Russia despite the availability of Western imports. The local markets favour plain chocolate and a distinctive form of packaging, providing Kommunarka with a niche market, which it has fostered with consistent production and a stream of new product variations. It exports 70% of its output to and imports 73% of its inputs from Russia. Short-term turnaround strategies have been unnecessary. Indeed capacity has been increased by 20% since privatization. Wages average about \$170 per month.*

Kommunarka estimates that to compete on world markets, it would need to invest around \$30 million over five years, but it has no plans to do this. Nevertheless, it claims that it is an attractive target for foreign investors. Its current strategy is to develop new products for the domestic and Russian markets and to improve packaging. This requires investment in machinery, but the directors have no intention to allow outsiders to acquire shares and control. Although directors hold only 4% of voting shares, employees have 65%, the State 2.5%, and 'friendly' outsiders 28.5%, all believed to be under the control of individual directors. The directors control the Board, with six directors out of nine. (Employees nominate two directors and the State one.) All are anxious to prevent outsiders from buying shares and registering them.

During 1997, the government of Belarus issued a decree requiring that all privatized firms must have their share registers kept by an independent book-keeper, in the case of Kommunarka by the joint-stock company Agorkapital. Unfortunately, the subsequent transfer of Kommunarka's register and its computerization now means that share registrations take two months rather than the previous two days. Also, share dealings are forbidden for ten weeks before a General Meeting and for ten days afterwards. Agorkapital levies a transfer charge on buyers of 100,000 Belarusian rubles per share, about ten times the face value of each share. Taken together, these restrictions restrict stock tradeability and deter outside investments.

Without outside injections of funds, it seems unlikely that Kommunarka will be able to finance significant investment programmes in the future to protect even its niche market from firms in Russia and other countries.

The hostility shown towards outside investors in *Kommunarka* and other in privatized firms in Russia and Belarus effectively rules out most long-term investments for business recovery, despite the fact that outsiders already have obtained one to two-fifths of all shares (Table 1). It may be that managers themselves will be the ultimate sources of limited recovery strategies as well as of turnaround. On the basis of Western evidence in relation to management buy-outs, however (Wright et al. 1994), it seems likely that managers wishing to preserve their equity positions in the firm but also to raise outside funds must be prepared to submit themselves to extensive monitoring by outside investors who wish to prevent current consumption by managers and employees of funds intended for long-term investment. The local power of enterprise managers is reflected in the finding that since privatization the General Director had been replaced in 37% of Russian firms and in only 25% in Belarus.

V. CONCLUSION

Although the shortcomings of Russian economic reforms have been widely recognised and criticised in this paper and elsewhere, it seems likely that political realities after the break-up of the USSR in 1991 produced a reform package as market-oriented as was practicable at the time. At least the distribution of shares at privatization to favor enterprise managers and other employees sustained support for the government throughout the regions of Russia, and enabled the government to push ahead with other reforms, which have resulted in significant political and press freedoms and less hostility towards private business and foreign traders and investors. Without such a Russian privatization programme, even though flawed, the results would have been similar to those in Belarus.

In Belarus, privatization favouring the interests of the State and enterprise employees was strangled at birth. The outcome is a populist dictatorship that seriously constrains press freedoms and the activities of private business, and which continues to be dominated by insiders and the State, (Table 1). In May 1996 all private firms in Belarus had to re-register and seek permission to carry on in business, and about one-third (30,000) of all companies were instantly liquidated (EBRD 1997, p155), some because the State's inspectors considered them insufficiently profitable! Private banks were instructed to make directed credits to favoured enterprises and the State arbitrarily seized a proportion of the hard-currency balances of private firms to relieve its financial crisis. In December 1997 a presidential decree introduced a 'golden share' for the State in any future privatizations, which effectively rules out any foreign participation, since the State can veto any turnaround strategy proposed for the firm. Aggregate economic statistics are regularly massaged

(mostly by enterprise managers anxious to demonstrate their 'achievement' of fictitious plan targets), and international agencies such as the IMF and IBRD have withdrawn from the country both their offices and financial support.

This focus on Belarus has been deliberate in order to make judgements on the 'what might have been' counterfactual position in Russia. It is not unrealistic to argue that a similar scenario could have developed in Russia in the absence of its mass privatization programme, which seemed from a distance to be seriously flawed. Without this programme it seems unlikely that in 1998 in Russia there would be a proposed joint venture (JV) between GAZ and Fiat in Nizhny Novgorod, a JV between Renault and Moskvitch in Moscow, and Ford's JV with Russky Dizel near St. Petersburg, all in one industry: motor manufacturing. The positive results of shock therapy now are beginning to show.

Generally, however, apart from portfolio investment by financial institutions from the West, mostly in natural resource-based companies where share values are backed with physical reserves, Western investors have voted with their feet and have made few direct investments in either Russia or Belarus, preferring to concentrate on other emerging markets like China. In 1999, Western entrepreneurs are aware of the continuing hostility they face from enterprise incumbents in the heartland of Russian and Belarusian industry, in privatized manufacturing companies. This hostility has undoubtedly contributed to the national crisis which developed in Russia and Belarus late in 1998, with insiders' immediate self-interests prolonging the admitted lack of competitiveness of local industry, which in turn has contributed to a balance of payments crisis and a massive State budget deficit from shortfalls in enterprise tax payments.

Still, in Russia mass privatization was achieved, even if imperfectly. Outside ownership in the survey sample averaged 38.3% in 1997, up from 33.2% in only two years from 1995, and by 1998 there were signs that enterprise incumbents, in some firms at least, appreciate the danger of continuing to be uncompetitive internationally, appreciating the danger of even further retrenchment without outside investment.

In Russia, mass privatization and the subsequent evolution of privatized firms by mid-1998 created a climate that had begun to bear fruit. Ironically, however, progress in companies admitting outside investors for the purpose of financing recovery investments may now be swept away in a new national economic crisis, for which more defensive companies are partly to blame. Nevertheless, without its mass privatization, Russia could already have followed the path of Belarus in its struggle with Somalia and Sierra Leone to the bottom of the pile in terms of foreign direct investment.

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