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Andreas Heinrich, Aleksandra Lis
and Heiko Pleines

**Corporate Governance in the
Oil and Gas Industry.
Cases from Poland, Hungary, Russia
and Ukraine in a Comparative
Perspective**

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1. Introduction

This working paper analyses the corporate governance of post-socialist companies. In the broadest sense, represented by the stakeholder approach, corporate governance covers a company's relationship to its owners, employees, suppliers, creditors and customers. In the narrower sense, embodied by the shareholder approach, and which will be applied here, corporate governance focuses solely on the owners of property rights in a company.

In large modern companies, in which not all property rights are specified or held in one person's hand, ownership and control are separated.¹ One reason for this separation, i.e. risk liability from decision-making power, is the advantage to be gained from specialised management.² The separation of ownership and control gives managers discretionary room for manoeuvre which in turn allows them to pursue their personal goals. This creates the potential for conflicts of interest between shareholders and management.³ In addition, conflicts between different owners may arise, especially when a majority owner wants to monopolise decision-making and thereby influence the company management.

In this context corporate governance describes mechanisms which allow all company shareholders fair participation in decision-making and ensure that the management acts in the common interest. The basic components of this kind of corporate governance are transparency of the company's financial situation and ownership structure, integration of all relevant shareholders into decision-making processes (usually through representation at the company board) and a fair distribution of profits among all shareholders (comprising dividend payments as well as the absence of manipulations, such as asset stripping or dilution of shareholdings, on behalf of a specific group of shareholders). These fundamental elements are present in all four major corporate governance models (i.e., the Anglo-Saxon, German, French and Scandinavian models) commonly identified in the literature.⁴ As such, they describe the general rules for company development and investment in a market economy, whereas the concrete design and implementation of these components are influenced by cultural specifics.⁵

¹ Berle, A. A. and Means, G. C. (1968) *The Modern Corporation and Private Property*. New York: Harcourt, Brace & World.

² Fama, E. F. and Jensen, M. C. (1983) Separation of Ownership and Control, *Journal of Law and Economics*, (26) 2, pp. 301–325, here: pp. 301–302.

³ Jensen, M. C. and Meckling, W. H. (1976) Theory of the Firm. Managerial Behavior, Agency Costs and Ownership Structure, *Journal of Financial Economics*, (3) 3, pp. 305–360.

⁴ Overviews are provided by: La Porta, Rafael / Lopez-de-Silanes, Florencio / Shleifer, Andrei / Vishny, Robert (1998) Law and finance, *Journal of Political Economy*, (106) 6, pp. 1113–1155; Baker, C. Richard / Wallage, Philip (2000) The future of financial reporting in Europe. Its role in corporate governance, *International Journal of Accounting*, (35) 2, pp. 173–187.

⁵ On cultural specifics of corporate governance regulation and implementation see for example: Buck, Trevor / Shahrin, Azura (2005) The translation of corporate governance changes across national cultures. The case of Germany, *Journal of International Business Studies*, (36), pp. 42–61; Roberts, Graham (2004) Convergent capitalisms? The internationalisation of financial markets and the 2002 Russian corporate governance code, *Europe-Asia Studies*, (56), 8, pp. 1235–1248; Federowicz, Michal (2003) *Bridging East and West. Re-examining the Notion of Corporate Governance and Explaining Institutional Change*, Berlin: WZB; Buck, Trevor (2003) Modern Russian corporate governance. Convergent forces or product

Prior research has focused primarily on companies with dispersed ownership and on minority shareholders. With a large dispersion of capital, small individual shareholders usually find it difficult to monitor and control the management, as they lack the power to obtain and the capacity to process the necessary information. The costs of control increase proportionally with the dispersion of ownership. Therefore, small minority shareholders have no incentive to engage in managerial monitoring, preferring to free-ride on other actions. Thus, although it may be in the best interest of the collective group of minority shareholders to engage in actions aimed at disciplining management, no single rational individual shareholder will undertake such actions. In this context, in the absence of other controlling mechanisms, the management will have some additional discretion to run the corporation pursuant to its own interests.⁶

But companies with dispersed ownership are few and far between outside the Anglo-American area. World-wide, most companies have just one major shareholder, such as financial intermediaries, industrial families or the state.⁷ Thus, large blockholders are able to play an active role in monitoring corporate governance and to influence the style of management. Their increased shareholdings may give them a stronger incentive to monitor firm performance and managerial behaviour as well as better access to sensitive company information.⁸ This potentially helps to circumvent the free-rider problem associated with ownership dispersion.

However, several constraints, institutional and otherwise, may act as inhibiting forces to large blockholders' performance as a monitor. Legal regulations, agency costs within the institutions, information costs, competition (e.g., between mutual funds), collective action problems and limited institutional competence are some of the partial explanations for the alleged lack of activism by institutional investors.⁹ Therefore, institutional activism is mostly crisis-driven; institutions are usually reluctant to be involved in proxy fights, and often prefer informal, behind-the-scenes interventions to formal coalitions.¹⁰

Moreover, the notion that large blockholders help to align the interests of shareholders and managers is not uncontested. Large shareholders may have incentives to pursue

of Russia's history?, *Journal of World Business*, (38), pp. 299–313; McCarthy, Daniel and Puffer, Sheila (2002) Corporate Governance in Russia. Towards a European, US, or Russian model?, *European Management Journal*, (20) 6, pp. 630–640.

⁶ Grossman, S./ Hart, O. (1980) Takeover Bids, the Free Rider Problem and the Theory of the Corporation, *Bell Journal of Economics*, (11), pp. 42–64.

⁷ La Porta, R. / Lopez-de-Silanes, F. and Shleifer, A. (1999) Corporate Ownership around the World, *Journal of Finance*, (54) 2, pp. 471–517; Barca, F./ Becht, M. (2001) *The Control of Corporate Europe*. Oxford: Oxford University Press.

⁸ Demsetz, H. and Lehn, K. (1985) The Structure of Corporate Ownership: Causes and Consequences, *Journal of Political Economy* (93), pp. 1155–1177; Shleifer, A. and Vishny, R. (1986) Large Shareholders and Corporate Control, *Journal of Political Economy* (94), pp. 461–488; Demsetz, H. (1983) The Structure of Ownership and the Theory of the Firm, *Journal of Law and Economics* (26), pp. 301–325.

⁹ Black, B. (1998) Shareholder activism and corporate governance in the United States, in Peter Newman (ed.), *The New Palgrave Dictionary of Economics and the Law*, London: Macmillan, pp. 459–465; Roe, M. (1994) *Strong Managers, Weak Owners: the Political Roots of American Corporate Finance*, Princeton, NJ: University Press.

¹⁰ Black, B. and Coffee, J. (1994) Hail Britannia?: Institutional Investor Behavior Under Limited Regulation, *Michigan Law Review* (92), pp. 1997–2087.

their own interests at the expense of smaller shareholders. This situation causes a different agency problem within the company.¹¹ Especially in post-socialist transition countries, most of the blockholders are related to the management. In addition, for the most part, banks and investment funds play no active role in monitoring the management due to the fact that these financial organisations are themselves badly regulated and supervised, resulting in a lack of transparency.¹²

Accordingly, the corporate governance of post-socialist companies deserves separate analysis¹³; indeed, there is already a considerable body of literature on the topic. However, the majority of analyses treatments is mostly descriptive¹⁴ and focuses only on single aspects of corporate governance in post-socialist countries, such as ownership structure¹⁵, legal regulations¹⁶, business culture¹⁷ or global factors¹⁸. Accordingly, a real

¹¹ Shleifer, Andrei and Vishny, Robert W. (1997) A Survey of Corporate Governance, *Journal of Finance*, (52), 2, pp. 737–783.

¹² On the countries covered in this study see: Dzierzanowski, Maciej and Tamowicz, Piotr (2004) Ownership and control of Polish corporations, *Corporate Ownership & Control*, (1) 3, pp. 20–30; Earle, J.S./Kucsera, Cs./Telegdy, A. (2001) *Corporate Control in Hungary*, Budapest: ECGI 2001 (www.ecgi.org); Radygin, A.D./Entov, R.M./Gontmakher, A.E./Mezheraups, I.V./Turuntseva, M.Yu. (2004) *Ekonomiko-pravovye faktory i ograniicheniya v stanovlenii modelei korporativnogo upravleniya*, Moscow: IET, pp.176–219; Kostyuk, Alexander (2003) Market for corporate control in Ukraine, *Problems and Perspectives of Management*,(1), pp. 24–28.

¹³ Cf. Berglöf, E. and Thadden, E.-L. von (2000) The Changing Corporate Governance Paradigm. Implications for Transition and Developing Countries. In: Pleskovic, B. and Stiglitz, J. E. (eds) *Annual World Bank Conference on Development Economics 1999*. Washington, D.C.: World Bank, pp. 135–162.

¹⁴ See e.g. Goldberg, Itzhak and Desai, Raj (1999) Corporate Governance in Russia. In: Broadman, Harry G. (ed.) *Russian Enterprise Reform. Policies to Further the Transition*. Washington DC.: World Bank (Discussion Paper No. 400), pp. 40–56; Fox, Merrit B. and Heller, Michael A. (2000) Corporate Governance Lessons from Russian Enterprise Fiascos, *New York University Law Review*, (75), pp. 1720–1780; Bushev, Andrei (2001) The Theory and Practice of Corporate Governance in Russia, *Review of Central and East European Law*, (27) 1, pp. 71–91.

¹⁵ See e.g. Yakovlev, Andrei (2004) Evolution of Corporate Governance in Russia: Government Policy vs. Real Incentives of Economic Agents, *Post-Communist Economies*, (16) 4, pp. 387–403; Buck, Trevor/Filatov, Igor/Wright, Mike/Zhukov, Vladimir (1999) Corporate Governance and Employee Ownership in an Economic Crisis: Enterprise Strategies in the Former USSR, *Journal of Comparative Economics*, (27) 3, pp. 459–474; Krivogorsky, Victoria (2000) Corporate Ownership and Governance in Russia, *International Journal of Accounting*, (35) 3, pp. 331–353; Sprenger, Carsten (2002) *Ownership and Corporate Governance in Russian Industry. A Survey*. London: EBRD 2002 (Working Paper No. 70); Gray, Cheryl W. (1996) *In Search of Owners. Lessons of Experience with Privatization and Corporate Governance in Transition Economies*. Washington DC.: World Bank (Working Paper No. 1595).

¹⁶ See e.g. Koladkiewicz, Izabela (2001) Building of a Corporate Governance System in Poland. Initial Experiences, *Corporate Governance. An International Review*, (9) 3, pp. 228–237; Earle, John S./Kaznovsky, Viktor/Kucsera, Csaba/Telegdy, Álmos (2001) *A Survey on Corporate Governance Rules in Hungary and Romania*. Brussels: European Corporate Governance Network; Black, Bernhard S. and Kraakman, Reinier (1996) A Self-enforcing Model of Corporate Law, *Harvard Law Review*, (109), pp 1911–1982.

¹⁷ See e.g. Buck, Trevor / Shahrin, Azura (2005) The translation of corporate governance changes across national cultures. The case of Germany, *Journal of International Business Studies*, (36), pp. 42–61; Roberts, Graham (2004) Convergent capitalisms? The internationalisation of financial markets and the 2002 Russian corporate governance code, *Europe-Asia Studies*, (56), 8, pp. 1235–1248; Buck, Trevor (2003) Modern Russian corporate governance. Convergent forces or product of Russia's history?, *Journal of World Business*, (38), pp. 299–313; McCarthy, Daniel and Puffer, Sheila (2002) Corporate Governance in Russia. Towards a European, US, or Russian model?, *European Management Journal*, (20) 6, pp. 630–640.

comparative dimension is still lacking as is a comprehensive analytical framework to explain corporate governance performance in post-socialist countries.

A recent exception is a project conducted jointly by the Institute for Industrial and Market Studies at the State University Higher School of Economics (Russia), the Center for Comparative Studies (Bulgaria) and Ohio State University (USA). The participants in the project developed a comprehensive framework to explain corporate governance improvements and applied it to Russia and Bulgaria.¹⁹ The analytical framework developed in Part 4 of this working paper tries to consolidate their approach into a smaller number of explaining variables in order to allow for quantitative tests across several countries.

In order to conduct a systematic comparison between different companies and across countries, corporate governance performance will be measured with the help of an index which comprises all its relevant aspects according to the shareholder approach. As data collection for a representative sample of post-socialist companies is an immense task, this working paper focuses on examples from one branch, the oil and gas industry, in four countries, Poland, Hungary, Russia and Ukraine, for the period 1997 to 2004.²⁰

The oil and gas industry was chosen because the respective companies are, firstly, of considerable relevance to the national economies and, secondly, due to the globalised nature of the oil and gas business, they are integrated into international business networks. Accordingly, they represent cases where pressure for improved corporate governance should be felt first. While this makes them of special interest for this study, they should not be regarded as typical for their respective countries.

Here the quality of corporate governance is measured by the Heinrich Index, which is a composite of indices developed by the World Economic Forum, the Institute of Corporate Law and Corporate Governance (Moscow) and Standard & Poor's.²¹ It consists of the following indicators: (1) disclosure of financial information; (2) transparency of ownership structure; (3) management and supervisory board structure; (4) dividend payments; and (5) corporate violation of shareholders' rights.

(1) An important criterion for the quality of corporate governance is the disclosure of financial information verified by an independent auditor. However, national accounting standards are rarely comparable to international accounting standards, such as the US GAAP (Generally Accepted Accounting Practices) or the IAS (International Accounting

¹⁸ Heinrich, A. (2005) Why Corporate Governance in the Russian Oil and Gas Industry Is Improving, *Corporate Governance: The International Journal of Business in Society*, 5(4), pp. 3–9; Lis, A. / Pleines, H. (2005) *The Global Impact on Corporate Governance: Case Study Ukrnafta (Ukraine)*. Paper presented at the VII World Congress of the International Council for Central and East European Studies (ICCEES), Berlin, Germany, 25–30 July 2005.

¹⁹ Institute for Industrial and Market Studies et al. (2004) *Insiders, outsiders, and good corporate governance in transitional economies. Cases of Russia and Bulgaria*, Regional Think Tank Partnership Program. Working Paper Series WP 2-5.

²⁰ Earlier years were not included, because firstly, many of the companies under consideration were completely restructured in the mid-1990s and secondly, there are serious data collection problems for the period before 1997.

²¹ Cf. World Economic Forum (2001) *The Corporate Governance Initiative of the World Economic Forum. Changing Corporate Governance in Russia*. Moscow: World Economic Forum, p. 26, <http://www.iclg.ru> and http://www.ricd.ru/db.php?db_id=201&l=en.

Standard). In the case of post-socialist countries the national accounting standards often leave companies considerably more possibilities for data manipulation. Therefore, financial information in the national accounting standard is only assigned a value of 1, while the use of an international accounting standard (US GAAP, IAS or IFRS) is represented by a value of 2.

When the indicator cites the publication of financial information, it refers to the publication date of e.g. an annual report and not to the year covered by the report; i.e. a company report for the year 2002 published in 2003 indicates that the company disclosed financial information in 2003, but does not say anything about the disclosure of financial information in 2002.

(2) The disclosure of ownership structure is also important for investors and their subsequent decisions, as insider-dominated enterprises are notorious for poor corporate governance. An only partial disclosure of ownership structure is represented by a value of 1, while a complete disclosure is represented by a value of 2.

(3) Regarding the structure of management and supervisory boards, it was analysed if independent directors and/ or representatives of minority shareholders are elected to the executive-, or, in a two-tier system, supervisory board. This indicator covers the existence of independent directors (yes = 1, no = 0) and representatives of minority shareholders (yes = 1, no = 0).

(4) At annual shareholder meetings, participants determine the volume of dividend payments for the preceding year. The indicator measures company compliance with payment obligations. If dividends are illegally withheld, a value of 0 is assigned. An illegal manipulation of payments (less than the required sum or considerable delays in payment) is represented by a value of 1, while correct payment is represented by a value of 2. If the shareholders' meeting lawfully decides to suspend dividend payments, a value of 2 is likewise assigned.

This indicator, similar to the "disclosure of financial information" indicator, is used to analyse a company's behaviour in the previous year. Therefore, the volume of dividends a company paid out for the previous year were verified, as these payments were determined at the annual meetings in the years analysed with the index.

(5) The last indicator takes into account a company's corporate governance violations. For this purpose the sum of the indicators "dilution" (illegal increase in charter capital: yes = 1, no = 0) and "asset stripping" (illegal use of enterprise capital for personal purposes: yes = 1, no = 0) is determined.

The total value of the indicators generated by the index will be divided by the number of indicators used in each specific case. Five indicators are available for listed companies, while only four can be used for non-listed companies, as dividend payments are not applicable to the latter.

In a formalised version, the index to measure the quality of corporate governance can be described as follows:

$$I_{\text{corpgov}} = (\text{FIN} + \text{OWN} + \text{BOD} + \text{DIV} - \text{VIO}) / 5$$

- FIN = Disclosure of financial information
[none = 0; disclosure only in the national accounting standard = 1; disclosure in the national and an international accounting standard (IAS, IFRS, US GAAP) = 2]
- OWN = Disclosure of ownership structure
[none = 0; partial = 1; complete = 2]
- BOD = Structure of management and supervisory board
[Sum of (1) independent directors on the executive or supervisory board: no = 0; yes = 1, (2) representatives of minority shareholders on the executive or supervisory board: no = 0; yes = 1]
- DIV = Dividend payments
[illegal refusal = 0; illegal manipulation = 1; correct payment = 2]
- VIO = Corporate governance violations
[Sum of violations of shareholders' rights with dilution = 1 and asset stripping = 1]

Accordingly a value of -0.4 (or -0.5 in the case of non-listed companies) stands for the worst corporate governance possible, whereas the maximum score is 1.6. The maximum score for corporate governance indicates company behaviour which by Western legal standards is considered normal.

2. Case Studies

Altogether this study includes 15 oil and gas companies from four countries for the period 1997 to 2004.²² An overview of the companies is given in the appendix. Here five companies have been selected for more detailed case studies. These are PKN Orlen (Poland), MOL (Hungary), Bashneft and Yukos (both Russia) and Ukrnafta (Ukraine).

The case studies shall illustrate different factors potentially influencing a company's corporate governance performance. The analytical framework for a systematic analysis of these factors will be elaborated upon in the chapters following the case studies. The companies covered in the case studies are used as examples especially in the section on the operationalisation of these factors.

2.1. PKN Orlen (Poland)

2.1.1. Company Profile

PKN Orlen, founded in 1999, is Poland's largest oil and petrochemical company.²³ It operates one of Europe's most modern refineries at Plock and Poland's largest network

²² Thus the study includes all major oil and gas companies in the four countries which are not exclusively state owned, i.e. all at least partly privately-owned joint stock companies.

²³ The company study is based on a NewsBase archive search (www.newsbase.com) and information from the Energy Information Agency and PKN Orlen. For more detailed analyses see Nowak, Bartłomiej (2004) Foreign Direct Investment in the Petroleum Sector in Poland. In: Nowak, Alojzy Z./ Steagall,

of filling stations. It owns 1,906 filling stations, of which 485 are located in Germany. On the domestic wholesale and retail gasoline market PKN Orlen has a market share of around 55%. However, the company is only marginally involved in upstream operations. Main indicators of its economic performance are given in Table 2-1.

Table 2-1: PKN Orlen economic performance 1999–2004

	1999	2000	2001	2002	2003	2004
Total crude oil processing (mt)	12.5	13.1	12.9	12.5	11.7	12.2
Oil imports (mt)*	na.	na.	na.	na.	na.	na.
Net sales (US\$m)	3,347	4,285	4,156	4,540	6,917	7,958
Net profit (US\$m)	237.9	207.7	91.8	113.1	266.0	651.9
Share of profit paid as dividends	1.6%	2.3%	5.6%	11.9%	6.2%	11.9%

Note: *) While the exact figures for PKN Orlen's oil imports are not available, it can be assumed that at least 90% of the processed crude oil was imported.

Source: PKN Orlen company data.

The company's strategy is to create a regional, vertically integrated oil company in Central Eastern Europe. To reach this goal, it strives for acquisitions and international alliances in the area as a springboard for creating a strong regional corporation to partner with upstream companies. The development of a pan-regional retail network is also part of the strategy, which aims to take advantage of the opportunities occasioned by Poland's accession to the EU.

PKN Orlen's self-initiated internationalisation started in December 2002 with the acquisition of 494 filling stations in Germany, giving it a market share of nearly 3% in terms of the total number of stations. In 2002, PKN Orlen also acquired a 9.22% share in AW S.A. Holland II B.V. (AWSA). AWSA is the dominant holding company of Autostrada Wielkopolska S.A., which is licenced to develop motorways in Poland.

In June 2004, PKN Orlen purchased a 63% stake in the Czech oil firm Unipetrol, which has a 50% market share in the Czech gasoline market. In the wake of a Czech corruption scandal, it was later alleged that the Czech government had been bribed to favour PKN Orlen in the Unipetrol privatisation.

In summary, PKN Orlen's progress towards regional expansion has been slow. Plans for a merger with Hungary's national oil company, MOL, were stopped in late 2004 on an order from the Polish Treasury minister, who argued that the interests of the state in PKN as a strategic enterprise were not guaranteed after a merger.

2.1.2. Ownership Structure

PKN Orlen was established in 1999 following the merger of Centrala Produktów Naftowych and Petrochemia Plock. In the same year it was listed on the Warsaw Stock Exchange and in the form of Global Depository Receipts (GDRs) on the London Stock Exchange.²⁴

Jeffrey W./ Balamoune, M. N. (eds): *Globalization, International Business and European Integration*. Warsaw: Drukania "KART", pp.215–233.

²⁴ The following ownership figures are all taken from PKN Orlen's annual reports.

At the end of 1999, the company was primarily owned, directly and indirectly, by the Polish State Treasury. While the Treasury directly held 10.38% of the share capital, the state-owned holding company Nafta Polska S.A. controlled 44.06% of the shares. Foreign investors had a shareholding of 18.96%, while other investors (including employees) held 26.6% of the shares.

With the second public offering in July 2000, the shareholder structure of PKN Orlen changed significantly. Nafta Polska decreased its share to 18.06%, reducing the total share of the Polish state to 28.44%. The percentage of shares which were in free float on the capital markets increased to 71.56%; of these, foreign investors held 27.07% via GDR.

In 2002 and 2003 two bigger minority shareholders emerged. The Kulczyk Holding acquired a 5.69% stake and the Commercial Union obtained 5.04%. The share held by foreign investors in the form of GDRs decreased to 13.55% in 2002 and 11% in 2003.

At the end of 2004, the Kulczyk Holding disappeared from the company's shareholder list, implying that its share had been reduced to less than 5%. The state's share decreased slightly to 27.52%. However, with more than 25%, the Polish state maintained a blocking stake in PKN Orlen.

2.1.3. Corporate Governance

PKN Orlen has a two-tier board system. Therefore, the supervisory board is in charge of monitoring the management. Until 2004, however, PKN Orlen's supervisory board included neither independent directors nor special representatives of minority shareholders. In 2004 the president of the Kulczyk Holding, a minority investor in PKN, became head of the supervisory board.

He managed to get his candidate elected as head of the management. However, after criticism from the Polish prime minister, this individual was replaced by the government's candidate after just 20 days in office. Since then the government has used its blocking share in PKN Orlen to determine the head of the company management. In September 2004 a deputy finance minister was appointed to this position.

PKN Orlen's corporate governance has been on a consistently high level. In the years 2000 and 2001 – read with the annual reports for 1999 and 2000 – PKN Orlen published its financial information in the International Accounting Standard (IAS) and since 2002 in the International Financial Reporting Standard (IFRS). The ownership structure was disclosed and dividends were paid. No violations of shareholders' rights were in evidence. In summary, PKN Orlen has been characterised by a good corporate governance performance, particularly in its disclosure standards, as indicated by the index values presented in Table 2-2.

Nevertheless, the company has been heavily shaken by political scandals. In 2004 a parliamentary commission was established to examine possible irregularities at PKN Orlen. The allegations included donations by the company to foundations headed by the wife of the Polish president. Another parliamentary commission was set up to investigate allegations that Kulczyk, a minority shareholder in PKN, had been in negotiations with the Russian secret service to promote Russian business interests in the Polish oil industry. In the Czech Republic it was alleged that the Czech prime minister had been bribed to favour PKN in the Unipetrol privatisation. These scandals have not helped the

company's image. In addition the government's politically motivated opposition to a merger with MOL has seriously hampered PKN's regional expansion.

Table 2-2: PKN Orlen corporate governance index 1999–2004

	1999	2000	2001	2002	2003	2004
Financial information	2	2	2	2	2	2
Ownership structure	2	2	2	2	2	2
Board structure	0	0	0	0	0	1
Dividend payments	2	2	2	2	2	2
Violations of shareholders' rights	0	0	0	0	0	0
Quality of corporate governance	1.2	1.2	1.2	1.2	1.2	1.4

2.2. MOL (Hungary)

2.2.1. Company Profile

MOL, Hungary's largest company, is a downstream oil and gas firm specialised in refining and distribution.²⁵ MOL dominates both the Hungarian wholesale market for petroleum products, with a market share of 80%, and the gasoline market, with a 40% market share. MOL's reserves and production of crude oil and natural gas have contracted significantly since privatisation in the mid-1990s. Despite the substantial decline in its reserves and production, MOL's sales volume has remained fairly stable due to an increase in imports, mainly from Russia. Even if MOL's dependence on imports is high, the company also exports parts of its own production and is active in the transit of natural gas to other countries. In 2004, the company had a network of 452 filling stations in eight countries. Main indicators of the company's economic performance are given in Table 2-3.

Table 2-3: MOL economic performance 1997–2004

	1997	1998	1999	2000	2001	2002	2003	2004
Total crude oil processing (mt)	6.7	6.8	7.0	6.8	6.8	6.0	10.5	12.0
Oil imports (mt)	5.3	5.6	5.8	5.7	5.8	5.0	9.4	11.1
Total gas sales (bcm)	12.2	12.2	12.4	12.2	13.4	13.4	14.6	14.0
Gas imports (bcm)	8.1	8.7	9.0	9.0	9.6	10.7	12.2	11.0
Net sales (US\$m)	3,411	2,957	3,129	3,633	3,857	4,495	6,701	9,652
Net profit (US\$m)	163.9	219.6	149.2	71.6	4.2	253.1	444.2	1,033
Share of profit paid as dividends	25.5%	18.7%	21.5%	21.4%	450%	8.3%	5.2%	2.9%

Source: MOL company data.

²⁵ The company study is based on a NewsBase archive search (www.newsbase.com) and MOL company reports. For more detailed analyses see Heinrich, Andreas (2005) *Between a Rock and a Hard Place: The Energy Sector in Central and Eastern Europe*. In: Liuhto, Kari/ Vincze, Zsuzsanna (eds) *Wider Europe*. Tampere: Esa Print, pp. 457–490 and Liuhto, Kari (2001) *The internationalisation of a Hungarian corporation*. In: Liuhto, Kari (ed.): *East Goes West. The Internationalisation of Eastern Enterprises*, Lappeenranta: University of Technology, pp. 435–467.

Already in 1994 MOL started a strategic initiative focused on international exploration and production. This led to a shopping spree in the former Soviet Union, North Africa, the Middle East and South Eastern Europe. Since 1999, however, the company has changed its strategic direction and has decided to concentrate on refining and marketing in Central and Eastern Europe and to focus its reserve acquisitions primarily on Russia and Kazakhstan. Thus, MOL has developed regional rather than global aspirations.

In 2000 and 2002 MOL acquired major stakes in Slovakia's Slovnaft oil refining and distribution company, and in 2004 finally took complete control. In 2003 MOL bought 25% of the Croatian oil firm INA. The acquisition gave MOL direct access to crude oil supplies from the Adriatic Sea and also meant a strategic alliance for further expansion in Central Europe. In 2004, MOL acquired a majority interest in Roth Heizöle GmbH, the largest family-owned company in the Austrian mineral oil sector operating in the Graz and Linz region. In 2005, MOL took over Shell Romania, which comprises a network of 59 retail service stations spread across Romania as well as lubricants, aviation and commercial businesses.

2.2.2. Ownership Structure

The privatisation of MOL started in 1995.²⁶ By the end of 1997, the ownership structure of MOL had changed essentially. The share in state ownership – which was held by the Hungarian state property agency ÁPV Rt. – had been decreased to 36.2%. While foreign investors owned 45.1%, domestic investors, mostly private households, held a share of 12.9% in MOL. In addition minor interests were held by local governments (1.1%), MOL's employees and management (3.7%) as well as MOL's treasury fund (1.0%).

In 1998, the state's share was further reduced to 25.0%. In 2000 the Austrian oil company OMV acquired a 9.3% stake in MOL, which it increased to 10% in 2001. In 2002, MOL's treasury fund increased its shareholding to 5.2%, mostly at the expense of foreign investors. During the takeover of Slovnaft, which was financed with a share emission in 2003, the state's share was reduced to 22.7%, OMV's share to 9.1% and the share of MOL's treasury fund to 4%. In addition, a new minority shareholder emerged with Slovbena/Slovintegra, the former owners of Slovnaft, which received 9.8% of MOL.

In 2004, the Hungarian state reduced its shareholding in MOL to 11.8% in an additional privatisation. OMV with 10.0% and Slovbena/ Slovintegra with 8.0% were the largest private minority shareholders. MOL's treasury fund held 4.9%. The remaining shares in MOL were in free float on the domestic and foreign stock exchanges.

2.2.3. Corporate Governance

MOL has a two-tier board system. Since the mid-1990s MOL's supervisory board has always included at least one independent director. In 1998, the number of independent directors increased to three, and since 1999 four independent directors have served on the board. However, a special representative of minority shareholders did not hold a seat on the supervisory board.

MOL's corporate governance has been on a consistently high level. From 1997 to 2001 – read with the 1996 annual report – MOL published its financial information in the

²⁶ The following ownership figures are all taken from MOL's annual reports.

international accounting standard (IAS) and since 2002 in the International Financial Reporting Standard (IFRS) and disclosed its reserve base in accordance with the US GAAP standard. The ownership structure was disclosed, dividends were paid and no violations of shareholders' rights were observed.

By the mid-1990s, the company had already started to adjust to the EU corporate governance regulations and standards in preparation for the accession. MOL also disclosed sensitive company information, which other firms in Central and Eastern Europe were reluctant to do and mostly still are. In summary, MOL has been a leading corporate governance actor in post-socialist Europe, particularly in its disclosure standards and its board structure and functioning. Its disclosure on board remuneration and incentive schemes is above the European average. The quality of MOL's corporate governance performance is also demonstrated by the index values presented in Table 2-4.

Table 2-4: MOL corporate governance index 1997–2004

	1997	1998	1999	2000	2001	2002	2003	2004
Financial information	2	2	2	2	2	2	2	2
Ownership structure	2	2	2	2	2	2	2	2
Board structure	1	1	1	1	1	1	1	1
Dividend payments	2	2	2	2	2	2	2	2
Violations of shareholders' rights	0	0	0	0	0	0	0	0
Quality of corporate governance	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4

2.3. Bashneft (Russia)

2.3.1. Company Profile

After the dissolution of the Soviet Union, the regional government of Bashkortostan took over the majority of shares in the regional oil company Bashneft.²⁷ It used the company's revenues to subsidise the regional economy. In 1998 Bashneft, the regional refinery group Bashneftechim, the regional pipeline operator and the regional electricity company were merged into the regional energy holding Bashkirskaya Toplivnaya Kompaniya (BTK). Within the holding transactions were administratively regulated without regard for market prices. The holding also had to supply regional customers with cheap energy. As a result Bashneft's economic performance was rather poor. Main indicators of the company's economic performance are given in Table 2-5.

²⁷ The company profile is based on a NewsBase archive search (www.newsbase.com) and information provided by United Financial Group (www.ufg.com). For more detailed analyses see: Prospekt Investment (2002) *Bashneft*. Moscow: Prospekt Investment; Krasovsky, Gennady (2002) *Bashneft*. Moving Out of the Shadow. Moscow: Nikoil 2002; O'Sullivan, Stephen (2002) *Bashneft*. A Siberian Turnaround?. Moscow: United Financial Group.

Table 2-5: Bashneft economic performance 1997–2004

	1997	1998	1999	2000	2001	2002	2003	2004
Total crude oil production (mt)	15.4	12.9	12.3	11.9	11.9	12.0	12.0	12.0
Oil exports (mt)	3.4	3.8	3.9	3.8	3.9	4.1	4.2	3.9
Net sales (US\$m)	2,333	3,379	2,352	1,314	1,572	1,426	1,289	1,993
Net profit (US\$m)	207.4	52.8	460.9	432.9	406.7	186.2	194.6	143.8
Share of profit paid as dividends	3.0%	4.7%	0.3%	0.5%	0.5%	na.	na.	na.

Sources: Bashneft company data; NewsBase (www.newsbase.com); Ekspert 38/2005 (www.expert.ru).

The main problem was the decline in oil production, the largest decrease among all Russian oil companies in the 1990s, due to a lack of restructuring and investment. As oil reserves in Bashkortostan had been exhausted to nearly 80% and as crude oil produced in the region is of poor quality, there was an urgent need for a diversification of the resource base.

However, it was only at the end of the 1990s that the company started to diversify its resource base. In 1999 licences for oil fields in Western Siberia were acquired, allowing Bashneft to produce oil outside the region of Bashkortostan for the first time. In November 2001 the company won a tender for the exploitation of oil fields in Kazakhstan. The oil fields, located near Bashkortostan, are doubling Bashneft's reserve base.

2.3.2. Ownership Structure

Information about the ownership structure of Bashneft is incomplete and partly contradictory. In early 1997, the regional government held 67.9% of the company's share capital. Trading in Bashneft shares was restricted. Sales to foreign investors required the approval of the supervisory board and the share of foreigners in the company was limited to 10%. Within the company the regional government was represented by members of the family of the head of the regional government, Murtaza Rakhimov. For example, his son, Ural Rakhimov, served as head of the Bashneft supervisory board for some time.

In early 2002 the BTK Holding, which was being controlled by the regional government, and its subsidiaries had a 78.1% shareholding in Bashneft; the regional government directly held another 1.2%. The remaining shares were held by private investors including a free float on the Moscow stock exchange. Independent investors, among them foreigners, accumulated a stake of more than 10%. However, after they were illegally denied representation on the company board in spring 2003, most of them sold their shares.

In order to attract investment capital, Bashneft decided in 2002 to lift the restrictions on foreign ownership. As a result the company was able to enter foreign stock markets, where Bashneft shares have been traded in the form of GDRs since summer 2002.

The regional government also issued a decree allowing for the privatisation of regional energy companies, including Bashneft. In summer 2003 Bashneft was sold to anonymous buyers. The Russian State Audit Chamber described the sale as "large-scale theft of state assets". However, on demand from a minority shareholder in Bashneft, a local court annulled the sale in November 2003. In May 2005 the respective shares were fi-

nally returned to the control of the Bashkir government after a decision by the regional arbitration court.

In August 2005 a 19.9% stake in Bashneft was sold to the Russian holding company AFK Sistema, which announced its intention to acquire a blocking stake, i.e. 25% plus one share. By October 2005 AFK Sistema had raised its share to 23%.

2.3.3. Corporate Governance

In its whole post-Soviet history Bashneft has exemplified bad corporate governance.

Between 1998 and 2001 Bashneft failed to publish annual reports, with the consequence that trade of its shares was terminated on Russian stock exchanges. In 2002, the company resumed publication of annual reports in the Russian accounting standard.

Bashneft has also failed to make its ownership structure transparent. The regional government's ownership was dispersed among a multitude of government-controlled entities. From 2003 to 2005 no information on the final owners of the former state-owned majority stake in the company was available.

When minority shareholders consolidated a 10% share, entitling them to a seat at the company board, they were illegally banned from participation in the shareholders' meeting of April 2003. As a result they were not able to vote for their candidate, and the board again comprised only representatives of the Bashkir government.

During the whole period under review, Bashneft violated the shareholders' rights of adequate dividend payments, which never amounted to the required 10% of the company's net profits.

Due to the opaque situation at Bashneft, it is not possible to prove cases of asset stripping apart from the 2003 sale of a major stake in the company investigated by the Russian State Audit Chamber. However, with reference to transfer pricing within the BTK and to the dominant and uncontrolled position of members of the Rakhimov clan within the company, it is not unreasonable to assume that asset stripping took place on a regular basis. The resulting values of the corporate governance index are indicated in Table 2-6.

Table 2-6: Bashneft corporate governance index 1997–2004

	1997	1998	1999	2000	2001	2002	2003	2004
FIN	1	0	0	0	0	1	1	1
OWN	1	1	1	1	1	1	1	1
BOD	0	0	0	0	0	0	0	0
DIV	1	1	1	1	1	1	1	1
VIO	1	1	1	1	1	1	1	1
I_{corpgov}	0.4	0.2	0.2	0.2	0.2	0.4	0.4	0.4

2.4. Yukos (Russia)

2.4.1. Company Profile

Yukos was founded as a fully state-owned oil company in 1993.²⁸ In 1995 the company was sold to the Rosprom Holding of Bank Menatep, which was controlled by Mikhail Khodorkovsky. Rosprom overstretched the financial capacities of Yukos through the acquisition of additional assets, including the Russian oil company VNK, and through asset stripping. As a result, a serious conflict with minority shareholders in Yukos production subsidiaries, namely with the American investor Kenneth Dart, arose. Low oil prices and the Russian financial crisis of 1998 then brought the company to the brink of bankruptcy. A planned merger with Sibneft, another major Russian oil company, was cancelled.

After Bank Menatep collapsed in the course of the financial crisis, its chairman Mikhail Khodorkovsky transformed himself from banker to oil magnate as he turned his attention to re-building Yukos. The oil market began to improve, and the post-devaluation environment was looking favourable for export-oriented businesses. The year 2000 then became a turning point in the company's history.

At the end of 2000, the reduction of corporate debts was almost completed. Yukos was also able to secure control over its production subsidiaries that year and started to expand abroad. Major acquisitions included stakes in a Croatian pipeline project, in Lithuania's premier oil company and in Slovakia's oil pipeline operator.

In the following years, Yukos became the most successful Russian oil company in terms of increase in production and share price. In 2003 Yukos again announced a merger with Sibneft. Main indicators of the company's economic performance are given in Table 2-7.

²⁸ The company profile is based on a NewsBase archive search (www.newsbase.com) and on information provided by United Financial Group (www.ufg.com). For more detailed analyses see Tompson, William (2005) Putting Yukos in perspective, *Post-Soviet Affairs*, (21) 2, pp. 159–181; Adachi, Yuko (2005) *Reconstitution of post-Soviet ex-state enterprises into Russian business firms under institutional weakness*, CSESCE Working Paper No. 56, London: School of Slavonic and East European Studies, University College London (www.ssees.ac.uk); Iji, Yuko (2003) *Corporate Control and Governance Practices in Russia*, CSESCE Working Paper No. 33, London: School of Slavonic and East European Studies, University College London (www.ssees.ac.uk); Mazalov, Ivan (2000) *Yukos*, Moscow: Troika Dialog Research; Reznikov, Konstantin (2000): *Yukos. Look who's coming back*, Moscow: Alfa-Bank.

Table 2-7: Yukos economic performance 1997–2004

	1997	1998	1999	2000	2001	2002	2003	2004
Total crude oil production (mt)	35.6	44.6	44.5	49.6	58.1	69.5	80.8	85.7
Oil exports (mt)	9.1	13.3	17.9	22.4	30.1	35.5	43.0	34.0
Net sales (US\$m)	4,619	2,480	2,110	8,948	10,135	11,373	13,349	22,100
Net profit (US\$m)	171.6	-1,735	254.2	3,331	4,006	3,065	na.	na.
Share of profit paid as dividends	0%	—	47.8%	9.2%	13.0%	22.8%	> 10%	na.

Note: Due to back claims by the tax administration, which resulted in long-lasting court proceedings, Yukos could not present final financial results for the years 2003 and 2004. However, the dividend payment for 2003, amounting to more than US\$2 billion was definitely above the required 10% share in net profits.

Sources: Yukos company information.

However, Khodorkovsky's subsequent attempts to engage in politics in opposition to Russia's president Vladimir Putin led to the destruction of the company by state agencies from 2003 to 2005. Tax claims were used to confiscate Yukos' major production unit and charges of economic crimes were used to put the company's leading owners and managers, including Khodorkovsky, in jail.

2.4.2. Ownership Structure

The privatisation of Yukos started in 1995. In December 1995 the Rosprom-Holding of Bank Menatep acquired a 78% share of the company and the bank was able to increase its shareholding to 85% in the following year.²⁹

In 1997 Bank Menatep pledged a 30% stake of Yukos to procure a loan from Standard Bank (South Africa), West Merchant Bank (Germany) and Daiwa Bank (Japan/ UK). When the bank was unable to meet its liabilities in the wake of the 1998 financial crisis, the Yukos stake was claimed by its creditors. However, shortly after a debt-for-equity swap agreement with the lenders was reached, the Yukos supervisory board decided to double the company's share capital, thus diluting the stake to be handed over to the banks. During 1999 Standard Bank acquired the shareholdings of its partner banks thus accumulating a 31.9% stake. The Russian investment bank Troika Dialog alleged the existence of a personal link between Standard Bank and Yukos and concluded that Standard Bank was securing internal control of Yukos.³⁰

In early 2002 Group Menatep, formed around Khodorkovsky and his partners, directly and indirectly owned around 63% of Yukos' share capital. Standard Bank still controlled 19.8%, Yukos employees held 3.4% and BCEN Eurobank held 2.6%. The remaining 11.3% were on free float on Russian and Western stock exchanges.

²⁹ On the privatisation auctions see: Allan, Duncan (2002) Banks and the loans-for-shares auctions. In: Lane, David (ed.): *Russian banking*, Aldershot: Edward Elgar, pp.137–159; Pleines, Heiko (2000) Large-scale corruption and rent-seeking in the Russian banking sector. In: Ledeneva, Alena/ Kurkchiyan, Marina (eds): *Economic crime in Russia*, The Hague: Kluwer, pp. 191–207.

³⁰ Troika Dialog (1999) *Bulletin on Corporate Governance Actions*, 23 June, p.5 and 01 December, p.8.

In preparation of the merger with Sibneft, the ownership structure of Yukos changed in 2003, as Millhouse, Sibneft's owner, acquired a 26% stake in Yukos in exchange for Sibneft shares. Thus the share controlled by Menatep Group was reduced to 51.5%.

2.4.3. Corporate Governance

In the second half of the 1990s Yukos' corporate governance was characterised by significant violations of corporate governance standards. In addition to the dilution of minority shareholders through the emission of new shares and their sale to insiders or companies controlled by Yukos, the company has been accused of asset stripping via transfer pricing and the illegal transfer of shares to unnamed Cypriot companies. As a result Yukos earned the lowest corporate governance rating of all companies covered in this study in 1999.

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

In 1999 the company started to adopt a more investor-friendly stance. In this year Yukos disbursed its first dividend payments which met the required 10% of the company's net profit. In 2000 the company started to publish financial reports in international accounting standards. Also in 2000 three independent directors were elected to the company board for the first time. However, no representatives of minority shareholders have ever been elected to the board.

In conclusion, there is a sharp contrast between the company's bad corporate governance in the 1990s and its adherence to virtually all major corporate governance rules since 2002. The corresponding values of the corporate governance index are indicated in Table 2-8.

Table 2-8: Yukos corporate governance index 1997–2004

	1997	1998	1999	2000	2001	2002	2003	2004
FIN	1	1	1	2	2	2	2	2
OWN	1	1	1	1	1	2	2	2
BOD	0	0	0	1	1	1	1	1
DIV	0	0	—	2	1	2	2	2
VIO	0	1	1+1	1	1	0	0	0
I_{corpgov}	0.4	0.2	0.0	1.0	0.8	1.4	1.4	1.4

2.5. Ukrnafta (Ukraine)

2.5.1. Company Profile

Ukrnafta is Ukraine's national oil company.³¹ It is the largest and the only privatised oil producing company in Ukraine, extracting oil and gas from the continental part of the

³¹ The company profile is based on a NewsBase archive search (www.newsbase.com) and on company information (www.ukrnafta.com). For more detailed analyses see: Gostik, Andriy (2003) *Ukrnafta*, MFK

country. Ukrnafta provides for about 75% of total Ukrainian crude oil and condensate extraction and 20% of natural gas extraction. As Ukraine imports most of its oil and gas, Ukrnafta's share in domestic consumption stands at a mere 9% for oil and 5% for gas.

Ukrnafta's activities have remained restricted to the domestic market. Here it has increasingly needed the support of Western partners in order to produce oil and gas under unfavourable geological conditions. On the retail market Ukrnafta has faced increasing competition from Russian oil companies, namely TNK and Lukoil, since 2000. Main indicators of the company's performance are given in Table 2-9.

Table 2-9: Ukrnafta economic performance 1997–2004

	1997	1998	1999	2000	2001	2002	2003	2004
Oil production (mt)	3.0	3.0	3.0	2.9	2.8	2.8	2.9	3.0
Gas production (bcm)	2.2	2.6	2.7	2.7	2.6	3.3	3.3	3.4
Net sales (US\$m)	560	538	344	538	486	384	556	822
Net profit (US\$m)	163	57	56	182	182	84	167	254
Share of profit paid as dividends	0	2%	0	0	0	0	6%	na.

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

In 2000, the newly appointed, rather ambitious management of Ukrnafta developed plans to engage in oil production in foreign countries, including Yemen, Libya and Russia. However, due to a conflict between the major shareholders, no decision could be reached until 2003. The new management, which was appointed in spring 2003, then started negotiations on foreign projects with Russia, Iraq, Yemen and Libya. In October 2003, the 100%-owned subsidiary Ukrneft was established in Moscow. A year later plans to invest in Russia were abandoned. Until 2005 no agreement on any of Ukrnafta's foreign investment plans could be reached.

Instead the company started to concentrate on the domestic retail market in 2005. Negotiations were started to acquire two of the country's major refineries. In summer 2005 it bought 43 filling stations. Its declared aim is to increase its share in the fuel market to more than 30%.

2.5.2. Ownership Structure

Already in 1992, the first year of Ukrainian independence, the Ukrainian State Property Fund initiated the reorganisation of the oil and gas sector. After more than one year of administrative proceedings Ukrnafta became a separate company in August 1993. In early 1994 the company was then transformed into a limited company with headquarters registered in Kiev. The sole founder was the State Committee for Oil, Gas and Oil Refining.

Company Note 07 May 2003, Kiev: MFK (www.mfkgroup.com); Bespyatov, Andrey (2002) *Case Study: Impact of the State on Corporate Governance Practices at Ukrnafta*, presentation at the 3rd Meeting of the Eurasian Corporate Governance Roundtable, organised by IFC, OECD and World Bank, Kiev 17–18 April; Pleines, Heiko (1998) *Energy in Ukraine*, London: Financial Times Energy Publishing; Sovetov, Valentin (1997) *Ukrnafta*, Kiev: Alfa Capital.

After another year of administrative proceedings, a plan for the privatisation of Ukrnafta was finally agreed on in January 1995. 30.5% of the shares were to be auctioned off to Ukrainian citizens in exchange for privatisation vouchers. 15% were to be tendered to foreign investors. A further 15% were to be offered to domestic investors. 9.5% were reserved for the workers of Ukrnafta and the remaining 30% were to remain state property managed by the State Property Fund.

By summer 1995, 8.6% of Ukrnafta shares were sold to its workers. The further progress of the company's privatisation was hampered by parliament when it decided, in disregard of the existing law on privatisation, that some of Ukrnafta's subsidiaries could not be privatised because of their national relevance. Citing the superiority of the law on privatisation, the State Property Fund nevertheless organised an auction for Ukrnafta shares in September 1995. As envisaged in the privatisation programme, 30.5% of Ukrnafta shares were sold to Ukrainian citizens. But the Ukrainian parliament proved unwilling to accept the privatisation of Ukrnafta. The State Property Fund and the prosecutor general were forced to investigate the lawfulness of the auctions. In the end the State Property Fund stopped the issue of shares to the winners of the auction after only 3.4% of Ukrnafta shares had been given away. Although the lawfulness of the privatisation of Ukrnafta was confirmed by an independent commission and by a court in 1996, the remaining 26.1% of Ukrnafta shares auctioned in 1995 were not issued due to a political stalemate between the government, parliament and State Property Fund.

In the following two years the state sold another 20% of Ukrnafta in public offerings, of which 6% were offered at German and American stock exchanges in the form of ADRs. In addition, stakes adding up to 10% were sold to financial investors in the second half of the 1990s. As a result, Ukrnafta's minority shareholders included Alfa Nafta (which belongs to the Russian Alfa Group), Privatbank, Ukrsibbank and affiliated companies, such as Copland Industries S.A., Watford Petroleum Ukraine, Occidental Management Co. Ltd. and others. The state retained an absolute majority of shares in Ukrnafta, amounting to 50% plus one share. The state's stake in Ukrnafta was transferred to the national oil and gas holding company Naftohaz Ukrainy. By 2001 Privatbank and Ukrsibbank had jointly gained control of 41% of Ukrnafta, mainly through companies registered in Cyprus. In 2002–2003 Ukrsibbank transferred full control over the stake to Privatbank.³²

2.5.3. Corporate Governance

Ukrnafta has a two-tier management system. In the late 1990s the management of the effectively state-controlled oil company engaged in asset stripping of an estimated US\$50m with the help of inflated bills from insurance companies.³³

The new management, which took over in 2000, was hampered by a conflict between the state as majority shareholder and Ukrainian financial investors as minority shareholders, who demanded a say in the company management. According to Ukrainian legislation, in order for a general shareholder meeting to take place, 60% plus one share

³² Information on the ownership structure is based on information provided by the company (www.ukrnafta.com, only available in the Ukrainian version) and by MFK Investment Bank (www.mfkgroup.com).

³³ Prudka, Natalka (2001) Ukrnafta, *Energobiznes* No.21, pp. 16–18; *Energobiznes* 15/2001, p. 9.

must be registered. Privatbank and Ukrsibbank, who gained two out of eleven seats on the supervisory board at the September 2000 general shareholder meeting, used this possibility to block subsequent shareholder meetings in order to pressure for a total of five seats, which would have meant a veto position on key issues, where a 60% quorum is required. As a result, company operations requiring approval at general shareholder meetings, such as the adoption of long-term strategies, the creation of joint ventures or dividend payments, could not take place.

An attempt by the government to reduce the legally required quorum for a general shareholder meeting from 60% to 50% was rejected by parliament. At the extraordinary general meeting of Ukrnafta shareholders in March 2003 an agreement was finally reached. Privatbank received four out of eleven seats on the supervisory board and its candidate, Ihor Palytsya, was appointed as head of the management. The general meeting also agreed to pay no dividends for the preceding years in order to make more funds available for investment. However, conflicts continued and general shareholder meetings were repeatedly delayed. The 2004 meeting, due in February, took place in November. Accordingly, dividend payments for 2003 were only made in 2005.

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

In 2003 the international auditing company Ernst & Young concluded a long-term contract with Ukrnafta, which included the conversion of Ukrnafta's financial balances to international accounting standards. However, until 2005 the company did not publish financial results in IAS. – The resulting values of the corporate governance index are given in Table 2-10.

Table 2-10: Ukrnafta corporate governance index 1997–2004

	1997	1998	1999	2000	2001	2002	2003	2004
FIN	1	1	1	1	1	1	1	1
OWN	1	1	1	1	1	1	1	1
BOD	0	0	0	1	0	0	1	1
DIV	0	0	2	0	0	0	2	2
VIO	1	1	1	0	0	0	0	0
I_{corpgov}	0.2	0.2	0.6	0.6	0.4	0.4	1.0	1.0

3. A Comparative Perspective

Corporate governance presents another example of the difference between Central European countries, which have established functioning market economies and in 2004 joined the EU, and CIS countries, where the market environment is still marked by considerable deficits, including a weak rule of law and widespread corruption. However, apart from the fact that a reference to geographic location is no substitute for an analysis of causal links, the picture is more complex.

First, there are huge differences in corporate governance performance within the CIS countries which have to be explained. In terms of the central aspects of corporate gov-

ernance, as measured by the Heinrich Index, Russia's Yukos was at the same level as Hungary's MOL from 2002–2004, and for two years it even scored better than Poland's PKN Orlen. Meanwhile, Bashneft, another Russian company, was marked by persistently bad corporate governance.

Second, there have been rapid changes in the corporate governance performance of individual CIS companies. Yukos is a prime example. From an index value of 0.0 in 1999, the lowest score among all major oil and gas companies in the countries and period under study here, within just three years it climbed to a value of 1.4, close to the maximum score. Ukrnafta has also seen considerable changes in its corporate governance performance, recently with a clear tendency towards improvements.

For the five companies presented in the above case studies, a number of factors have been given in the literature to explain their specific corporate governance performance. In MOL's case, analysts have pointed to the company's ambitions to adopt EU standards in order to allow for regional expansion and successful competition with Western oil majors.³⁴ A similar argument of the relevance of international business promotion has been made to explain the rapid improvement in the corporate governance performance of Yukos and other world-market oriented Russian oil companies.³⁵

For PKN Orlen, where corporate governance is slightly worse and where political scandals have hampered business development, the problem of state involvement in company management has been stressed.³⁶ The same point has been made regarding Ukrnafta. In addition, private outside minority shareholders have been seen as important promoters of corporate governance improvements.³⁷

The bad corporate governance performance exhibited by Bashneft and Yukos in the 1990s has mainly been explained in terms of the short-term horizon of company owners and managers in post-Soviet Russia. As they were not concerned with long-term profitability, they tried to wring as much money as possible out of the company in the short term. The result was asset stripping to the disadvantage of minority shareholders and blatant disrespect for international business standards.³⁸

However, in Yukos' case an alternative explanation has been suggested more recently. To explain the rapid improvement in the company's corporate governance performance, it is maintained that the company owners had a long-term horizon right from the beginning, i.e. from their acquisition of the company in 1995. However, in order to ensure the long-term development of their business, they first needed to consolidate the company

³⁴ The arguments for this position are presented by: Heinrich, Andreas (2005) Between a Rock and a Hard Place: The Energy Sector in Central and Eastern Europe. In: Liuhto, Kari/ Vincze, Zsuzsanna (eds) *Wider Europe*. Tampere: Esa Print, pp. 457–490.

³⁵ Heinrich, Andreas (2005) Why Corporate Governance in the Russian Oil and Gas Industry Is Improving, *Corporate Governance: The International Journal of Business in Society*, 5(4), pp. 3–9

³⁶ See e.g. Petroleum Argus FSU Energy, Vol. 7, No. 8, 01 March 2002.

³⁷ Bespyatov, Andrey (2002) *Case Study: Impact of the State on Corporate Governance Practices at Ukrnafta*, presentation at the 3rd Meeting of the Eurasian Corporate Governance Roundtable, organised by IFC, OECD and World Bank, Kiev 17–18 April.

³⁸ With reference to Mancur Olson this argument is developed e.g. by Segbers, Klaus (2001) Actors and interests in a changing Russia. In Segbers, Klaus (ed.): *Explaining post-Soviet patchworks, Bd.1, Actors and sectors in Russia between accommodation and resistance*, Aldershot: Ashgate 2001, pp.1–34.

structure and to secure their property rights. In the absence of a functioning legal regulation pertaining to conflicts of interest between majority and minority shareholders, they referred to corporate governance violations like dilution and asset stripping to achieve their aims. Thereafter they were able to enter the second phase of their long-term business strategy, the expansion to global markets, which then required good corporate governance.³⁹

In summary, the five case studies presented above already offer a multitude of explaining factors for the corporate governance performance of post-socialist companies. The aim of the following chapter is to integrate them all into a consistent analytical framework.

4. Factors Influencing Corporate Governance Performance. An Analytical Framework

4.1. Major Factors Influencing Corporate Governance

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

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

The post-socialist institutional environment in the early stage of transformation gave the owners – majority shareholders (outsiders) and managers-owners (insiders) alike – of a company little incentive to restructure the firm or maximise its value. As long as ownership rights were insecure, owners typically withdrew cash flows from their enterprises through fictitious expenses or outright theft at the expense of minority shareholders, instead of increasing the firm's value through reinvestment. Within short time horizons, the owners diverted cash flows to offshore accounts and shell corporations, concentrated losses among subsidiaries held by outsiders (rather than evenly distributing them between the insider-owned holding company and subsidiary), and delayed the payment of dividends.⁴⁰

Even owners interested in the long-term performance of their enterprise did not automatically improve corporate governance. Under the socialist central planning system, enterprises externalised business functions to government ministries and other organisations. Accordingly, owners had to rectify the enterprise's lack of resources and capaci-

³⁹ Adachi, Yuko (2005) *Reconstitution of post-Soviet ex-state enterprises into Russian business firms under institutional weakness*, CSESCE Working Paper No. 56, London: School of Slavonic and East European Studies, University College London (www.ssees.ac.uk); Iji, Yuko (2003) *Corporate Control and Governance Practices in Russia*, CSESCE Working Paper No. 33, London: School of Slavonic and East European Studies, University College London (www.ssees.ac.uk).

⁴⁰ Desai, Raj M./ Goldberg, Itzhak (2000) *The Vicious Circle of Control: Regional Governments and Insiders in Privatized Russian Enterprises*. Washington DC: World Bank.

ties. In the weak post-socialist institutional environment at the early stage of transition, the concentration of ownership was a necessary precondition for restructuring measures to secure full control over a company and to enable the owners to benefit from a successful reconstruction and increased competitiveness. To wield this control the owners used informal practices (including violations of shareholders' rights) to increase their shareholding and to dilute the shares of minority stakeholders. During corporate restructuring, the owners again utilised informal methods, such as centralising the cash flows generated by subsidiaries in a holding company, thereby violating the interests of the shareholders in these subsidiaries.⁴¹ This enabled the owners to bring the various business functions under a single controlling mechanism within the administrative framework of the firm (possibly including vertical integration).

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

Minority shareholders, on their part, have an interest in improved corporate governance when they suspect that the company management is trying to put them at a disadvantage by manipulating corporate information and financial statements. However, outside minority shareholders can only translate this interest into improved corporate governance when they have the means to put pressure on the company board. In the literature on corporate governance, three groups of shareholders are assumed to be especially likely to enforce improvements in a company's corporate governance behaviour. First, financial institutions, such as banks or investment funds; second, strategic investors with a strong minority shareholding; and third, foreign investors, who are normally outsiders and therefore rely on good corporate governance to obtain attractive returns on their investments. In this sense the ownership structure of a company is linked to its corporate governance performance.

However, this link is far from being absolute. For post-socialist countries it has been claimed, for example, that financial institutions play no relevant role in corporate governance issues as they are underdeveloped and themselves badly regulated.⁴² For Ukraine, an empirical study bluntly concludes that no ownership form has managed to change corporate behaviour there.⁴³ Contrary to the argument above, it is reasoned that

⁴¹ Adachi, Yuko (2005) *Informal Corporate Governance Practices in Russia in the 1990s*. Unpublished Ph.D. thesis, London: School of Slavonic and East European Studies, University College London. A substantially shortened version has been published as: Adachi, Yuko (2005) *Reconstitution of post-Soviet ex-state enterprises into Russian business firms under institutional weakness*, CSESCE Working Paper No. 56, London: School of Slavonic and East European Studies, University College London (www.ssees.ac.uk). See also: Iji, Yuko (2003) *Corporate Control and Governance Practices in Russia*, CSESCE Working Paper No. 33, London: School of Slavonic and East European Studies, University College London (www.ssees.ac.uk).

⁴² Estrin, Saul/ Wright, Mike (1999) Corporate Governance in the Former Soviet Union: An Overview, *Journal of Comparative Economics*, (27) 3, pp. 398–421, here: pp. 414–415. See also: Dittus, Peter (1996) Why East European banks don't want equity, *European Economic Review* (40), pp. 655–662 and Frydman, Roman/ Pistor, Katharina/ Rapaczynski, Andrzej (1996) Exit and voice after mass privatization. The case of Russia, *European Economic Review* (40), pp. 581–588.

⁴³ Estrin, Saul / Rosevear, Adam (2003) Ownership changes and corporate governance in Ukraine 1995–1999, *Problems and Perspectives of Management* (1), pp. 29–38. A similar scepticism is voiced for Russia by: Peng, Mike/ Buck, Trevor/ Filatotchev, Igor (2003) Do outside directors and new managers help

in Russia's case strong outside minority shareholders often lead to the deterioration of corporate governance as majority shareholders, along with the management, try to oust troublemakers by dodgy means.⁴⁴ Though ideas about the causal mechanism vary, all studies focusing on ownership structure examine the position of outside minority shareholders as an explaining variable for a company's corporate governance performance.

Improvements in corporate governance can also be the result of cultural learning. In the post-socialist cases, where the domestic economy is initially marked by the absence of corporate governance regulation, the main source of learning is activity on foreign markets characterised by higher corporate governance standards. When a company wants to enter a foreign market, it has to make an effort to adapt to the foreign business environment, potentially including the adoption of foreign corporate governance standards. In other words, the more important foreign markets become to the company, i.e. the more the company becomes internationalised⁴⁵, the likelier it is to at least partly assume the foreign corporate governance practices.⁴⁶ Accordingly, internationalisation is another possible explaining variable for a company's corporate governance performance.

Finally, the state can develop an interest in corporate governance in order to improve the investment climate and to fight a criminalisation of the economy, as the financial manipulations related to bad corporate governance are often fraudulent and can also be used to avoid taxes. The state can accordingly create legal regulations to foster good corporate governance. Their enforcement would then lead to improved corporate governance.

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

improve firm performance? An exploratory study in Russian privatization, *Journal of World Business* (38), pp. 348–360 and Krivogorsky, Victoria (2000) Corporate ownership and governance in Russia, *International Journal of Accounting* 2000 (3), pp. 331–353.

⁴⁴ Woodruff, David (2004) Property rights in context. Privatization's legacy for corporate legality in Poland and Russia, *Studies in Comparative International Development*, (38) 4, pp. 82–108; Adachi, Yuko (2005) Reconstitution of post-Soviet ex-state enterprises into Russian business firms under institutional weakness, CSESCE Working Paper No. 56, London: School of Slavonic and East European Studies, University College London (www.ssees.ac.uk); Iji, Yuko (2003) *Corporate Control and Governance Practices in Russia*, CSESCE Working Paper No. 33, London: School of Slavonic and East European Studies, University College London (www.ssees.ac.uk).

⁴⁵ Here internationalisation refers solely to a company's efforts to enter foreign markets and to find partners abroad. It does not include cooperation with foreign companies on the domestic market. Firstly, in this instance the foreign partner and not the domestic company is forced to engage in cultural learning. Secondly, if the foreign partner acquires a share in the domestic company, this will be covered by the ownership structure.

⁴⁶ For post-socialist countries this argument is supported by empirical studies like: Heinrich, Andreas (2005) Why Corporate Governance in the Russian Oil and Gas Industry Is Improving, *Corporate Governance: The International Journal of Business in Society*, 5(4), pp. 3–9; Heinrich, Andreas (2004) *Globale Einflußfaktoren auf das Unternehmensverhalten. Die corporate governance des russischen Erdöl- und Erdgassektors*. Münster: Lit; Walsh, Patrick / Whelan, Ciara (2001) Firm performance and the political economy of corporate governance. Survey evidence for Bulgaria, Hungary, Slovakia and Slovenia, *Economic Systems* (25), pp. 85–112.

test of the relevance of these potential explaining factors of corporate governance performance, an operationalisation will be presented in the following section.

4.2. Operationalisation

The following operationalisation presents the framework for a planned research project. For the quantitative part, the project aims to examine about 500 big industrial enterprises in nine post-socialist countries (Bulgaria, Czech Republic, Lithuania, Hungary, Poland, Russia, Slovakia, Slovenia, Ukraine). For the qualitative part companies of special interest will be selected for case studies.

So far 15 oil and gas companies from four countries (Poland, Hungary, Russia and Ukraine) have been covered in a test phase. The values for all these companies are given in the appendix. Resulting correlations will be discussed in Part 5. Here the five companies depicted in the above case studies will be used to illustrate the proposed operationalisation of the four explaining variables.

4.2.1. Strategies of Majority Shareholders

As has been argued above, the interests and strategies of majority shareholders can be distinguished in (1) asset stripping, (2) ensuring property rights, (3) internal consolidation and (4) long-term profitability/ entrepreneurship. While in the first case (asset stripping) majority shareholders enrich themselves at the expense of minority shareholders, in the cases of ensuring property rights and internal consolidation (corporate restructuring), the majority shareholders use bad corporate governance as a means to accomplish their aims. Bad corporate governance performance is rendered counter-productive only if the majority shareholders develop a long-term entrepreneurial strategy aimed at profitability in a market context.

For each company and for each year under study, the interests and strategies of majority shareholders (V_{strat}) will be determined and indicated by a single-digit number:

- 0 stands for the strategy of asset stripping by majority shareholders and/or the management,
- 1 stands for a situation in which majority shareholders use bad corporate governance (i.e., the violation of shareholders' rights) as a means to ensure property rights in a company or to conduct its internal consolidation/restructuring or do not stop the management from doing so,
- 2 stands for a situation in which relevant majority shareholders develop a strategy of long-term profitability (entrepreneurship) in a market context.

Of the five companies covered in the above case studies, only PKN Orlen and MOL have been guided by a long-term business strategy during the entire period covered here. The quality of that long-term strategy may be questioned especially in the case of PKN Orlen, but there were no attempts to violate standards of corporate governance in order to favour the interests of the majority shareholders or the management. Accordingly both companies receive a value of 2 for all years.

The development of Bashneft was, during the whole period, hampered by attempts from groups close to the regional government to transfer company assets as subsidies to other companies or as profits into their own pockets. Therefore Bashneft receives a value of 0 for all years.

Ukrnafta was marked by a similar problem during the 1990s, as the management embezzled company funds. However, the situation changed radically in 2000 when new management was appointed, which developed a comprehensive long-term business strategy aimed at internationalisation. Again, though this strategy proved to be a complete failure, its adoption committed the management to better corporate governance behaviour. Accordingly, Ukrnafta receives a value of 0 for the period 1997 to 1999 and a value of 2 for the period 2000 to 2004.

Yukos was originally marked by bad corporate governance. Although there were cases of asset stripping by the majority shareholder, the main corporate governance violation was the consolidation of the ownership structure. This is confirmed by the fact that after this consolidation was realised, corporate governance improved in line with the development of a long-term business strategy. Yukos accordingly receives a value of 1 for the period 1997 to 2001 and a value of 2 for the period 2002 to 2004.

4.2.2. Position of Minority Shareholders

When analysing the ownership structure of a company, it is important not only to list individual owners but also to establish the combined share of the group most likely to lobby for improvements in corporate governance, i.e. private outside minority shareholders.⁴⁷

The formal possibilities of minority shareholders to influence a company's policy then depend on legal regulation. Accordingly, the important indicator is not the share itself, but the legal possibilities for action attached to that share.

For each company and for each year under study, the legal position of relevant minority shareholders (V_{minority}) will be determined and indicated by a single-digit number:

- 0 stands for a situation in which the combined holdings of relevant minority shareholders are not enough to gain representation on the company board, though their representatives may be elected with support from the majority shareholder;
- 1 stands for a situation in which relevant minority shareholders would be legally entitled to representation on the company board if they voted together, but would not be able to block any decisions,
- 2 stands for a situation in which relevant minority shareholders could veto or block decisions related to the company's corporate governance performance if they voted together,
- 3 stands for a situation in which relevant minority shareholders could pass formal decisions related to the company's corporate governance performance if they voted together.

As privatisation of the oil industry was still ongoing in all four countries covered here during the period of investigation, the relevance of minority shareholders continuously increased. In the cases of Ukrnafta and Yukos, the first private outside minority owner entitled to board representation appeared in 1999; in MOL's case in 2000; in PKN Orlen's in 2002 and in Bashneft's in 2003. For these companies, the value of V_{minority} therefore changes from 0 to 1 in the corresponding years. However, only the combined

⁴⁷ This means minority holdings by insiders (i.e. holders related to the majority owners or the management) and the state, as well as the free float on stock exchanges, are not considered here.

shareholdings of minority owners in Ukrnafta crossed the threshold required for veto powers, securing a value of 2.

4.2.3. Internationalisation

As internationalisation is here seen as an indicator for cultural learning induced through experience in a different environment, it refers solely to a company's efforts to enter foreign markets and to find partners abroad.

Since internationalisation is a dynamic, complex process, restricting its measurement to any one indicator inevitably yields an incomplete or even distorted picture. Accordingly, internationalisation will be measured by the Heinrich Index⁴⁸, which covers (1) exports, (2) level of foreign direct investment (FDI), (3) spread of international activities and (4) international strategic partnerships.

The Heinrich Index thereby focuses on the aspects of internationalisation related to potential cultural learning and was created taking into consideration the most important multidimensional indices, such as the UNCTAD's "Transnationality Index"⁴⁹; the "Transnationality Spread Index" developed by Ietto-Gillies⁵⁰; Sullivan's "Degree of Internationalisation" index⁵¹; the Gomes and Ramaswamy "Multinationality Index"⁵²; and the "Two Dimensions Index" by Hassel et al.⁵³

The weighting of the indicators in the Heinrich Index is based on the degree of their specificity. Specific investments are characterised by the fact that they have a higher profitability than unspecific investments and their costs are sunk. As a company's room for manoeuvre decreases through its engagement (open competition before the conclusion of an agreement becomes an exclusive relationship afterwards), the specificity of the engagement increases accordingly. Opportunism becomes riskier for a company as the specificity of an engagement rises. Therefore, for internationalisation to progress, both the adaptation of knowledge and the development of trust between companies are required.⁵⁴

⁴⁸ The index is still being developed. The version presented here differs from versions used in earlier publications (see e.g. Heinrich, A. (2005) Why Corporate Governance in the Russian Oil and Gas Industry Is Improving, *Corporate Governance: The International Journal of Business in Society*, 5(4), pp. 3–9 or Heinrich, Andreas (2004) *Globale Einflußfaktoren auf das Unternehmensverhalten. Die corporate governance des russischen Erdöl- und Erdgassektors*. Münster: Lit). In the future, borrowing on international capital markets and ADR/GDR programmes may be added to the index as further indicators. In addition, the weighting between the index components is still being tested.

⁴⁹ UNCTAD (2001) *World Investment Report 2001. Promoting Linkages*. New York: United Nations.

⁵⁰ Ietto-Gillies, Grazia (1998) Different Conceptual Frameworks for the Assessment of the Degree of Internationalisation: An Empirical Analysis of the Various Indices for the Top 100 Transnational Corporations, *Transnational Corporations*, (7) 1, pp. 17–39.

⁵¹ Sullivan, Daniel (1994) Measuring the Degree of Internationalisation of a Firm, *Journal of International Business Studies*, (25) 2, pp. 325–342.

⁵² Gomes, Lenn/ Ramaswamy Kannan (1999) An Empirical Examination of the Form of the Relationship Between Multinationality and Performance, *Journal of International Business Studies*, (30), 1, pp. 173–188.

⁵³ Hassel, Anke/ Höpner, Martin/ Kurdelbach, Antje/ Rehder, Britta/ Zugehör, Rainer (2003) Two Dimensions of the Internationalisation of Firms, *Journal of Management Studies*, (40) 3, pp. 705–723.

⁵⁴ Cf. e.g., Williamson, Oliver E. (1975) *Markets and Hierarchies, Analysis and Antitrust Implications: A Study in the Economics of Internal Organizations*. New York: Free Press.

(1) Exports are the classical starting point for the internationalisation of companies. To analyse companies without their own crude oil or natural gas production, imports of oil and gas can be chosen instead. This first step of internationalisation requires relatively little market knowledge. The exports, or imports, are measured in relation to a company's total production or total sales, respectively, represented by a value between 0 and 5. The indicator will be assigned a specificity of 1.

(2) The indicator "FDI" focuses only on investments in the core business of the companies under review. Investments in export companies or export facilities are also excluded from the index.

FDI can be divided into five investment forms with increasing specificity: joint ventures (including production-sharing agreements), minority shareholdings, majority shareholdings, mergers and the establishment of new companies in a foreign country.

A joint venture can be described as the co-operation of at least two companies on only one single project. Therefore, a joint venture has a specificity of 1. All other forms of FDI – from minority shareholdings to majority shareholdings and mergers – have a higher specificity because these investments are not confined to one single project. On the contrary, these forms of investment generally amount to participation in the whole business policy of the foreign company. As the degree of shareholding increases, so does the control over the foreign company; however, the costs for exiting this kind of investment simultaneously rise too. A higher degree of share ownership therefore means a higher specificity. The form of FDI with the highest specificity is the establishment of a new company in a foreign country. The investing company foregoes the benefit of a local partner and its market knowledge, which increases the risk of the investment. This form of FDI has been assigned a specificity of 5.

The entire indicator "FDI" has been assigned a specificity of 2 and its measure of the volume of FDI in relation to a company's sales will be represented by a value between 0 and 5.

(3) The indicator "spread of FDI" distinguishes between the spatial and psychic dispersions of a company's international operations. According to Hallen and Wiedersheim-Paul, psychic dispersion describes the difference in perception between the home market and foreign market.⁵⁵ Evans et al. define psychic distance as "the distance between the home market and a foreign market resulting from the perception and understanding of cultural and business differences". "Cultural distance" is often used synonymously with psychic distance.⁵⁶

Spatial dispersion is measured by the total number of countries in which a company is investing (grouped in activities in less than seven countries, which is represented by a value of 1; activities in seven to sixteen countries, represented by a value of 2; and activities in more than sixteen countries, which is represented by a value of 3). The psychic dispersion of a company's international operations is measured by the distribution

⁵⁵ Hallen, Lars/ Wiedersheim-Paul, Finn (1993) Psychic Distance and Buyer-Seller Interaction, in P. J. Buckley and P. N. Ghauri (eds): *The Internationalisation of the Firm: A Reader*. Academic Press: London, pp. 291–302.

⁵⁶ Evans, Jody/ Treadgold, Alan/ Mavondo, Felix (2000) Psychic Distance and the Performance of International Retailers: A Suggested Theoretical Framework, *International Marketing Review*, (17) 4–5, pp. 373–391.

of activity among the psychic zones, whereby the number of zones is counted. Like the indicator “FDI”, the indicator “spread of activities” has been assigned a specificity of 2.

While the spatial dimension is covered by the number of foreign countries in which a company has investments, measuring the psychic dispersion follows the logic of Ronen and Shenkar⁵⁷, who calibrated the dispersion of FDI among the psychic zones of the world. Each zone is supposed to have unique principles of management⁵⁸ as well as different legal traditions.⁵⁹

In this paper 13 psychic zones are distinguished: (1) the Nordic zone (Denmark, Norway, Sweden, Finland, Iceland); (2) the Germanic zone (Germany, Austria, Switzerland, the Netherlands); (3) the Anglo zone (the United States, Canada, Australia, New Zealand, the United Kingdom, Ireland, South Africa); (4) the Latin European zone (France, Belgium, Italy, Spain, Portugal); (5) the Central and Eastern European zone; (6) the Balkans zone (including Greece, Bulgaria, Romania, Turkey); (7) the former Soviet Union zone; (8) the Near Eastern zone (Saudi Arabia, Kuwait, Oman, UAE, Bahrain, Abu-Dhabi, Iran); (9) the Far Eastern zone (Malaysia, Hong Kong, Singapore, Philippines, Vietnam, Indonesia, Taiwan, Thailand); (10) the Middle and Latin American zone (Mexico, Argentina, Brazil, Venezuela, Chile, Mexico, Peru, Colombia); (11) the African zone; (12) the Offshore zone (Cyprus, Gibraltar, Virgin Islands); and (13) the Independent zone (India, Japan, Israel, China).

(4) “Strategic alliances can be defined as purposive strategic relationships between independent firms that share compatible goals, strive for mutual benefits, and acknowledge a high level of mutual dependence”.⁶⁰ Companies involved in strategic alliances have to co-ordinate their business policies, which also inevitably means internalising critical information or capabilities from each other. The indicator “strategic alliances” has been assigned the highest specificity in the index, 3.

In a formalised version, the index to measure the degree of internationalisation can be described as follows:

$$I_{\text{intern}} = 1 \cdot \text{EXP} + 2 \cdot (\text{FDI} + \text{SPR}) + 3 \cdot \text{ALL}$$

EXP = Exports (in relation to total production) or imports (in relation to total sales)
 [no exports/ imports = 0; -5% = 0.25; 6–10% = 0.5; 11–15% = 0.75; 16–20% = 1; 21–25% = 1.25; 26–30% = 1.5; 31–35% = 1.75; 36–40% = 2; 41–45% = 2.25; 46–50% = 2.5; 51–55% = 2.75; 56–60% = 3; 61–65% = 3.25; 66–70% = 3.5; 71–75% = 3.75; 76–80% = 4; 81–85% = 4.25; 86–90% = 4.5; 91–95% = 4.75; 96–100% = 5]

⁵⁷ Ronen, Simcha/ Shenkar, Oded (1985) Clustering Countries on Attitudinal Dimensions: A Review and Synthesis, *Academy of Management Review*, (10) 3, pp. 435–454.

⁵⁸ Hofstede, Geert (1993) Cultural Constraints in Management Theories, *Academy of Management Executive*, (7) 1, pp. 81–94.

⁵⁹ Cf. La Porta, Rafael/ Lopez-de-Silanes, Florencio/ Shleifer, Andrei/ Vishny, Robert (1998) Law and Finance, *Journal of Political Economy*, (106) 6, pp. 1113–1155.

⁶⁰ Kale, Prashant/ Singh, Harbir/ Perlmutter, Howard (2000) Learning and Protection of Proprietary Assets in Strategic Alliances: Building Rational Capital, *Strategic Management Journal*, 21, pp. 217–237, here p. 218.

- FDI = Foreign direct investments (as a product of the investment volume in relation to total sales and the specificity of the investment; in the case of several investments the sum of the products is built)
 Volume: [no FDI = 0; -5% = 0.25; 6–10% = 0.5; 11–15% = 0.75; 16–20% = 1; 21–25% = 1.25; 26–30% = 1.5; 31–35% = 1.75; 36–40% = 2; 41–45% = 2.25; 46–50% = 2.5; 51–55% = 2.75; 56–60% = 3; 61–65% = 3.25; 66–70% = 3.5; 71–75% = 3.75; 76–80% = 4; 81–85% = 4.25; 86–90% = 4.5; 91–95% = 4.75; 96–100% = 5]
 Specificity: [none = 0; joint venture = 1; minority shareholding = 2; majority shareholding = 3; merger = 4; new establishment = 5]
- SPR = Spread of FDI (as a sum of spatial and psychic dispersion)
 Spatial dispersion: [FDI in fewer than seven countries = 1; FDI in seven to sixteen countries = 2; FDI in more than sixteen countries = 3]
 Psychic dispersion: [number of psychic zones in which a company is investing]
- ALL = Strategic alliances
 [no strategic alliances = 0; strategic alliance = 2]

As internationalisation here focuses on effects of cultural learning, high internationalisation values are only possible in the case of FDI which is big enough to be relevant for the company's overall business development. This is clearly not the case for Ukrnafta, as Table 4-1 indicates.

Table 4-1: Ukrnafta internationalisation index 1997–2004

	1997	1998	1999	2000	2001	2002	2003	2004
EXP	0	0	0	0	0	1.25	0.25	na
FDI	0	0	0	0	0	0	0	0
SPR	0	0	0	0	0	0	0	0
ALL	0	0	0	0	0	0	0	0
I_{intern}	0	0	0	0	0	1.25	0.25	na

Accordingly, high internationalisation index values are achieved by companies which focus on international expansion, such as MOL. The index values for Yukos, given in Table 4-2, indicate the relevance of increasing FDI, especially if investments are spread among several regions.

Table 4-2: Yukos internationalisation index 1997–2004

	1997	1998	1999	2000	2001	2002	2003	2004
EXP	1.5	1.5	2.0	2.25	2.75	2.75	2.75	2.0
FDI	0	0	0	0.25	3.0	3.0	3.0	2.0
SPR	0	0	0	1+1	1+5	1+5	1+5	1+5
ALL	0	2	2	2	2	2	2	2
I_{intern}	1.5	7.5	8.0	12.75	26.75	27.25	27.25	24.5

The index values for the other companies are given in the appendix.

4.2.4. Legal Regulation

In this study the quality of corporate governance is measured by an index comprising five indicators: (1) disclosure of financial information, (2) transparency of ownership structure, (3) management and supervisory board structure, (4) dividend payments and (5) corporate violation of shareholders' rights.⁶¹ In order to assess the impact of legal

⁶¹ The construction of the corporate governance index is described in Part 1.

regulation on corporate governance, therefore, the legal regulation index covers the same five aspects. As the corporate governance index is unweighted, so is the legal regulation index.

(1) In accordance with the corporate governance index, the legal obligation to publish and audit financial information according to national accounting standards only is assigned the value 1, whereas the legally binding introduction of international accounting standards is represented by the value 2. If a comprehensive law on the disclosure of financial information is lacking, a value of 0 is assigned.

(2) For the transparency of a company's ownership structure, three legal provisions are of special relevance: the obligation to publish changes in ownership above a certain threshold,⁶² the obligation to name the real and not just the nominal holder of the shares, and thirdly, the obligation to indicate any shareholdings by the company management. Only if all three provisions are included in the legislation is a complete disclosure of ownership guaranteed by the law; a value of 2 is assigned. If only one or two of the provisions are legally binding, a value of 1 is assigned. In the absence of any legal provision related to ownership disclosure, a value of 0 is assigned.

(3) Legislation can promote the election of minority shareholders and independent directors to company boards. First, it is important that minority shareholders have a fair chance to attend the annual shareholder meetings, where board members are elected. Related legal provisions include adequate registration of shareholders as well as a timely announcement and an accessible location. Second, minority shareholders can be granted the right to vote for a common candidate to the board (cumulative voting). In addition legislation can make the election of an independent board member compulsory. Legislation promoting minority shareholder representation as well as legislation promoting independent directors will each be assigned a value of 1, while the value 0 indicates the absence of such legislation. The value of the indicator is the sum of both figures.

(4) Legislation which either makes dividend payments compulsory or gives full authority over dividend payments to the annual shareholder meeting is assigned the value 2 if it is without loopholes and the value 1 if it can be manipulated (e.g. by manipulation of the indicators for compulsory payments). A value of 0 indicates the absence of respective legislation.

(5) As the most prominent and severe violations of minority shareholders' rights, asset stripping and dilution have been included in the corporate governance index. Accordingly, laws banning these practices are necessary to provide a legal basis for good corporate governance in this respect. In addition, the existence of an "oppressed minority rule", i.e. the right to initiate legal action against the management on the basis of "duty of care", is of vital importance. Accordingly, a value of 2 will be assigned if all aspects are regulated comprehensively, while a value of 1 is assigned if at least one aspect is covered in full, while a value of 0 indicates the absence of any meaningful legislation on the issue.

⁶² This threshold should be reasonably low, i.e. it should at least allow the identification all shareholders entitled to a seat on the company board. A rather common minimum threshold for disclosure is the acquisition of a 5% share.

As legislation can only have a direct impact on company behaviour when it is enforced, the legal regulation index covers not only the quality of legislation, as operationalised above, but also the degree of enforcement. For each of the five indicators, a value of 0 is assigned if there is no enforcement at all, a value of 1 is assigned if there is only inconsistent enforcement and a value of 2 represents universal enforcement. As universal enforcement of inconsistent or deficient legislation does not promote good corporate governance, the value for enforcement cannot be higher than the corresponding value for the quality of legislation. The value for the degree of enforcement is based on expert assessments.

As legal regulation tends to be universal – at least at the level of joint stock companies, which are covered in this study – the corresponding index was designed for countries and applies to all companies from these countries. However, when legal regulation or enforcement differs for specific companies included in the study, e.g. according to size, branch or region, a different index value will be indicated.

In a formalised version, the legal regulation index can be described as follows:

$$I_{\text{legal}} = (FIN_{\text{legal}} + OWN_{\text{legal}} + BOD_{\text{legal}} + DIV_{\text{legal}} - VIO_{\text{legal}}) / 5$$

$$FIN_{\text{legal}} = (FIN_{\text{law}} + FIN_{\text{enforcement}}) / 2$$

FIN_{law} : quality of legislation on disclosure of financial information
[none = 0; disclosure only in the national accounting standard = 1; disclosure in the national and an international accounting standard (IAS, US GAAP) = 2]
 $FIN_{\text{enforcement}}$: enforcement of legislation on disclosure of financial information
[no = 0; inconsistent = 1, universal = 2; with $FIN_{\text{law}} \geq FIN_{\text{enforcement}}$]

$$OWN_{\text{legal}} = (OWN_{\text{law}} + OWN_{\text{enforcement}}) / 2$$

OWN_{law} : quality of legislation on disclosure of ownership structure
[none = 0; partial = 1; complete = 2]
 $OWN_{\text{enforcement}}$: enforcement of legislation on disclosure of ownership structure
[no = 0; inconsistent = 1, universal = 2; with $OWN_{\text{law}} \geq OWN_{\text{enforcement}}$]

$$BOD_{\text{legal}} = (BOD_{\text{law}} + BOD_{\text{enforcement}}) / 2$$

BOD_{law} : quality of legislation on company board election
[Sum of (1) promotion of minority shareholders' rights: no = 0; yes = 1, (2) promotion of independent directors: no = 0; yes = 1]
 $BOD_{\text{enforcement}}$: enforcement of legislation on company board election
[no = 0; inconsistent = 1, universal = 2; with $BOD_{\text{law}} \geq BOD_{\text{enforcement}}$]

$$DIV_{\text{legal}} = (DIV_{\text{law}} + DIV_{\text{enforcement}}) / 2$$

DIV_{law} : quality of legislation on dividend payments
[none = 0; partial = 1; complete = 2]
 $DIV_{\text{enforcement}}$: enforcement of legislation on dividend payments
[no = 0; inconsistent = 1, universal = 2; with $DIV_{\text{law}} \geq DIV_{\text{enforcement}}$]

$$VIO_{\text{legal}} = (VIO_{\text{law}} + VIO_{\text{enforcement}}) / 2$$

VIO_{law} : quality of legislation on corporate governance violations
[none = 0; partial = 1; complete = 2]
 $VIO_{\text{enforcement}}$: enforcement of legislation on corporate governance violations
[no = 0; inconsistent = 1, universal = 2; with $VIO_{\text{law}} \geq VIO_{\text{enforcement}}$]

The calculation of the legal regulation index shall be demonstrated on the Russian example. Major corporate governance legislation, included in the Federal Law on Joint-Stock Companies, entered into force at the beginning of 1996. Accordingly the quality of legislation does not differ over the period under examination.

Companies are required to disclose audited financial statement according to Russian accounting rules. The introduction of international accounting standards on a compulsory basis had been discussed since the late 1990s, but no relevant legislation was passed until the end of 2004. Enforcement of the requirement to disclose financial statements in national standards has been fairly universal, and noncompliant companies have faced sanctions, as in the case of Bashneft, which saw its shares suspended from trade on Russian stock exchanges. However, as enforcement does not cover international standards, the value for both FIN_{law} and $FIN_{enforcement}$ is 1 for the whole period.

According to the law on joint-stock companies, Russian companies have to provide full information on their ownership structure. The threshold for ownership disclosure is set at 5%. However, in many cases real ownership was hidden behind unknown offshore firms. As company registrars were privately managed, even information on nominal ownership was often unavailable. As has been mentioned in the case study of Yukos, the head of the company management revealed his position as major shareholder only in 2002. However, due to some pressure, most prominently from the stock exchange commission, enforcement was achieved in some cases. Accordingly, the value for OWN_{law} is 2; for $OWN_{enforcement}$ it is 0 for the period from 1997 to 2001 and 1 from 2002 to 2004.

Relevant Russian legislation includes all provisions to promote the election of minority shareholders to the company board, but does not require the election of independent board members. Accordingly, the value for BOD_{law} is 1. However, enforcement of the rules was virtually non-existent in the 1990s, when companies in many cases barred minority shareholders from participation in shareholders' meetings. Such cases continued to surface in the following years, as demonstrated by the example of Bashneft in 2003, but some of them were successfully challenged in courts. Thus the value for $BOD_{enforcement}$ is 0 for the period from 1997 to 2001 and 1 from 2002 to 2004.

The law gives full authority over dividend payments to the annual shareholders' meeting, and in addition company charters mandate a minimum dividend payment of 10% of net profits. However, as financial information need only be provided in national accounting standards, information related to dividend payments can be manipulated. In the oil industry, for example, transfer pricing between production subsidiaries and holding structures was very common in the 1990s. As a result the subsidiaries reported losses and minority shareholders, most famously the American investor in Yukos subsidiaries, Kenneth Dart, did not receive dividends. Though the economic recovery has promoted a rise in dividend payments, there is still no enforcement of related regulation. Accordingly the value for DIV_{law} is 1 and for $DIV_{enforcement}$ it is 0 for the whole period.

Russian legislation provides all means to fight and sanction violations of minority shareholders' rights like dilution and asset stripping. However, enforcement was non-existent in the 1990s, as cited in the Yukos case, and has remained inconsistent in subsequent years, as the Bashneft example indicates. Accordingly, the value for VIO_{law} is 2; for $VIO_{enforcement}$, it is 0 for the period from 1997 to 2001 and 1 from 2002 to 2004.

The resulting values for Russia's legal regulation index are presented in Table 4-3. They indicate that while the quality of legislation is rather high, enforcement is still inconsistent. If Russian companies had stuck to the law, they would have achieved a corporate governance index value of 1.0.⁶³ If they had complied only with those legal provisions which are at least inconsistently enforced, they would have received an index value of -0.2 in the 1990s⁶⁴ and a value of 0.8 as of 2002⁶⁵.

Table 4-3: Russia legal regulation index 1997–2004

	1997	1998	1999	2000	2001	2002	2003	2004
FIN	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1
OWN	(2+0)/2=1	(2+0)/2=1	(2+0)/2=1	(2+0)/2=1	(2+0)/2=1	(2+1)/2=1.5	(2+1)/2=1.5	(2+1)/2=1.5
BOD	(1+0)/2=0.5	(1+0)/2=0.5	(1+0)/2=0.5	(1+0)/2=0.5	(1+0)/2=0.5	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1
DIV	(1+0)/2=0.5	(1+0)/2=0.5	(1+0)/2=0.5	(1+0)/2=0.5	(1+0)/2=0.5	(1+0)/2=0.5	(1+0)/2=0.5	(1+0)/2=0.5
VIO	(2+0)/2=1	(2+0)/2=1	(2+0)/2=1	(2+0)/2=1	(2+0)/2=1	(2+1)/2=1.5	(2+1)/2=1.5	(2+1)/2=1.5
I_{legal}	(7+1)/10=0.8	(7+1)/10=0.8	(7+1)/10=0.8	(7+1)/10=0.8	(7+1)/10=0.8	(7+4)/10=1.1	(7+4)/10=1.1	(7+4)/10=1.1

Sources: Ernst & Young (2000) *Corporate Governance in Russia. Is there any chance for improvement?*, Moscow: Ernst & Young; Hashi, Iraj (2003) *The Legal Framework for Effective Corporate Governance: Comparative Analysis of Provisions in Selected Transition Economies*. Warsaw: Center for Social and Economic Research (Studies and Analyses No. 268); Lovells CIS (2003) *Principles of Corporate Governance and Corporate Governance Checklist*. Russia, Moscow: Lovells CIS; Makarova, Olga A. (2005) *Korporativnoe pravo*, Moscow: Wolters Kluwer; Radygin, A.D./ Entov, R.M./ Gontmakher, A.E./ Mezheraups, I.V./ Turuntseva, M.Yu. (2004) *Ekonomiko-pravovye faktory i ogranycheniya v stanovlenii modelei korporativnogo upravleniya*, Moscow: IET, pp. 35–175.

The legal regulation index values for the other countries covered in this study are given in the appendix.

5. Conclusion

On the basis of the five case studies, it has been argued in Part 3 that there is no single explaining factor for corporate governance performance. This assessment is confirmed by the analysis of all 15 companies included in this study. As the Tables 5-1 to 5-4 demonstrate, there are some significant correlations between the four explaining factors discussed here and corporate governance performance, but no single relationship is strong enough to claim a monocausal link.

⁶³ $I_{\text{corp.gov}} = (\text{FIN} + \text{OWN} + \text{BOD} + \text{DIV} - \text{VIO}) / 5 = (1 + 2 + 1 + 1 - 0) / 5 = 1.0$

⁶⁴ $I_{\text{corp.gov}} = (\text{FIN} + \text{OWN} + \text{BOD} + \text{DIV} - \text{VIO}) / 5 = (1 + 0 + 0 + 0 - 0) / 5 = -0.2$

⁶⁵ $I_{\text{corp.gov}} = (\text{FIN} + \text{OWN} + \text{BOD} + \text{DIV} - \text{VIO}) / 5 = (1 + 2 + 1 + 0 - 0) / 5 = 0.8$

Table 5-1: Correlation between strategy of majority shareholders and corporate governance

	1997	1998	1999	2000	2001	2002	2003	2004
Spearman's rho	0.800**	0.697**	0.633*	0.562*	0.618*	0.625*	0.638*	0.614*
Significance	0.001	0.006	0.011	0.029	0.018	0.017	0.026	0.034
Number of cases	14	14	15	15	14	14	12	12

Note: * correlation is significant at the 0.05 level (2-tailed).

** correlation is significant at the 0.01 level (2-tailed).

Table 5-2: Correlation between position of minority shareholders and corporate governance

	1997	1998	1999	2000	2001	2002	2003	2004
Spearman's rho	0.014	-0.157	-0.543*	-0.029	-0.199	-0.270	-0.026	0.206
Significance	0.961	0.593	0.037	0.920	0.496	0.350	0.936	0.520
Number of cases	14	14	15	15	14	14	12	12

Note: * correlation is significant at the 0.05 level (2-tailed).

Table 5-3: Correlation between internationalisation and corporate governance

	1997	1998	1999	2000	2001	2002	2003	2004
Spearman's rho	0.522	0.643*	0.307	0.720**	0.680**	0.557*	0.492	0.225
Significance	0.056	0.013	0.265	0.002	0.007	0.038	0.104	0.507
Number of cases	14	14	15	15	14	14	12	12

Note: * correlation is significant at the 0.05 level (2-tailed).

** correlation is significant at the 0.01 level (2-tailed).

Table 5-4: Correlation between legal regulation and corporate governance

	1997	1998	1999	2000	2001	2002	2003	2004
Spearman's rho	0.624*	0.577*	0.620*	0.625*	0.524	0.434	0.270	0.598*
Significance	0.017	0.031	0.014	0.013	0.055	0.121	0.396	0.040
Number of cases	14	14	15	15	14	14	12	12

Note: * correlation is significant at the 0.05 level (2-tailed).

A more complex framework is therefore necessary to explain corporate governance performance. On the basis of research conducted so far we would suggest the following causal mechanisms:

The strategy of majority shareholders is positively correlated with corporate governance performance. However, there are intervening variables. First, the strategy of majority shareholders has an impact on corporate governance only above a lower limit set by legal regulation. In addition, if the position of minority shareholders is strong (i.e. if $V_{\text{minority}} \geq 2$), they have the potential to neutralise the strategy of majority shareholders. However, as Table 15 seems to indicate, the presence of weak minority shareholders ($V_{\text{minority}} = 1$) provoked corporate governance violations to their disadvantage, thus leading to worse corporate governance, especially in the late 1990s. If the strategy of majority shareholders is oriented towards long-term profitability (i.e. if $V_{\text{strat}} = 2$), its positive

impact on corporate governance performance is strengthened if the degree of internationalisation is high.

This leads to the following working hypothesis:

A company's corporate governance is good

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

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

Condition (1) describes the situation in the central East European countries like Poland and Hungary. The big and established companies, which are covered in this study, are unlikely to risk legal proceedings. Although illegal manipulations naturally take place, they are an exception rather than the rule. Still, as the values of the legal regulation index for Poland and Hungary indicate, there is considerable room for improvement. Whether companies just fulfil the legally required minimum standards or aim for higher standards, as MOL consistently did, depends on other factors. In MOL's case, internationalisation seems to be the main cause for improved corporate governance performance.

Condition (2) describes the situation in CIS countries like Russia and Ukraine. As the minimum standard set by legal regulations is very low, mainly due to lack of enforcement, the actual corporate governance performance of companies in these countries can differ dramatically. The main explaining factor for these differences seems to be the strategy of majority shareholders. In the case of the oil and gas industry, which is covered in this study, a strategy of long-term profitability automatically leads to internationalisation. Accordingly there is a strong link between strategy and internationalisation, which both promote better corporate governance. Minority shareholders, however, are of minor relevance in our sample. Only in two instances did they reach a veto position and only in the case of Ukrnafta did this influence corporate governance performance.

In conclusion, it is clear that the causal links described here have to be tested using a much bigger sample. As mentioned above the project aims to examine about 500 big industrial enterprises in nine post-socialist countries. We hope to attract the necessary funding in 2006 and would then conduct the quantitative data analyses in 2006 or 2007.

Onako (Russia)

	1997	1998	1999	2000
FIN	1	1	1	1
OWN	1	1	1	1
BOD	0	0	0	0
DIV	0	0	1	1
VIO	1	1	1	1
I_{corpgov}	0.2	0.2	0.4	0.4

PKN Orlen (Poland)

	1997	1998	1999	2000	2001	2002	2003	2004
FIN	-	-	2	2	2	2	2	2
OWN	-	-	2	2	2	2	2	2
BOD	-	-	0	0	0	0	0	1
DIV	-	-	2	2	2	2	2	2
VIO	-	-	0	0	0	0	0	0
I_{corpgov}	-	-	1.2	1.2	1.2	1.2	1.2	1.4

Sibneft (Russia)

	1997	1998	1999	2000	2001	2002	2003	2004
FIN	2	2	2	2	2	2	2	2
OWN	1	1	1	1	1	1	1	1
BOD	0	0	2	1	2	2	2	2
DIV	0	0	0	0	1	2	2	2
VIO	1	1	1	1	1	0	0	0
I_{corpgov}	0.4	0.4	0.8	0.6	1.0	1.4	1.4	1.4

Sidanco (Russia)

	1997	1998	1999	2000	2001	2002
FIN	1	1	1	1	1	1
OWN	1	1	1	1	1	2
BOD	0	1	1	1	1	1
DIV	0	0	0	0	0	0
VIO	1	1	1	1	1	0
I_{corpgov}	0.2	0.4	0.4	0.4	0.4	0.8

Slavneft (Russia)

	1997	1998	1999	2000	2001	2002
FIN	1	1	1	1	1	2
OWN	1	1	1	1	1	1
BOD	0	0	0	0	0	0
DIV	0	0	—	1	1	0
VIO	0	1	1	1	1	0
I_{corpgov}	0.4	0.2	0.25	0.4	0.4	0.6

Ukrnafta (Ukraine)

	1997	1998	1999	2000	2001	2002	2003	2004
V _{strat}	0	0	0	2	2	2	2	2

Yukos (Russia)

	1997	1998	1999	2000	2001	2002	2003	2004
V _{strat}	1	1	1	1	1	2	2	2

6.3. Position of Minority Shareholders

Bashneft (Russia)

	1997	1998	1999	2000	2001	2002	2003	2004
V _{minority}	0	0	0	0	0	1	1	0

Gazprom (Russia)

	1997	1998	1999	2000	2001	2002	2003	2004
V _{minority}	1	1	1	1	1	1	1	1

Lotos (Poland)

	1997	1998	1999	2000	2001	2002	2003	2004
V _{minority}	0	0	0	0	0	0	0	0

Lukoil (Russia)

	1997	1998	1999	2000	2001	2002	2003	2004
V _{minority}	0	0	0	1	1	1	1	1

MOL (Hungary)

	1997	1998	1999	2000	2001	2002	2003	2004
V _{minority}	0	0	0	1	1	1	1	1

Onako (Russia)

	1997	1998	1999	2000
V _{minority}	0	0	0	0

PKN Orlen (Poland)

	1997	1998	1999	2000	2001	2002	2003	2004
V _{minority}	0	0	0	0	0	1	1	1

Sibneft (Russia)

	1997	1998	1999	2000	2001	2002	2003	2004
V _{minority}	0	0	0	0	0	0	0	0

Sidanco (Russia)

	1997	1998	1999	2000	2001	2002
V _{minority}	1	1	1	2	2	1

Slavneft (Russia)

	1997	1998	1999	2000	2001	2002	2003	2004
V _{minority}	1	1	1	1	1	1	1	1

Surgutneftegas (Russia)

	1997	1998	1999	2000	2001	2002	2003	2004
V _{minority}	0	0	0	0	0	0	0	0

Tatneft (Russia)

	1997	1998	1999	2000	2001	2002	2003	2004
V _{minority}	0	0	0	0	0	0	0	0

TNK (Russia)

	1997	1998	1999	2000	2001	2002	2003	2004
V _{minority}	3	0	0	0	0	0	0	0

Ukrnafta (Ukraine)

	1997	1998	1999	2000	2001	2002	2003	2004
V _{minority}	0	0	1	1	2	2	2	2

Yukos (Russia)

	1997	1998	1999	2000	2001	2002	2003	2004
V _{minority}	0	0	1	1	1	1	1	1

6.4. Internationalisation

Bashneft (Russia)

	1997	1998	1999	2000	2001	2002	2003	2004
EXP	1.25	1.5	1.75	1.75	1.75	1.75	1.75	1.75
FDI	0	0	0	0	0	0.5	0.5	0.5
SPR	0	0	0	0	0	1+1	1+1	1+1
ALL	0	0	0	0	0	0	0	0
I _{intern}	1.25	1.5	1.75	1.75	1.75	6.75	6.75	6.75

Gazprom (Russia)

	1997	1998	1999	2000	2001	2002	2003	2004
EXP	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
FDI	3.5	3.5	4.25	6.0	7.25	7.5	12.5	12.25
SPR	2+6	2+7	2+8	2+9	3+10	3+10	3+10	3+10
ALL	2	2	2	2	2	2	2	2
I _{intern}	30.75	32.75	36.25	41.75	48.25	48.75	58.75	58.25

Lotos (Poland)

	1997	1998	1999	2000	2001	2002	2003	2004
IMP	4.75	4.75	4.75	4.75	4.75	4.75	4.75	4.75
FDI	0	0	0	0.75	0.75	0.75	0.75	0.75
SPR	0	0	0	1+1	1+1	1+1	1+1	1+1
ALL	0	0	0	0	0	0	0	0
I _{intern}	4.75	4.75	4.75	8.25	8.25	8.25	8.25	8.25

Lukoil (Russia)

	1997	1998	1999	2000	2001	2002	2003	2004
EXP	1.75	2.0	2.25	2.0	2.25	2.25	2.5	2.0
FDI	3.0	3.75	5.75	7.0	8.25	8.0	11.0	12.0
SPR	1+2	1+3	1+3	2+4	2+4	2+4	2+5	2+5
ALL	2	2	2	2	2	2	2	2
I_{intern}	19.75	23.5	28.75	34.0	36.75	36.25	44.5	46.0

MOL (Hungary)

	1997	1998	1999	2000	2001	2002	2003	2004
IMP	3.75	4.0	4.0	4.0	4.0	4.25	4.5	4.5
FDI	6.75	17.5	5.0	6.0	6.0	7.25	6.25	5.75
SPR	2+4	2+5	1+4	1+4	1+4	1+4	1+4	1+4
ALL	0	0	0	2	2	2	2	2
I_{intern}	33.25	62.0	22.0	32.0	32.0	36.75	32.0	31.0

Onako (Russia)

	1997	1998	1999	2000
EXP	1.25	1.25	1.5	0.75
FDI	0	0	0	0
SPR	0	0	0	0
ALL	0	0	0	0
I_{intern}	1.25	1.25	1.5	0.75

PKN Orlen (Poland)

	1997	1998	1999	2000	2001	2002	2003	2004
IMP	-	-	4.5	4.5	4.5	4.5	4.5	4.5
FDI	-	-	0.25	0.25	0.25	0.25	0.25	0.5
SPR	-	-	1+1	1+1	1+1	1+1	1+1	1+2
ALL	-	-	0	0	0	0	0	0
I_{intern}	-	-	9.0	9.0	9.0	9.0	9.0	11.5

Sibneft (Russia)

	1997	1998	1999	2000	2001	2002	2003	2004
EXP	1.5	1.75	1.75	1.75	1.75	2.25	2.0	2.0
FDI	0	0	0	0	0	0	0	0
SPR	0	0	0	0	0	0	0	0
ALL	0	0	2	2	2	2	2	2
I_{intern}	1.5	1.75	7.75	7.75	7.75	8.25	8.0	8.0

Sidanco (Russia)

	1997	1998	1999	2000	2001	2002
EXP	1.5	1.75	1.25	1.5	1.75	1.75
FDI	0	0	0	0	0	0
SPR	0	0	0	0	0	0
ALL	2	2	2	2	2	2
I_{intern}	7.5	7.75	7.25	7.5	7.75	7.75

Slavneft (Russia)

	1997	1998	1999	2000	2001	2002
EXP	1.25	2.0	1.75	1.75	2.0	2.0
FDI	0.25	0	0.25	0.25	1.0	1.0
SPR	1+1	0	1+1	1+1	1+2	1+2
ALL	0	0	0	0	0	0
I_{intern}	5.75	2.0	6.25	6.25	10.0	10.0

Surgutneftegas (Russia)

	1997	1998	1999	2000	2001	2002	2003	2004
EXP	1.75	1.5	1.75	1.75	2.0	1.75	1.75	1.75
FDI	0	0	0	0	0	0	0	0
SPR	0	0	0	0	0	0	0	0
ALL	0	0	0	0	0	0	0	0
I_{intern}	1.75	1.5	1.75	1.75	2.0	1.75	1.75	1.75

Tatneft (Russia)

	1997	1998	1999	2000	2001	2002	2003	2004
EXP	1.25	1.75	1.75	2.25	2.25	2.25	2.5	2.25
FDI	0	0.25	0.5	0.5	1.25	1.25	1.25	1.25
SPR	0	1+1	1+2	1+2	1+3	1+4	1+3	1+3
ALL	0	0	0	0	0	0	0	0
I_{intern}	1.25	6.25	8.75	9.25	12.75	14.75	13.0	12.75

TNK (Russia)

	1997	1998	1999	2000	2001	2002	2003	2004
EXP	1.75	1.75	1.75	1.75	2.0	2.5	2.75	2.5
FDI	0	0	0	0.75	0.75	0.75	0.75	0.75
SPR	0	0	0	1+1	1+1	1+1	1+1	1+1
ALL	0	2	2	2	2	2	2	2
I_{intern}	1.75	7.75	7.75	13.25	13.5	14.0	14.25	14.0

Ukrnafta (Ukraine)

	1997	1998	1999	2000	2001	2002	2003	2004
EXP	0	0	0	0	0	1.25	0.25	na
FDI	0	0	0	0	0	0	0	0
SPR	0	0	0	0	0	0	0	0
ALL	0	0	0	0	0	0	0	0
I_{intern}	0	0	0	0	0	1.25	0.25	na

Yukos (Russia)

	1997	1998	1999	2000	2001	2002	2003	2004
EXP	1.5	1.5	2.0	2.25	2.75	2.75	2.75	2.0
FDI	0	0	0	0.25	3.0	3.0	3.0	2.0
SPR	0	0	0	1+1	1+5	1+5	1+5	1+5
ALL	0	2	2	2	2	2	2	2
I_{intern}	1.5	7.5	8.0	12.75	26.75	27.25	27.25	24.5

6.5. Legal Regulation

Hungary legal regulation index 1997–2004

	1997	1998	1999	2000	2001	2002	2003	2004
FIN	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1
OWN	(2+1)/2= 1.5	(2+1)/2= 1.5	(2+1)/2= 1.5	(2+1)/2= 1.5	(2+1)/2= 1.5	(2+1)/2= 1.5	(2+1)/2= 1.5	(2+1)/2= 1.5
BOD	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1
DIV	(2+1)/2=2	(2+1)/2=2	(2+1)/2=2	(2+1)/2=2	(2+1)/2=2	(2+1)/2=2	(2+1)/2=2	(2+1)/2=2
VIO	(2+2)/2=2	(2+2)/2=2	(2+2)/2=2	(2+2)/2=2	(2+2)/2=2	(2+2)/2=2	(2+2)/2=2	(2+2)/2=2
I_{legal}	(8+6)/10= 1.4	(8+6)/10= 1.4	(8+6)/10= 1.4	(8+6)/10= 1.4	(8+6)/10= 1.4	(8+6)/10= 1.4	(8+6)/10= 1.4	(8+6)/10= 1.4

Sources: Hashi, Iraj (2003) *The Legal Framework for Effective Corporate Governance: Comparative Analysis of Provisions in Selected Transition Economies*. Warsaw: Center for Social and Economic Research (Studies and Analyses No. 268); Ozsvald, Éva (2005) *Corporate Governance in Hungary. An Overview*. In: Iwasaki, Ichiro (ed.): *Corporate Governance in Transition Economies. Part II. The Case of Hungary*. Tokyo: Hitotsubashi University (IER Discussion Paper), pp. 1–20; Patel, Sandeep/ Balic, Amra/ Bwakira, Liliane (2002) Measuring transparency and disclosure at firm-level in emerging markets, *Emerging Markets Review* (3), pp. 325–337; Radygin, A.D./ Entov, R.M./ Gontmakher, A.E./ Mezheraups, I.V./ Turuntseva, M.Yu. (2004) *Ekonomiko-pravovye faktory i ogranycheniya v stanovlenii modelei korporativnogo upravleniya*, Moscow: IET, pp. 35–119.

Poland legal regulation index 1997–2004

	1997	1998	1999	2000	2001	2002	2003	2004
FIN	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(2+1)/2= 1.5	(2+1)/2= 1.5	(2+2)/2=2	(2+2)/2=2
OWN	(2+1)/2= 1.5	(2+1)/2=1 .5	(2+1)/2= 1.5	(2+1)/2= 1.5	(2+1)/2= 1.5	(2+1)/2= 1.5	(2+1)/2= 1.5	(2+1)/2= 1.5
BOD	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1
DIV	(2+1)/2=2	(2+1)/2=2	(2+1)/2=2	(2+1)/2=2	(2+2)/2=2	(2+2)/2=2	(2+2)/2=2	(2+2)/2=2
VIO	(2+2)/2=2	(2+2)/2=2	(2+2)/2=2	(2+2)/2=2	(2+2)/2=2	(2+2)/2=2	(2+2)/2=2	(2+2)/2=2
I_{legal}	(8+6)/10= 1.4	(8+6)/10= 1.4	(8+6)/10= 1.4	(8+6)/10= 1.4	(9+7)/10= 1.6	(9+7)/10= 1.6	(9+8)/10= 1.7	(9+8)/10= 1.7

Sources: Brody, Richard/ Moscove, Stephen/ Wnek, Robert (2005) Auditing Standards in Poland. Past, Present and Future, *Managerial Auditing Journal* (20) 1, pp. 36–46; Hashi, Iraj (2003) *The Legal Framework for Effective Corporate Governance: Comparative Analysis of Provisions in Selected Transition Economies*. Warsaw: Center for Social and Economic Research (Studies and Analyses No. 268); Instytut Rozwoju Biznesu – Centrum Prywatyzacji (2001) *Corporate Governance VII*, Warsaw: IRB; Patel, Sandeep/ Balic, Amra/ Bwakira, Liliane (2002) Measuring transparency and disclosure at firm-level in emerging markets, *Emerging Markets Review* (3), pp. 325–337; Radygin, A.D./ Entov, R.M./ Gontmakher, A.E./ Mezheraups, I.V./ Turuntseva, M.Yu. (2004) *Ekonomiko-pravovye faktory i ogranycheniya v stanovlenii modelei korporativnogo upravleniya*, Moscow: IET, pp. 35–119.

Russia legal regulation index 1997–2004

	1997	1998	1999	2000	2001	2002	2003	2004
FIN	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1
OWN	(2+0)/2=1	(2+0)/2=1	(2+0)/2=1	(2+0)/2=1	(2+0)/2=1	(2+1)/2= 1.5	(2+1)/2= 1.5	(2+1)/2= 1.5
BOD	(1+0)/2= 0.5	(1+0)/2= 0.5	(1+0)/2= 0.5	(1+0)/2= 0.5	(1+0)/2= 0.5	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1
DIV	(1+0)/2= 0.5	(1+0)/2= 0.5	(1+0)/2= 0.5	(1+0)/2= 0.5	(1+0)/2= 0.5	(1+0)/2= 0.5	(1+0)/2= 0.5	(1+0)/2= 0.5
VIO	(2+0)/2=1	(2+0)/2=1	(2+0)/2=1	(2+0)/2=1	(2+0)/2=1	(2+1)/2= 1.5	(2+1)/2= 1.5	(2+1)/2= 1.5
I_{legal}	(7+1)/10= 0.8	(7+1)/10= 0.8	(7+1)/10= 0.8	(7+1)/10= 0.8	(7+1)/10= 0.8	(7+4)/10= 1.1	(7+4)/10= 1.1	(7+4)/10= 1.1

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Ukraine legal regulation index 1997–2004

	1997	1998	1999	2000	2001	2002	2003	2004
FIN	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1	(1+1)/2=1
OWN	(2+0)/2=1	(2+0)/2=1	(2+0)/2=1	(2+0)/2=1	(2+0)/2=1	(2+0)/2=1	(2+0)/2=1	(2+0)/2=1
BOD	(1+0)/2= 0.5	(1+0)/2= 0.5	(1+0)/2= 0.5	(1+0)/2= 0.5	(1+0)/2= 0.5	(1+0)/2= 0.5	(1+0)/2= 0.5	(1+0)/2= 0.5
DIV	(1+0)/2= 0.5	(1+0)/2= 0.5	(1+0)/2= 0.5	(1+0)/2= 0.5	(1+0)/2= 0.5	(1+0)/2= 0.5	(1+0)/2= 0.5	(1+0)/2= 0.5
VIO	(2+0)/2=1	(2+0)/2=1	(2+0)/2=1	(2+0)/2=1	(2+0)/2=1	(2+0)/2=1	(2+0)/2=1	(2+0)/2=1
I_{legal}	(7+1)/10= 0.8	(7+1)/10= 0.8	(7+1)/10= 0.8	(7+1)/10= 0.8	(7+1)/10= 0.8	(7+1)/10= 0.8	(7+1)/10= 0.8	(7+1)/10= 0.8

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