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Privatization in the Russian Federation

by

Alexander Radygin

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CASE - Center for Social & Economic Research

00-585 Warszawa, Bagatela 14

tel (48-22) 628 09 12, (48-22) 629 43 83; fax (48-22) 628 65 81

"Privatization in Post-communist Countries"

Coordinator: Barbara Błaszczuk

Work on this project, financed by the Committee of Scientific Research (KBN), began in December 1994 and consists of research focusing on legal and institutional aspects of privatization as well as the courses and outcomes of privatization processes under way in the countries of Central and Eastern Europe. In the first stage of the project, country reports on privatization in those countries where the ownership transformation process is most advanced were prepared. In the second stage, reports are to be prepared on particular aspects of the privatization process. Foreign participants in the project include scholars from the Czech Republic, Slovakia, Hungary, Slovenia, Russia, and Germany. Publication of the papers prepared during the course of the project in the *Studies and Analyses* series is currently under way. The publication of a book is also intended to conclude the project. In November 1995 a two-day seminar was held on voucher privatization and management-employee buyouts. An international conference is being planned for April 1996, in which experts in privatization policy and practice will participate in a discussion of the research results, which we hope will facilitate their dissemination both in countries which are leaders in the systemic transformation process and those which are less advanced. Conclusion of the project is planned for June 1996.

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EXPERIENCE WITH MANAGEMENT AND EMPLOYEE BUYOUTS IN THE RUSSIAN FEDERATION

1. Peculiarities of Management-Employee Buyouts Within the Russian Privatization Model

The uniqueness of Russia with respect to privatization lies not only in its far from optimal combination of different particular methods of privatization (this is typical of the majority of countries in transition). Russia became the only post-Socialist state characterized by a combination of different approaches towards the privatization process as a whole. The voucher privatization technique, borrowed from the Czech scheme for free distribution of state property to citizens at the theoretical level (but not with respect to the exact technical implementation), was supplemented by a real possibility for domination by "inside investors" at the level of legal security (as was the case in Yugoslavia) as well as at the level of the actual ownership structure in the privatized enterprises (as in Romania), which triggered an evolutionary development in the direction of a managerial revolution on a scale which is unmatched throughout Central and Eastern Europe. The purchase of large blocks of shares occurring as a result of the free trade in vouchers proved to be practically incompatible with the fiscal, investment and restructuring orientation which characterized this process in East European countries. In an attempt to overcome this limitation, emphasis was placed on large "outside investors" in the monetary stage of privatization, as had been done in Hungary and the former GDR. The common denominator throughout the entire course of privatization were the attempts by the administrative bodies controlling separate branches of the economy to secure considerable blocks of shares for the state in a number of those sectors.

The general scheme of privatization in Russia was based on the division of a considerable portion of state property into relatively small blocks of shares and their subsequent distribution to large numbers of people. The recipients belonged to different groups, depending on the particular variant chosen. The choice of this scheme (adopted in 1992) was based on the necessity to achieve a compromise between the government, the parliament, and certain important social groups, including the employees of the enterprises which were to be privatized (mainly in industry), state employees, employees in the non-production sphere, and emerging private business.

Vouchers distributed to the whole population at the end of 1992 became an instrument for ownership transformation. Citizens now had the ability to exchange them directly for shares of privatized enterprises or for securities issued by check investment funds (CIFs), which traded the vouchers thus obtained for enterprise shares. It was also possible to sell vouchers for cash to other citizens or to commercial institutions which later could make use of the vouchers at check auctions.

At the same time, the State Privatization Program enacted on June 11, 1992, introduced *an extensive system of privileges for the employees* of the enterprises to be privatized, including their management as a separate category. Those privileges included acquisition of free and privileged shares and the ability of managers and employees of the enterprise to pay for shares partly with vouchers instead of cash. Along with other variants (see Appendix 1 of Radygin [1996]), this system included the possibility of redemption in a closed subscription (i.e., on a non-competitive basis) of 51 per cent of the shares of the privatized enterprises at their book value, with an insignificant surcharge coefficient of 1.7 (this was the so-called second variant, which became the most popular one). Later this system of privileges was completely reaffirmed by the State Privatization Program adopted on December 24, 1993, and, in a slightly changed form, by the general guidelines of the program from July 1, 1994 onwards.

As a result, the distribution of former state property went on predominantly not in the form of voucher usage by citizens through check auctions and CIFs, but through closed subscriptions at enterprises in which their employees and management participated. Thus, the average share of the authorized capital of the joint-stock companies replacing state enterprises which was sold on check auctions for vouchers was 18-19 per cent, in some months rising to a maximum level of 23-23.5 per cent. Through July 1, 1994 (the date on which voucher validity expired), three fourths of the enterprises which had undergone the share distribution procedure since the beginning of the privatization process chose the second variant, described above, which emphasized closed subscriptions. (By January 1, 1995, this number was somewhat reduced to 73.2 per cent.) During this same period, the third variant, based on the purchase of 20 per cent (raised to 30 per cent from 1994 onwards) of the shares at their nominal value by a group of persons (*in fact, the enterprise managers*) on the condition that they assume the responsibility for averting bankruptcy of the enterprise, was applied to a very limited extent (by 1.9 per cent of all enterprises having undergone the share distribution procedure).

Nevertheless, it is important not to exaggerate the role of enterprises that chose the second variant (the insider privilege variant) in the process of distribution of shares in the national economy as a whole.

On the one hand, although they undoubtedly dominate in terms of sheer numbers, the main part of the authorized capital within the whole bulk of the enterprises that underwent the share distribution procedure seems to belong to those that used other variants. Thus, according to the results of 1994, 60.8 per cent of enterprises privatized during the last year through share distributions chose the second variant, but at the same time, only 18.8 per cent of the total authorized capital was actually held by those enterprises. Even taking into account the 7.4 per cent of joint-stock companies established by means of reformation of rental enterprises (which in the majority of cases means "insider" domination), the total share of enterprises controlled by "inside" owners was about 22 per cent. It is doubtful whether the previous years, 1992 and 1993, would provide a different picture. Obviously, in large enterprises with a substantial production potential and consequently substantial authorized capital, it was impossible for the employees and managers in the majority of cases to redeem the controlling block of shares by closed subscription; therefore, they had to adopt the first variant, in which insider privileges were smaller in scope (one fourth of the

non-voting shares are obtained by the employees free of charge in a closed subscription, 10 per cent are sold to them at a discounted price, 5 per cent are sold to the management, and the rest is sold to outsiders for vouchers or cash).

This situation is the result of the initial distribution of joint-stock capital within the framework of the voucher program and the domination of "inside" investors (which was a compromise necessary for the launching of the privatization program).

2. The Initial Structure of Joint-Stock Capital and Its Subsequent Development

The short-term result of the approaches described above (i.e., the result which emerged during and shortly after the completion of the privatization program of 1992-1994) was the establishment of an indistinct ownership structure in the majority of privatized enterprises, where no single group of shareholders could achieve a stable majority of shares in the authorized capital and at the same time feared all possible changes in that ownership structure and attempted to prevent them. In practice it strengthened the positions and the influence of the managers who had run the enterprise before privatization.

2.1 Some Estimates of the Initial Ownership Structure During and After Privatization

There are a number of different qualitative estimations of the distribution of joint-stock capital of privatized enterprises. On the basis of research conducted in 143 large and medium-size enterprises in 32 regions by Joseph Blasi's team in 1994 in 32 regions, the conclusion was made that on the average 65 per cent of the shares of a privatized Russian enterprise belonged to "insiders" (8.6 per cent were owned by the managers), 22 per cent by "outside" investors (11 per cent were owned by investors who possessed more than 5 per cent of the enterprise's shares), and 13 per cent by the state. Median values were 60 (5), 20 and 12 per cent respectively (Blasi, 1994). The Russian researcher V. Soupiyan estimates the situation approximately in the same way: on the average 60-65 per cent of joint-stock capital of the privatized enterprises in 1994 belonged to non-managerial employees and 15-17 per cent to managerial staff.¹

¹ We should point out that a similar investigation carried out by Blasi in the first half of 1995 (in 133 privatized enterprises in 33 regions of Russia) resulted in the following conclusions: on the average the insiders (management included) owned as much as 57.06 per cent of shares (median value 53 per cent), the outsiders 30.56 per cent (median value: 30.00 per cent), and the state 12.61 per cent (median value: 6.50 per cent). This gives us another proof of the existence of certain tendencies in the ownership structure which will be analyzed in detail.

The broadest investigations of the initial structure of joint-stock capital were carried out in 1994 by the Russian Marketing Association. The survey covered 1,000 joint-stock companies established through the privatization of state-owned enterprises. The results are presented in Table 1.

Table 1. Distribution of blocks of shares in joint-stock companies established in the course of privatization (by branches and main investors as of April 1994, %)

Shareholders	The size of blocks of shares by branches (%)				
	Engineering	Chemical Ind.	Food Ind.	Light Ind.	Average
Employees	51.86	54.50	51.26	56.09	52.01
Managers	14.81	8.25	13.38	13.15	14.16
Large outsiders	12.64	9.25	10.83	7.28	11.53
Small outsiders	7.69	11.00	9.36	6.41	8.17
State	13.00	17.00	15.17	17.07	14.13
Total	100	100	100	100	100

Source: Braverman et al., 1994

It is evident from the data presented here (which are consistent with the results of other research) that on the average, in the spring of 1994, the insiders' share in privatized enterprises amounted to 66 per cent and the outsiders' share to about 20 per cent, while the state share averaged 14 per cent and did not exceed 17 per cent. We can safely assert that these figures represent a fairly objective reflection of the pattern of ownership in Russian privatized enterprises existing when the privatization program was concluded. In other words, these data represent the typical initial structure of joint-stock capital of Russian enterprises privatized in the voucher program. Now let us consider the key quantitative tendencies characteristic of its formation and subsequent development.

In the process of initial securing of property rights in privatized enterprises, two tendencies can be clearly distinguished: the formation of a stock of Russian corporate capital which is closed to outside investors and the preservation of regional and branch monopolies.

The first tendency is a result of the use of the privileges of the first and second models (see Appendix 1 in Radygin [1996]). The complex of extensive privileges for employees (free and preferentially priced shares, distribution of shares, and privatization funds financed from the enterprises' revenues), together with the widespread practice of lowering the price of privatized property, permitted them to become the owners of large national firms at minimum expense, by keeping controlling blocks of shares in possession of the employees and the management or by putting the state-owned share under trust control. Due to closed share subscriptions, the organization of auctions to which institutional investors were given limited access, and especially to the wide dispersion of private investors, a new capital structure was initially formed which formally fell under the legal status of an open-type joint-stock company but in many cases resembled the capital structure of a closed-type corporation in reality.

This tendency is realized in practice throughout a whole complex of formal and, more importantly, informal restrictions which the management of privatized enterprises places on the sale of shares by the employees to outside investors in order to retain control over the enterprises, to ensure itself an income, and to preserve jobs. The last motivation is also very typical of the majority of employees who do not belong to the management. According to the data from one of the inspections of check investment funds in Russia, 48 per cent of the funds that had tried to increase their share in the joint-stock capital of enterprises which had been privatized at least partially through check auctions stated that the most serious barrier was created by the efforts of the management of these enterprises to prevent the sale of shares by the employees to outsiders, and 23 per cent of the funds affirmed that the securities market on which they were operating was controlled by the managers (Pistor, Frydman, and Rapaczynski [1994]).

The effect of regional and branch monopolies under the new conditions imposes strict limitations on the effective flow of capital. Schemes for financial flows are being created under which those flows can remain isolated and yet allow not only mobilization, but also redistribution, of capital among firms with varying profitability located within a given regional or branch structure without resorting to the stock market. The tendency towards territorial and financial isolation impedes the free flow of financial capital and is clearly reflected in the will to establish holding companies and industrial groups which possess a common commercial bank or investment company as an important element of the structure. The indissolubility of technological and industrial-economic ties is typically used as an argument for merger, but the effort to establish financial systems mobilizing local capital and imposing limitations on penetration by "outside" (trade and bank) capital is an even more powerful stimulus (see IEP [March 1994], pp. 164-168).

The tendency towards branch isolationism manifests itself through the reservation of controlling blocks of shares in "privatized" enterprises for the state, which can later be transferred to the management on a trust basis in order to establish some holding structures and financial-industrial groups or kept as a "golden share" which can provide the state administrative bodies with a considerable degree of control over the enterprises. The tendency towards regional isolation, on the other hand, manifests itself through the placement of local government officials in management positions in the privatized companies. This practice is justified on the basis of the presence of unsold blocks of shares (potentially intended for future sales), secret preferences given to local banks in the course of actual privatization procedures, and trading and brokerage capital which is often connected with local government bodies or the management of privatized enterprises and the establishment of dependent firm registrars controlling the secondary redistribution of already privatized property.

Both tendencies will have a mixed impact on the viability of Russian corporations because the mechanisms by which they are realized are highly heterogeneous in nature. To some extent it is possible to consider these tendencies as a defensive reaction of enterprises and regions, but in any case they will not determine the development of the structure of capital in Russia in the medium term. That will depend on the intensive process of redistribution of property rights that has already begun.

2.2. Redistribution of Property Rights: Main Conclusions and Tendencies

In spite of the existing exclusivity of the structure of joint-stock capital in Russian privatized enterprises, an intensive process of transfer of property rights began already during the implementation of the privatization program. This affected the shares obtained during the first stage of the process by outside investors and the managers of enterprises. In other words, the initial floating of shares of privatized enterprises (all the above-mentioned limitations of the dynamics of their capital structure notwithstanding) represents a relatively short period of initial securing of property rights which is inevitably followed by a series of secondary transactions (the ideal result of which should be the emergence of an "ideal owner").

Another important observation concerns the beginning of the process of concentration of joint-stock capital which was initially dispersed as a result of voucher privatization.

The third important conclusion is that within the limits of the model of privatization operating between 1992 and the first half of 1994 (and even more so between July 1994 and July 1995, when the privatization process practically stopped), one of the most promising methods of acquisition of the capital of Russian privatized enterprises (and often the only one) for any outside investor _ whether foreign or native _ was the purchase of a share of capital by means of secondary trade in the shares from the first issue or in the course of a supplementary share issue. Undoubtedly, the tendencies described in the previous section represent a barrier to such acquisition, but the beginning of the process of erosion of the initial structure and the intentions of some Russian enterprises to carry out a new issue of shares inevitably weaken such barriers.

Let us examine the most typical variants and trends affecting the structure of joint-stock capital formed in the course of initial floating of shares.

First, the process of "erosion" of the initial block of shares received by the employees during the closed subscription began. Research shows that the management in the majority of enterprises succeeded in acquiring between 15 and 25 per cent of shares by use of the following methods: proportional distribution of shares in a closed subscription (beyond a required minimum received by every employee), options, repurchasing of shares from the employees after the end of the closed subscription, purchase of shares on closed auctions, and use of "fronts." Broker agencies and other professional intermediaries were very active in buying out small blocks of shares belonging to the employees. In another typical situation, engineering and technical staff members and skilled workers become holders of relatively large blocks of shares (e.g., 1-2 per cent), while many of the rank-and-file employees sell their shares within 2-3 months after the receiving them. This was promoted, for example, by the fact that only one third of the total number of privatized joint-stock companies were going to pay dividends according to the financial results of 1993. In many cases the market price offered by intermediaries looks attractive to the employees. Thus, for example, in the summer of 1994 many employees of Mosenergo were selling their shares acquired through closed subscription for checks at the price of 120-200 rubles per share

(while the nominal value of shares was 1,000 rubles, and market value in July, 1995 comprised already about 1500 rubles).

Naturally, share liquidity in the great majority of enterprises is as yet out of the question, and it is possible to sell them only to an intermediary acting to fulfil a specific order (received from an outside purchaser or from the management itself) or with the purpose of reselling the block of shares thus acquired at a different price on the market. New problems also emerged: among them blatant discrimination against outside shareholders by enterprise management, an illegal ban on sale of shares to outsiders by employees imposed by the management under threat of discharge, illegal restrictions in the company bylaws as to the upper limits on blocks of shares, etc.

The possibility of sales of shares by the employees to outside purchasers which are not controlled by the authorities gives rise to certain fears on the part of the management, especially if those purchasers offer an extremely high price (in one Moscow planning organization an outside purchaser _ a bank _ offered a price of over 50 times the nominal value for one share; in order to prevent the loss of control the management had to offer the same price to the employees). Obviously, shareholders sell their shares in order to secure an immediate material benefit and not because they want to change the corporate strategy or replace the management. The management can neutralize or minimize such threats only by sharing a part of the income on the property with the shareholders, because with the lack of stability with regard to the general situation, any arguments as to the possibility of long-term loss are not effective.

In the majority of cases, however, the management tries to redistribute the shares immediately after completing the subscription in order to guarantee its possession of the controlling block of shares. As a rule the shares are purchased directly from employees at low prices close to the nominal value, and this procedure is accompanied by the promise to preserve jobs. But very often this purchasing is carried out with the help of intermediaries at even higher prices if the management attempts to conceal from the employees (at least for a short period of time) the fact that the shares are being accumulated in the hands of the management itself.

If the danger of the disposal of the shares by the employees is not so serious, the management need not be in a hurry to buy up the shares. It applies mechanisms of transferring the administrative and controlling rights from minority shareholders to its own hands. The practice of electing department directors to be representatives to the shareholders' meetings is fairly common. For example, at one of Samara's enterprises internal "temporary regulations on the order of delegation of shares (votes) to collective plenipotentiary representatives for the trustee management" were adopted which openly recommended to the "shareholders" of major departments to transfer their shares to their directors for "trustee management," according to the traditional subordination structure.

The insiders' property is being clearly divided into the share belonging to the management and the share belonging to ordinary employees. Directors of departments and sometimes a small number of influential representatives of the "aristocracy of the working class" display an evident tendency to belong to the first group. In most cases it is easier for the management to integrate into the "ruling core" all individuals who could otherwise

become organizers of a consolidated inner opposition than to have to struggle with that opposition at a later date.

In reality, the ordinary employees of many enterprises could not possess more than 50 per cent of shares even if they privatized their enterprise according to the second variant because nearly everywhere a part of the shares assigned to the employees was acquired by pensioners and former employees, whose interests are somewhat different from the interests of current employees, and who tend to be more passive than even the most passive current employees. It can be suggested that their passivity is profitable for the management unless they sell their shares to an aggressive outside investor. Any consolidation of these two groups (former and current employees) is really possible only as a result of deliberate organizational action undertaken by the management.

Additionally, some of the shares formally received by employees in reality belongs to the management of an enterprise right from the start. Perhaps this could have happened only in cases where the employees themselves did not actually pay for their shares, which were bought using money from some special fund (a situation which was typical of former rental enterprises with the right to redemption, especially in 1991-1992). The transformation of former directors (usually with a group of supporters) into "new businessmen" who accumulate a controlling block of shares or at least blocks of shares which can guarantee them major influence over decision-making cannot be judged in black-and-white terms. The opinion that it is the only realistic way under existing conditions obviously has some grounds. But the problem is that conditions change quickly. Thus, this line of development seems to be not a strategic but a temporary one characterizing an intermediate stage of the process. So far, joint-stock companies operate by inertia thanks to their monopolistic or "socially valued" position as well as because of the support of the state which, however minimal it may be, is still preserved to a certain extent. In the absence of outside investments, under conditions of true separation of state and enterprise finances, the present management of joint-stock companies will scarcely be able to carry out the modernization and rationalization of those enterprises.

Major purchasers quite evidently dominated on check auctions. The lion's share of the shares sold on a check auction (which averaged 20 per cent per enterprise) is purchased by check investment funds and intermediary firms which subsequently resell them to an institutional holder or the management. Whereas initially the ratio of the management to outside investment institutions as purchasers on check auctions was 4:1 in St. Petersburg, during the second half of 1993 and first half of 1994 it clearly changed in favor of outsider investors. This did not, however, imply any antagonism between these two groups. On the contrary, in many cases they are identical, as many check funds were deliberately created by the privatized enterprises themselves. In such cases check funds served the purpose of accumulating the resources for the "self-redemption" of enterprises and for purchases (by mutual agreement or "aggressively") of shares in the capital of their subcontractors and counterparts on the commodity market. In other cases, joint control over blocks of shares owned by the management and the shares purchased by the check fund was established.

Among the major participants on check auctions, particularly worthy of mention are enterprises proper (or their intermediaries), check investment funds, and large institutional and private investors.

Whereas small investors were striving to invest their checks primarily in those enterprises which seemed reliable from a layman's point of view, the motivations of funds and large outside investors were quite varied, including, for example, possession of a lot or a building, real profitability of an enterprise, resale of a large block of shares, the possibility of restructuring and capacity increase, or export opportunity.

As for those enterprises which were buying up their own shares, the main motivation was, of course, possession of shares and, if possible, any other additional blocks of shares in order to keep the dividends "within the circle of the employees" and because of a fear of employment reductions as a result of the appearance of outside owners. These were the enterprises which agreed most willingly to participate in check auctions. However, there were also other advantages: the possibility to become a competent purchaser (and trust-holder) in privatization when the share of the state in the authorized capital is reduced to 25 per cent, redemption of a lot (which is possible only after check auctions), etc.

Naturally, in the majority of cases the initiative as to purchase of the shares of an enterprise by its employees at a check auction comes from the management, which was acting according to a "traditional" scheme. A typical example of such a practice is the activity of one of the largest Russian enterprises in the area of mechanical engineering, the joint-stock company GAZ (Gorky machine-building plant), which bought shares through 15 "dummy firms" and invested them on its own private auction over 1 million checks [Romanova, 1994]. In addition to the fact that the investment itself was illegal (the present share of the state prevents GAZ from being a purchaser in the course of privatization), the resources spent for this purpose are also likely to belong to the state. Another easy way to exclude "hostile" large investors, who usually submitted applications at the very last moment, was to close the application department earlier than was announced. This was a common practice adopted, for example, by "AvtoVAZ" on the Moscow check auctions [Kalinichenko, 1994]. In order to draw a veil of legitimacy over such actions, it was necessary to obtain the status of organizer of an auction of one's own shares, and this was widely practiced by the leading Russian oil companies. Another widely used method is the holding of an auction on the closed territory of the company itself or in any other place with restricted access.

The main tendency in 1994 in this sphere was a further reduction in the number of small investors, to the benefit of the above-mentioned purchasers. While in the middle of 1993 the share of small private investors on the auctions amounted to 15 per cent of the shares offered for sale (half of them were the employees of the enterprise), in 1994 their share fell to 5-10 per cent. The large wholesale trade in shares of the privatized enterprises was typical of the initial share placing throughout regional stock exchanges (the South-Ural, the Vladivostok International, the Perm' Commodity and Stock Exchange, the Ekaterinburg), which carried out regular tenders together with local property funds.

The data received on December, 1994 (see Table 2), confirm the general results formulated above. It is obvious from a comparison of Table 1 (April 1994) and Table 2 (December 1994) that dispersion of the share of employees continued during the whole period of research (the average reduction was from 52 per cent to 49.5 per cent) and that the share of the state was reduced (from 14.13 per cent to 6.9 per cent). Simultaneously the share of the management increased (from 14.16 per cent to 15.8 per cent), as did that of

outside investors. It is worth noting that the share of large outside investors increased most noticeably, from 11.53 per cent to 16.4 per cent.

Table 2. Distribution of block of shares in joint-stock companies established during the process of privatization

Shareholders	The Size of Blocks of Shares by Branches, %				
	Engineering	Chemical Ind.	Food Ind.	Light Ind.	Average
Employees	46.00	47.00	49.00	56.00	49.5
Managers	16.00	15.50	14.00	18.00	15.8
Large outsiders	19.00	17.50	21.00	8.00	16.4
Small outsiders	8.00	9.50	14.25	14.00	11.4
The state	11.00	10.50	1.75	4.00	6.9
Total	100	100	100	100	100

439 joint-stock companies established on the basis of former state-owned enterprises in 68 regions of Russia were surveyed.

Source: GKI RF (1994), Braverman, Lyukmanov and Ivanov (1995).

I will now discuss in more detail the problem of redistribution of the property dispersed among the employees of privatized enterprises. The problem is very delicate and subtle; therefore, it is hardly possible to expect reliable and exact information comparable to the official privatization procedures. According to some data, the employees of privatized enterprises (outside the management group) have already sold about one fourth of all their shares [Schleifer and Vasiliev, 1994].

The real situation seems to be not so homogeneous, depending to a great extent upon branch specificity. According to the data shown in Tables 1 and 3, the average block of employee shares was reduced only by 2.5 per cent, while the share of the management increased approximately by 1.6 per cent. Obviously, the increase of the blocks of shares belonging to outside investors (by 4.9 per cent for large investors and 3.2 per cent for small investors) occurs mainly at the expense of the state share, which fell by 7.2 per cent, and this happened in all the branches studied, achieving the maximum level in the light and food industries (over 13 per cent) and the minimum level in mechanical engineering (2 per cent).

The dynamics of other changes by branches is even more interesting. The reduction of the block of employee shares was greatest in the chemical industry (7.5 per cent), and smallest in the light industry (0.1 per cent). The increase of the block of management shares was greatest in the chemical industry (7.5 per cent) and smallest in the food industry (0.6 per cent), the increase of the block of shares belonging to large outside investors was greatest in the food industry (10.2 per cent) and smallest in light industry (0.7 per cent), and the increase of the block of shares belonging to small outside investors was greatest in light industry (7.6 per cent) and smallest in mechanical engineering (0.3 per cent).

Whereas the increase of the block of shares belonging to the management in mechanical engineering and the food industry represented 20.3 per cent and 26.1 per cent respectively of the reduction of the employees' block of shares (which meant redistribution of share capital to outsiders), in the chemical industry the increase of the block of

management shares almost equalled the reduction of the block of shares owned by ordinary employees. The comparison of reduction rates of the blocks of shares belonging to the state and the increase rates of the shares of outside investors leads to the following conclusions: whereas in mechanical engineering the contribution of the former factor to the latter factor is under 30 per cent, in the chemical and food industries the increase of the share of the outsiders (by 96.3 per cent and 89.4 per cent respectively) took place due to the state's sale of its shares.

A peculiar situation was observed in light industry, where only approximately two per cent of registered shifts in the share capital structure in favor of the management were accounted for by a reduction of the block of shares belonging to employees, while all the rest can be attributed to the reduction of the block of state shares. Approximately one third of the latter corresponded to the increase of the management's block of shares, and a little under two thirds covered the shares belonging to outsiders (mainly small investors). The employee share stayed at the maximum level both in April 1994 and in December 1994 in the light industry, which remained the only branch where the employee share exceeded 50 per cent and the share of small outside investors became larger than the share of large outside investors.

However, the priorities of other share-holders changed. Whereas in April the largest blocks of shares belonging to the management and to large outside investors were observed in mechanical engineering enterprises, in December this distribution pattern could be seen in the light and food industries, respectively, to which small outside investors flowed at the expense of the chemical industry. At the same time, the reduction of the share of small outside investors was noted only in the chemical industry. The greatest state share in December was observed in mechanical engineering, whereas in April it was observed in light industry. Thus it is possible to state that the most important reduction of the shares of insiders (employees and management) occurred in mechanical engineering enterprises, a smaller reduction in the food industry, and practically no reduction in the chemical industry, while the insiders' share in light industry increased, achieving the highest level among all four branches (74 per cent). In other branches the total share of insiders achieved a level of about 62-63 per cent.

We believe that the changes described above adequately reflect the real situation in privatized industrial enterprises. They show that the interests of private capital as well as of small outside investors shifted towards the food industry, which is characterized by a comparatively low capital to output ratio, a short production cycle, and, to a certain extent, guaranteed sale of products. In contrast, the permanent crisis in light industry has produced a situation in which the share of large outside investors practically did not increase, while the employees' share showed almost no reduction.

Naturally, it is necessary to take into consideration the fact that the enterprises of the metallurgical industry and fuel and power industries were not included in the group of enterprises selected for the present research. Their capital in many cases is controlled by the state or by large outside investors, who benefited from the redistribution of shares previously owned by the state and by employees. Thus, according to the estimates made by experts of the Russian Credit Bank, in the share capital of the company "Chernogorneft" (Chernogor oil _ the only enterprise within the branch whose controlling block of shares

never belonged to the state), only 8-10 per cent of the shares belong to the employees, although during privatization procedure 62.27 per cent of the authorized capital was distributed to them. The rest of the shares were fixed as state property (check auctions were not included in the privatization plan).

The first wave of primary distribution of shares of Russian privatized enterprises already allows us to suggest that the structure of the share capital of newly established joint-stock companies tends not so much in the direction of the Anglo-American dispersion model as that of the continental European model with strict majoritarian control of the capital. Naturally, it also bears some specifically Russian features and is associated with all the drawbacks of the transitional period.

At the same time, from our point of view, the formation of such a structure in the nearest future will hardly affect visibly the improvement of efficiency indices of privatized enterprises. That can be explained by the fact that although the greater part of the blocks of shares is concentrated in the hands of relatively large institutional holders, it is not intended at this stage for securing long-term management and control of the enterprise. That is why most of the present holders will hardly be interested in long-term investments dealing with reconstruction and development of enterprises.

In a broader sense, all the aforesaid leads us to the following conclusion: in Russia there already exist all the necessary conditions for redistribution of the property initially distributed in the course of privatization on a scale comparable to that of the "grand privatization" of the first stage.

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THE MASS PRIVATIZATION AND THE VOUCHER SYSTEM

1. Privatization Programme 1992-1994

Irrespective of the marked ideological shifts in the approaches in favour of a radical reform of relations of property at the edge of 1990-1991 some practical steps in this direction seemed to be a matter of remote future. At this time both the Union and Russia's authorities made only their first "trials" regarding the concepts of privatization. Naturally, elaboration and adoption of a fundamental law on privatization seemed to be the first goal to achieve.

The law of the RSFSR "On Privatization of the State and Municipal Enterprises in the RSFSR" was adopted on 3 July 1991. Article 1 of the law of the RSFSR "On Privatization of the State and Municipal Enterprises in the RSFSR" spells out that privatization "is an acquisition by citizens, joint-stock companies (partnerships) of various forms of property (as it is provided for by the law) from the state and from the local Soviets of the People's Deputies as private property. The share of the state, local Soviet, or public organization, or charitable fund was limited to 25 per cent in the authorized capital of the buying legal entity. The law provided for a sale of shares of the enterprise being privatized, an auction sale or a sale through a tender, and certain benefits for the workers, and on the whole - a very wide range of all kinds of methods of privatization as well as possibilities for their interpretation.

The administrative and bureaucracy aspect of privatization were given to the State Committee of the RSFSR for the Management of State Property (GKI) within the framework of the Government, while the actual selling or "holding" of property - it was a function of the Russian Federal Property Fund. Thus the element of dualism inserted into the diagram of control over the privatization process became one of the key elements that was a brake on the path of privatization and reinforced the confrontation at all levels of authority between the legislative and executive organs in 1991-1993.

From November of 1991, after the changes in the composition of the Government of Russia, one can speak about a new stage in the ideology of privatization first of all, and on abrupt intensification of efforts to ensure a practical implementation of the privatization mechanism. From the very outset, having stated that privatization is one of the key elements of the economic reform, B. Eltsin's and E. Gaidar's Government stepped up their efforts in the area of development of the legislation on privatization, but at the same time it had no real opportunity of operational monitoring of the process of privatization. That is why one of the specific features of the economic reform of that government was a liberalization of prices before a period of wide-scale privatization which went beyond the dominating theoretical orthodoxy in the field of transition towards a market and was in contradiction with the experience of some foreign countries. And there were quite sound reasons for it:

- it was impossible to wait for the end of the "large-scale privatization" conducted in a classical way (i.e. within a number of years), this being so because of the sharpest shortage of goods - the situation one could observe in 1991;
- if prices were not liberalized, any state-owned enterprise actually became a state entity to ensure an administrative distribution of goods in short supply which could grow (even without free prices) into a serious conflict (as a final outcome);
- intensive spontaneous privatization.

A final version of the first State programme of privatization of the state-owned and municipal enterprises in the Russian Federation was adopted by a decree of the Supreme Soviet of the RF only on 11 June 1992. This programme adopted after a series of delays actually became a compromise, on the one hand between a "paid" (for the active part of the population) and gratuitous (with vouchers given to the entire population and the benefits given to work collectives) privatization and, on the other hand, between a model of privatization for all (GKI) and the division of property among the workers of enterprises (communists and workers' unions). With all that all the previous documents were taken into account and the resultant compromise - an inevitable thing to launch the entire model grew finally into a defeat of the pro-Communist forces of the Parliament. It should also be stressed that it was that very document which became a basic document for the subsequent large-scale privatization in 1992-1994.

According to the programme the privatization objectives were as follows: (a) emergence of a socially oriented market economy on the basis of the formation of the category of private owners; enhancing the efficiency of enterprises; (c) social infrastructure development using the gains from the privatization; (d) contribution to the financial stabilization; (e) contribution to the competitive economy and demonopolization; (f) attraction of foreign investors. However, in autumn and winter of 1992 the implementation of Russia's **model of mass privatization** became a primary goal of the privatization policy on which both the President and the Russian government counted.

All state owned enterprises were divided into 3 categories depending on the method of privatization used:

- small businesses (with an average work force of up to 200 employees and book value of the fixed capital less than 1 mln roubles as of 1 January, 1992) shall be sold at auctions and tenders;
- large-size enterprises (with an average work force more than 1,000 employees or a book value of the fixed capital of more than 50 mln roubles as of 1 January, 1992) shall be privatized by being transformed into open joint -stock companies;
- the remaining enterprises may be privatized by any method set in the Programme.

To understand correctly the course for mass privatization it is essential to take into account not only the above-given classification of the enterprises from the point of view of the permissible methods of privatization but also the total number of enterprises that Russia had prior to the "programmed" privatization process. The total number of enterprises of all

sizes before the process of privatization made up not less than 240,000 units according to the data of the GKI. At least that required high-speed and mass procedures of privatization.

2. General Privatization Dynamics in 1992-1994

It is paradoxical but with all the tensions in the area of political confrontation on the issues of the Russian privatization in the "upper echelons" and "in the field" the actual process of privatization in 1992-1994 was quite dynamic (see tables 1-3).

The quantitative success of privatization programme is quite evident. Within the framework of a small-scale privatization by 1 July 1994¹ Russia has already privatized 50 per cent of all small businesses. In the course of a large scale privatization by 1 July 1994 (on the basis of the medium-size and large-size state enterprises) more than 20,000 joint-stock companies have been established. By the middle of 1994 Russia had about 40 mln shareholders in the just created new joint-stock companies or cheque investment funds.

By 1 July 1994 one could see 100,000 privatized enterprises. With reference to the total number of enterprises available by the start of the privatization programme as many as 40 % of enterprises have been privatized (table 1). If in January 1992 there were about 1500 applications for privatization, by 1 July 1994 the figure was already 137501, and out of this figure some 74,8 % have already been implemented (table 2).

The most common method of small-scale privatization in commerce and public catering is a lease with a buy-out right approximately 46 and 52 %, while the number of items privatized by the contest it was 39 and 30 %. In the sphere of consumer services the prevailing form is sale through a tender (46 %). 12 % of all small-size enterprises were converted into joint-stock companies, 10 % were acquired by natural persons (not by the workers). And although the majority of buyers of the items of small-scale privatization are the workers themselves (about 70 % of all bargains) nevertheless, as the estimates show, only 10 % of the work collectives in St Petersburg could go about it without any "sponsor". The latter actually means the appearance on the stage of a large co-owner at the majority of small-scale privatized enterprises.

Among the most important problems typical of most of the objects of small-scale privatization, it is important to note the retention of the profile of business after it gets privatized, an access to credits, the relations with the distribution warehouses (bases) that became independent enterprises. Now if prior to 1990 Russia had only 1400 commercial enterprises (since acting as legal entities were only trade associations of wholesale and retail trade together with their bases), in November of 1991 as commerce was more and more commercialized, some 70,000 independent enterprises appeared. In many respects it conditioned a rupture of the former supply links. However, in our view the main problem remains to be the fact that most of the enterprises are being privatized without the premises

¹ The official deadline for voucher privatization programme, after which there was no important quantitative progress.

which are leased and this is a kind of a "hook" by which the local authorities hold these enterprises.

The aggregate analytical data of the privatization process in Russia in 1993-1994 on the whole exceeded the similar indicators for 1992 (see table 3). And though some indicators of the rates of privatization visibly swang to and fro within a year, and this sway was especially noticeable in the regions, the rates of privatization intensity went up significantly (the number of implemented applications / the number of enterprises subject to privatization): up to 0.820 in June 1994 and the average data of the order of 0.369 and 0.582 in 1992 and 1993.

Yet it should be noted that such successful results of privatization can be accounted for not only by the enthusiasm of the "microlevel" and the activities of the GKI but also by the build up of certain countertrends: the rates of the submission of applications got reduced which led to such high indicators of their realization. In other words, by the end of 1993 we can say that the so called peak of the voluntary and initiative privatization has been passed at the microlevel, and as to those enterprises that were left they can hardly be as active as in the period of 1992-1993.

Even at this stage of analysis the above-given information makes it possible to arrive at very important conclusions from the point of view of the prospects of the further participation of the "outer" Russian and foreign investors in privatization:

(1) those enterprises that are already involed in privatization (from the act of application submission to a post-privatization stage) because of the existing methods of privatization or lobby actions of the interested subjects are little interested in mostr cases or they are hard to get to for a serious foreign investor, at least at the stage of the initial placement of the shares;

(2) those enterprises that have not yet travelled the path of privatization may be divided into four conventional groups: first of all, these are direct candidates for bankruptcy that do not have a strong management or some plans of development and that cannot imagine their life without any state subsidies; secondly, these are the enterprises where the situation is of reverse nature, i.e. where they have clear-cut plans and counteragents for transformations but which using all the means possible tried to avoid cheque privatizationhoping for a "money stage"; and thirdly, this is a group of enterprises which are put on the prohibitive list of the state programme of privatization; and fourthly, these are the above-described "nomenclature spots of paradise" that will be privatized but this will be a privatization "for one's own lot". So out of all indicated groups only the second one, most probably, may be of practical interest for investors.

3. Mass Privatization Model in Russia (October 1992 - June 1994)

A very popular term "mass privatization" combines two independent but closely related processes:

- a corporatization of the medium-size and large-size state owned enterprises with a subsequent sale (transfer) of their shares into the hands of those citizens and non-state legal entities, i.e. it is a case of large privatization;
- providing all (or part) of the population with investment coupons (cheques, certificates, vouchers, etc.) which give a right for a part of the property being privatized (voucher privatization).

In other words within the model of mass privatization corporatization is the supply side and equipping the population with vouchers is the demand side. Acting as a "synthesis" of these processes in the Russian version is a policy of the sales of the shares by means of a closed subscription and at the cheque auctions.

3.1. Causes of the Programme Launch and Its Basic Concept

Both the critics and the advocates of the cheque model whose validity period expired by 30 June 1994, agree on one thing: a formal, quantitative success of the programme of mass privatization is indisputable and evident. As to the results of the programme of mass privatization, which are beyond the framework of the quantitative valuations, they always were and they are now a subject of heated and meaningful discussions as well as the subject of irrational speculations for political purposes. So to attempt to sum up some kind of results let us go back to 1992 and try to understand the real situation and purposes of the privatization cheque.

Let us recall in what conditions a strategic decision was taken to launch a cheque model (summer of 1992) as a method of stimulating a privatization process in Russia.

- absence of the financially sound demand of the population;
- zero interest in privatization in Russia on the part of the foreign investors;
- the presence of over 240,000 state-owned and municipal enterprises (which required standard typical procedures of privatization);
- the necessity of the maximum high rates of the legal privatization process (at the first stage) to block an intensive spontaneous privatization and to ensure an irreversible type of economic changes on the whole;
- the relatively good public opinion.

All these factors became prevailing for the development and launching of the Russian cheque model. So what were the strategic goals ? Naturally, the goals were not those that had been laid down in the first and second state programmes of privatization. It seems to me that the genuine goal was as follows: TEMPORARY MASSIVE REDISTRIBUTION AND STRENGTHENING OF THE PRIVATE PROPERTY RIGHTS IN RUSSIAN SOCIETY WITH A MINIMUM OF SOCIAL CONFLICTS HOPING FOR FURTHER TRANSACTIONS IN FAVOUR OF EFFICIENT RESPONSIBLE OWNERS.

3.2. Voucher Programme

The concept of Russia's voucher programme was approved at the sitting of the Government of the RF on 11 June 1992. Privatization cheques (privatization vouchers) represented state federal (and only federal) securities with a limited term of action, each of the vouchers at a face value of 10,000 roubles, and handed over to a bearer, with a right of a sale. From 1 October to 31 January 1993 an overwhelming portion of the cheques was given to citizens: 148 mln vouchers.

In the course of implementation of the voucher programme one of the key issues was an issue on a real purchasing power and a market price of a voucher. The initial position of the GKI was that it had to take into account the real cost of state enterprises and other property that could be sold for vouchers (35% or 1.4 trillion roubles in old balance prices). It was stressed that vouchers were used to acquire property at the old prices of the last balance sheet valuation and for that reason the actual purchasing power of the voucher should be considerably higher of the equivalent sum of 1992 in roubles and that its market price will have a tendency to go up. So if in October 1992 the representatives of the GKI gave an optimistic purchasing power of 200-300 thous roubles per voucher, in December that figure dropped and constituted only up to 12-13 thous. roubles.

Immediately (in the first days of October 1992) an exchange and over-the -counter market of vouchers was formed and it showed that in Russia as such one had a price spread from 200 roubles to 70,000 roubles. The first stock exchange operations were begun at the Russian Commodity and Raw Materials Exchange with a cheque value up to 5,000 - 10,000 roubles. During 1993 the rate of the cheque went up from half of the nominal rate up to two nominals and on the average it was kept at the level of 20,000 roubles during the first months of 1994 and finally with all the various fluctuations the rate reached some 40,000 roubles.

To a great extent the dynamics of the rate of the cheque was conditioned by a political situation, the rates of inflation and speculative exchange and over-the -counter turnover. To an extent a privatization cheque acquired the characteristics of a sort of financial instrument that was considered by the owner in separation from its real purpose. With all that it gives no reasons to treat the rate of the cheque as a certain value that has nothing to do with a privatization process.

To begin with, it is the current market rate that was taken as a basis of the preliminary "market" evaluations of the shares and enterprises after the cheque auctions (let us take this

example, with the rate of the cheque auction of Bolshevik factory being 0.1, or, in other words, 1 share to a cheque, and with the market rate being 6,000 roubles a share with a nominal rate of 1,000 roubles may be evaluated as it is worth 6,000 roubles in "cheque money", and correspondingly the authorized capital is also valued as being at least 6 times higher). With all that is quite obvious that an actual market price of the sold shares could be obtained only at the secondary market of the securities of the enterprises being privatized and this market, as we know, is in its rudimentary stage.

Secondly, it is the current cheque market rate (real expenditures for its purchase) that one compared the profitability of purchase of one or another type of shares at cheque auctions. And yet again one has to make a reservation here: the cheque price of shares is set not so much because of the financial position of enterprises, but rather because of the number of shares presented for a sale as the sale of securities.

Thirdly it is from the current rate of the cheque that the intensity of the purchases of the cheques depended. Those purchases were made by the enterprises themselves.

Because of this any attempt made to value the real cost (statically or in dynamics) is doomed to fail, if one follows only one type of the method of evaluation. In our view, it is only if we take a multitude of the cheque rates that can give us a real picture. In current conditions an attempt to evaluate the cheque through the "profitability" of the enterprises (even in an indirect way - through the shares acquired) can hardly be fruitful and thus it is possible to have only "quasi-market" and "property" approaches:

- current market rate in the form of exchange and out-of-the exchange turnover (both cash and cashless turnover);
- market rate in terms of the moment of the issue of cheques i.e. the issue of the autumn of 1992 with a corresponding inflation adjustment;
- weighted average rate of the cheque auctions (the number of nominals per one cheque) as the most probable indicator of the true situation;
- weighted average rate of the cheque auctions taking into account the revaluations of the fixed assets of the enterprises.

It is essential to point out that only 20% of the privatization cheques and fixed assets, judging by the estimates, belonged to the regions, their number being balanced, and in accordance with this, the market rates should be above the average rate. For example, if voucher coverage comprised only 53 % in the North, 58 % in Eastern Siberia, 76% in the Central and Black Soils area, 78% in the Far East, 92 % in the Povolzhie area, in the Ural the voucher excess is 3 %, in the North-West it is 8 %, in Northern Siberia it is 21 %, in the Volga-Vyatsk it is 22%, in the Central Area it is 25% and on the Caucasus - 67%. As a result one has a certain localization of the voucher markets in some central points and another characteristic feature is the fact that it became quite profitable to play on the differences in the rates. One could get as much as 200 % profit there.

More than once the government took a number of steps to support the rate of the cheque on the market (considering it as a pledge of prestige of one's own): the increase of

quotas of the cheque payment for property up to 35-90 %, getting land, housing and municipal property involved in the general cheque turnover, and granting a permission for enterprises to purchase cheques from out of the means of privatization funds, mandatory payment of 50% of the closed subscription by means of cheques and so on. However, accelerated incorporation process has always remained a key issue to ensure further cheque auctions.

3.3. Incorporation of State-Owned Enterprises

The Decree of the President of the RF, No 721, on obligatory incorporation of the federal enterprises on 1 July 1992 can be interpreted as a first radical step of the Government in this direction. And although the quality of drawing up the standard documentation and deliberate primitive nature of certain procedures of incorporation can hardly be regarded on a very high level, nevertheless the very fact of accelerated transformation of some 6,000 enterprises into joint-stock companies may be justified by the following considerations:

- the issue of vouchers in conditions of likely investment crisis was considered by the GKI as a major effort of feeding the "investment demand" on the part of the population, and in this sense, turning a considerable number of enterprises into joint-stock companies and the issue of shares were necessary to ensure adequate "investment supply";
- corporate form of property (even if the owner is not changed) seemed to be more attractive for creating the conditions for the attraction of capital and flow of capital between the economic agents in a situation when there was a crisis with the sources of finance (problems of own profits, budget and loans from the banks).

The incorporation of large-size state-owned enterprises began practically at once after the entry into force of the decree of the President N 721 (see table 4). The situation was as follows: if by 1 January 1993 the Register of enterprises subject to mandatory incorporation included 4979 enterprises, while those registered as joint-stock companies comprised 674 enterprises, by 1 July 1994 these indicators were as follows: 7,121 and 4,368 enterprises. All in all by 1 July 1994 registered as joint-stock companies were over 20,000 former state enterprises with a total authorized capital comprising 1.1 trillion roubles (in old book values) and at various stages of incorporation one had (and they were included in the All-Russia Register of enterprises being incorporated) over 30,000 enterprises with an estimated authorized capital more than 1.3 trillion roubles. And it is of interest to note that about 23,000 such enterprises joined the process of incorporation by their own free will. This way, if we treat this phenomenon formally, we shall see that the area of "supply" (within the terms of mass privatization) was prepared well enough.

And yet at this very time one could also see one negative trend progressing: with the reduction of the shares 1 and 3 of the options of privileges for the workers in the course of incorporation of enterprises a more and more pronounced was becoming a dominant share of option 2 which, by 1 July 1994, averaged as many as 75 % (see appendix 1). And this

means that as many as 3/4 of the enterprises (against 2/3 in 1992) planned to buy out the controlling interest with the help of the work collectives neglecting the coefficient of growth 1.7 with reference to the share nominal and 90 day term of the payment of the entire sum. The other motive for preferring version 2 was an aspiration of the workers to have total equality of rights for all from the members of the management to the category of unskilled manual workers.

From the medium-term perspective such trend is dangerous: first of all the problem of corporate control may get exacerbated and secondly, the mobilization of investment resources may get worse. And though in the course of incorporation (privatization) closed joint-stock companies are not to be formed, the very fact that the controlling interest rests with the work collective may well lead to a situation when the diktat of the workers-shareholders (or that of a narrow group of managers who are not controlled by a formal owner) will objectively lead to the prevalence of the current consumption in comparison to a long-term development or it may be a case of the policy of management to the detriment of the interests of shareholders. In other words in case of a closed subscription one determines two likely and equally negative ways of development of a new type of a joint-stock company: the appearance of an "aggressive consumer majority" (the presence of workers-shareholders) or the diktat of managers on the basis of dispersion of property.

It goes without saying that in the perspective a major portion of the block of shares will be with the current "investors". And yet any intervening period between the moment of the original distribution of shares and the appearance of a serious owner of a large block of shares is certainly an undoubtful block hindering the effective control of a joint-stock company with all the subsequent fall-outs. From this point of view it seems prudent if gradually the rights of the workers at the enterprise are diminished.

So far an outside Russian or foreign investor intending to buy at least a part of the block of shares that are distributed through a closed subscription will have to (in a direct way, through his branch or through a Russian intermediary) enter into negotiations with the workers on the subject of the immediate purchase of their shares (or buying these shares after the end of the subscription). As the practice shows, this is no problem, but it is hardly possible that this kind of approach will be of interest to a large investor who aims at the controlling interest.

Moreover, there were numerous technical problems associated with the sale of shares using the means of a closed subscription for the workers. As it is estimated, firstly this is (a) a problem of payments by the privileged shares of options 1 and 3 because of the indivisibility of the cheque; (b) difficulty to conclude personal agreements on matters of the acquisition (transfer) of shares at large enterprises which leads to an increase of the term of subscription; (c) if the terms of subscription are tight, not all the potential participants of the subscription have enough time to realize their rights; (d) additional purchase of cheques at the market by large enterprises who made a preference for option 2, generates some individual and financial problems. One may also report on multiple cases of the direct violations of the Provisions on the conduct of a closed subscription.

And at last what is just as important is that many stock companies that appeared in Russia have little similarity with the "classical" ones. This concerns both the joint-stock

companies set up on the basis of the state-owned enterprises and, first of all, due to the specifics of the institution of their organs of management. In particular, the principles of formation of the Board of Directors which are now in force, as applied to the newly created stock companies make it quite possible to get a controlling interest by the local authorities (up to 20 % of the voting shares belonging to the local property fund whose representative together with a representative of the local authorities are members of the Board of Directors together with the General Director and a representative of the workers).

In this connection the most important and current, and even to a larger extent medium-term problem, which is just to be analyzed, is a problem of the post-privatization existence of the newly instituted stock companies. It involves a broad spectrum of unsolved issues: management of the state blocks of shares and their determination in size order, delegation of the rights to manage the shares, payout of the dividends, the existing voting systems (voting trusts, powers of attorney, and so on) in large corporations, property trust operations, registration of the deals at the secondary markets (the latter thing is especially important to ensure an effective transfer of property rights) and so on.

3.4. Policies of the Sale of Shares. Cheque Auctions

In accordance with the course set by the GKI to ensure a priority backing of the voucher privatization, the regulations rigidly stipulate that there should be a sequence in the selling of the shares of a specific type of enterprise: a closed subscription for workers, sale of shares (it should be stressed that we speak here about shares and not blocks of shares) at a cheque auction, and only then out of the fund for incorporation for the workers of enterprises and other techniques. All enterprises that were forced to effect incorporation were divided into 5 groups in an arbitrary proportion, and those that got incorporated voluntarily depending on the period of registration of a stock company. Each group would have an extreme time to conduct cheque auctions.

The number of shares subject to selling at a cheque auction was determined as a total number of shares that were subject to sale for cheques (from 35 to 90 % depending on the level of property), minus the number of shares sold for cheques via a closed subscription and to the officials of the administration at preferential terms. Later on a single mandatory quota of shares was determined that were put out for a cheque auction, 29 % from the total number. The first type of the application - without indication of the minimum of shares per 1 cheque - it should be satisfied completely, and the second type of application - with an indication of the price - it should be satisfied depending on the demand for shares. Now taking into account the experience of the first auctions provision was also made for splitting the nominal of the shares to satisfy all the applications of the first type.

The first model-type cheque auctions were carried out in December 1992 in such cities as Moscow, St Petersburg, Vladimir, Nizhni-Novgorod and in some other cities. All in all in December 1992-June 1994 put out for auction were (it applies to 86 regions of Russia) more than 15,000 enterprises with a total authorized capital over 1.1 trillion roubles and with the number employed over 16 mln people or 1/2 of those engaged in industries (see table 5). On average 18.9 % of shares of each enterprise were put out for auctions (against 29 as required

by the law), and all in all sold for cheques (taking into account the closed subscription) - on average 71 % of shares (against 80 % as required by the regulations). The authorized capital of the joint-stock companies themselves whose shares were put out for auctions fluctuated from 1-2 mln up to 30 billion (RAO Norilsky Nickel) roubles while on average in Russia it is about 100 mln roubles. Almost the same spread is characteristic of the share of the authorized capital put out for auctions: minimum 3 % as is the case with joint-stock company "Stroitel" in the city of Vladivostok and maximum - 60 % as it is the case with joint-stock company "Sverdlovskdorstroy".

As estimated by the GKI, being most popular (until the shares of the fuel and energy complex appeared) were certain types of enterprises of mechanical engineering, as well as enterprises of food industry, tobacco industry, furniture industry and wood-working industry. As well as hotels, enterprises located in the most prestigious regions as well as the largest enterprises (keeping in mind the liquidity of their shares) and small-size businesses (the hope here being that it will be easier to establish control there). What is observed in this picture is a marked spread of the rates depending on the region, with the average weighted being 1.8 in all regions. The "cheapest" shares went with the enterprises of the provincial areas (up to 405 thousand-rouble-shares per one cheque) and as to the records on the most expensive shares - it was the enterprises in the capital which were small in size and located in the centre. On average one can speak in this case about a direct dependence between the number of shares put out for sale (and the size of the authorized capital accordingly) and the auction rate.

The analysis of the sectoral structure of the cheques invested in the cheque auctions shows that enterprises of eight branches of industry account for 70 % of the cheques; the distribution by sectors of industry is as follows: mechanical engineering (11.4 %), metallurgy (11.1 %), chemical industry (10.5 %), oil and gas extraction (9.1 %), oil-refining industry (8.9 %), power industry (8.1 %), postal services and communications (5.8 %), transport engineering industry (5.0 %) [Privalov, Bessonov, Kalinichenko, et al., 1994, p.61].

It goes without saying that the special features of these industries are not associated with any serious financial analysis (at least in most cases) prior to making investments. The basic factor accounting for such "exterior" investments is one's psychological perception of one or another type of industry or enterprise as a more or less "reliable" sector, this often being an erroneous perception having its effect on the rates at an auction. As to the institutional investors the reasons here are quite different and, as a rule, they are associated with a particular type of enterprise.

Among participants in the activities of cheque auctions one should specifically single out such participants as the enterprises themselves (their intermediaries), cheque investment funds and large institutional and private investors. And if small investors tried, first of all, to invest their cheques in those enterprises that seemed "reliable" from the point of view of average person, the motives of the funds and large investors are quite different: a plot of land, a building, the actual profitability of an enterprise, a re-sale of a large block of shares, the possibilities of reconstruction and increase of capacities and, at last, export potential.

As to the enterprises themselves that re-purchase their own shares, it goes without saying that they were primarily after a controlling block of shares and, if possible, any other blocks of shares in addition to the controlling interest (this being done to retain dividends among the members of the work collective and because of the fear that one may lose his job if other owners of property appear). It is these type of enterprises that welcomed auctions, however, there are other advantages not to be overlooked: a possibility to become a full-fledged buyer (and thus trust-holder) in privatization when the share of the state gets reduced up to 25 % in the authorized capital, the buy-out of a plot of land (this being possible only after a cheque auction) and some other such considerations.

Naturally, in most cases the initiative to buy one's own shares would come from the management of certain plants operating on the basis of the recently "tried-out" pattern. A typical example of such activities is the activity of one of the largest Russia's enterprises in automobile-making - AO "GAZ" that bought, through 15 dummy companies, and that put out for auction at its "own" cheque auction over 1 mln cheques. In addition to the fact that such investment is not legally qualified (with the assigned share of the state the GAZ cannot operate as a buyer in the course of privatization) the means used for these goals are also, probably, state-owned. It is also evident that prior to the end of the work of the Government's Commission one has as frozen the applications (and the monetary means) of all legitimate investors, especially if one takes into account the fact that the previous results of the auction may be cancelled and that a new auction may be assigned.

In the practice of holding an auction one may resort to some other trick designed to "cut off" the unwanted investors that submit their applications at the very last minute: closing the place that receives the applications earlier than it should have been as it was done by the AVTO-VAZ in Moscow [Kalinichenko, 1994]. To attribute some appearance of legality to this trick it is necessary to get a right of the organizer of an auction for one's shares a trick that was quite successful with the largest oil companies in Russia. Another trick is holding a formally open cheque auction but on the closed territory of an enterprise or at some other hard-to-get- to place.

Now because foreign investors use the services of intermediaries at the auctions, it is quite difficult to isolate the sectoral priorities or to identify the sphere of participation.

In general the participation of foreign investors acting through intermediaries can be estimated rather roughly, at the size of 10-12 % of shares that were put out for auctions. There is a host of reasons for this: in addition to the general climate for foreign investments, one shall take into account a difficult access to auctions of the enterprises of the fuel and energy complex, a priori indefinite nature of the results of the auctions, no controlling interests at the auctions, lack of desire to flaunt the purchase made and other reasons. In addition to the recent problems with the acquisition of cheques and their investment, it is the lack of possibility of buying a controlling stock that is, perhaps, the most weighty reason for direct non-participation of foreign investors in such auctions.

3.5. Qualitative Results of the Implementation of the Mass Privatization Programme

First of all, the expiration of the validity of the privatization checks marks the end of the first stage of the Russian privatization. This *qualitative* stage started in 1992 and was completed on 30 June, 1994. Despite various economic, political, and social problems connected with the circulation of the checks, the real fundamental task formulated in paragraph 3.1 has been fulfilled: the mass assignment and redistribution of property rights on a national scale. One can say that this transformation was purely formal and not always carried out in the most civilized way, but nevertheless it was only because of this privatization that Russia was able by mid-1994 to achieve the following:

- a corporate sector of the economy;
- a stock exchange and an over-the-counter securities market, including an infrastructure for trading privatization vouchers, a system of privatization auctions, and a secondary market for the shares of privatized enterprises;
- a system (so far transitional, but nevertheless quite powerful) of institutional investors in the form of check investment funds and other structures;
- a social stratum which _ despite all its flaws, heterogeneity, and legal weaknesses _ can be called a stratum of owners.

We can say that in many respects due to the privatization program realized in 1992-1994, effective barriers to the recreation of monopolies and the administrative, bureaucratic control of Russian enterprises were created, although it is still too early to discard the possibility of such a return to the past. When we take a broader perspective, we can say that the gigantic changes in the area of property relationships paved the way for a modification of power relationships in Russian society.

In spite of all the shortcomings of the Russian privatization model, the first stage of its implementation is over.

Naturally, the emergence in Russia in 1992-1994 of a considerable number of private enterprises and millions of new owners does not mean that administrative and bureaucratic control issues have already vanished from the economic agenda or that new incentives have already been created to ensure the effective growth of production. However, it was impossible to achieve these things in the first stage. The main achievement is the creation of a new system of property rights on the national scale. That system is still amorphous, fragile, even embryonic, but it is a system which is finally capable of implementing some key final goals of the privatization reform, such as providing for economic efficiency and creating a base for a genuinely democratic society.

In our view, an assessment of the Russian privatization program on the basis of a formal quantitative analysis of the current state of affairs is not appropriate. The positive qualitative result lies elsewhere; namely, in the beginning of the stage of transfer of property rights. Only after this process is well under way will we be able to speak about some tangible *positive* results of the Russian privatization model (assuming that a real capital market and system of property rights are formed). Thus, it is essential to take the whole package of problems into consideration _ both the economic ones mentioned earlier and those that relate to the social, political, and legal spheres.

First, we observe the problem of the stability of the currently binding legislation, which is closely connected with potentially destabilizing factors of a political or regional nature, the role of the *nomenklatura*, etc.

Second, there is the problem of the balance of interests in the process of the reformation of property relationships. While one can hardly disagree with the statement that the current Russian privatization model generates multiple problems and controversies that are connected with objective factors and government miscalculations, one must not forget that this model was formed in the course of a multilateral negotiation process, the result of which is a balance of economic interests of all the participants, embodied in the text of the relevant legislation. Only the further strengthening of this balance can lead to the irreversibility of the economic reforms. So the choice is really "simple": either we pursue a stable and consistent privatization policy to speed up the economic transformation, or we follow a long and agonizing process of "quasi-privatization" accompanied with social and political conflicts, strengthening of state control and bureaucratic structures and actual roll-back of the radical reforms in the economy and society. Therefore, the core of policy in this sphere should be the refusal to allow for discrimination against any of the participants of the privatization process in favor of any other participants. There should be no restriction of the interests of the private sector in order to slow down privatization and strengthen the state sector at the cost of the private and "privatized" sectors, nor should there be any attempts to return any aspects of control over the privatized enterprises to the state in an attempt to implement spontaneous ("*nomenklatura*") privatization.

Third, a very serious problem is the absence of interconnections between the reforms of property relationships and other elements of the economic transformation. The Russian experience shows that the development of privatization programs must be coordinated with the development of industrial policy and the finance system (an institutional device that transforms savings into investments and selects directions for their subsequent use in the production sector of the economy via the mediation of finance markets and institutions).

Fourth, there is the problem of the adjustment of the current normative base, taking into account the above-mentioned factors as well as the quickest possible liquidation of the gaps in the legislation which defines the environment in which Russian private, privatized and state enterprises operate. Areas in which such gaps are particularly glaring and require urgent attention include securities market regulation, mortgage laws, trust regulation, company laws, and land and real estate law. From a long-term perspective it is vital to have a civilized criminal and civil code in general, and a detailed and effective body of contract law in particular. And it is this aspect of the reforms _ the creation of the legal environment,

which is not necessary for the short-term accelerated privatization, but for the long-term operating conditions of the privatized enterprises _ which is still in its infancy.

Only when these conditions have been created, the general improvement of finances has been established, vigorous anti-inflation measures have taken root, and the system of private savings has been developed, will it be possible to attract significant investment resources and to effectively restructure enterprises. In other words, any "pumping" of resources into the economy by the state, as well as Western assistance programs in this field, will be meaningless to a considerable extent until a mechanism of "fair" control is developed, private capital markets coordinate corporate governance and resource allocation, and civilized land and real estate markets and a civilized business law are established. For this reason the role of the state should be strictly limited to the creation of an appropriate legal environment on the basis of which it may be possible to effect indirect (soft) state regulation and strict state legal control.

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Appendix 1:

Privileges for the personnel and administration of the enterprises being incorporated in accordance with the first programme of privatization.

Option 1: On a gratuitous basis all the members of the work collective in one particular period of time are given registered preference (non-voting) shares which shall comprise 25 % of the authorized capital but in total sum it should not be more than 20 minimum sizes of the monthly remuneration for work in terms of payment for one worker; common shares up to 10 % of the authorized capital but in total sum it should not be more than 6 minimum sizes of the monthly remuneration for work in terms of payment for one worker with a discount of 30 % from the nominal and with a a deferment of repayment up to 3 years; on the basis of the contracts concluded the authorized officials of the administration are given a right (option) to acquire common stock (shares) by its face value that constitute up to 5 % from the size of the authorized capital but it should not be more than 2,000 of the minimum sizes of the monthly remunerations for work in terms of payment for one worker.

Option 2: all the members of the work collective are given a right to acquire common (voting) shares which shall constitute up to 51 % from the size of the authorized capital.

Option 3: If a group of workers makes itself responsible for the execution of a privatization plan, for non-admission of its bankruptcy and if it gets a permit from the general meeting of the appropriate work collective, then the members of that group are given a right (option) to acquire (after an expiration of 1 year) 20 % from the authorized capital in the form of common stock (shares) by their face value. All the employees of an enterprise can buy common stock that shall constitute 20 % from the authorized capital but that sum shall not exceed the sum of 20 minimum monthly remunerations for work in terms of payment for one worker, with a discount of 30% from the vace value and a deferment of payment up to 3 years.

Tables:**Table 1. Ownership Structure in the RF by 1 July 1994, in %.**

	Public sector	Private sector
Light industry	52	48
Food industry	53	47
Construction	65	35
Construction materials industry	54	46
Motor transport, auto repairs	58	42
Wholesale trade	53	47
Retail trade	45	55
General Food catering	53	47
Community services	45	55
Other	79	21
All in all by Russia/*	59	41

*/The evaluations were rather conventional: the share of the private sector was calculated as a relation of the number of the privatized enterprises to the sum of the privatized enterprises and state enterprises with a separate balance sheet on the same date. The private enterprises that were formed outside the privatization process were not taken into account in this evaluation.

Source: data base of the GKI.

Table 2. Basic indicators of the progress of privatization in the RF for 1992 - 1994 /*

With a growing total rate since 1.01.1992	1.04.1992	1.01.1993	1.04.1993	1.01.1994	1.04.1994	1.07.1994
State enterprises with separate balance sheet (units)	139904	204998	194190	156635	151486	138619
Submitted applications for privatization (units)	18366	102330	114725	125492	132605	137501
Applications rejected (units)	656	5390	6879	9985	10802	11488
Applications being processed (units)	12677	46628	42788	24992	21637	19308
Implemented application (units)	5023	46815	61810	88577	98262	103796
Selling price of property (billion roubles)	1,9	157	297	752	901	1107
Cost of enterprise property on the basis of implemented applications (billion roubles)	1.1	193	405	648	788	958
State enterprises turned into joint-stock companies whose shares are on sale (units)	59	2376	4805	14073	16751	20298
Enterprises which are leased	9451	22216	19435	20886	19833	20606
including enterprises which are leased with a buyout right	7581	3868	10850	14978	14964	15658

*/ 1 January 1992 is a date of the official launch of the Privatization Programme in Russia.

Source: data base of the GKI

Table 3. Consolidated analytical table of the progress of privatization on the average in Russia: 1992-1994.

	T1	T2	T3	T4	T5 /*
On the average for 1992	0.430	0.457	0.197	0.532	0.369
On the average for 1993	0.501	0.610	0.308	0.530	0.582
For 1994:					
January	0.579	0.718	0.415	0.529	0.785
February	0.587	0.727	0.427	0.533	0.802
March	0.592	0.741	0.436	0.534	0.818
April	0.597	0.747	0.445	0.535	0.833
May	0.604	0.748	0.452	0.535	0.846
June	0.588	0.749	0.441	0.537	0.820

*/T1 - Rates of submission of applications (the number of applications supplied/the number of enterprises with their own balance sheet);

T2 - Rates of realization of applications (the number of applications realized / the number of applications supplied);

T3 - Actual rates of privatization (the number of realized applications / the number of enterprises with their own separate balance sheet);

T4 - Planned rates of privatization (the number of enterprises by the Programme /the number of enterprises with their own separate balance sheet);

T5 - Intensity rate of privatization (the number of applications realized / the number of enterprises subject to privatization in line with the Programme).

Source: data base of the GKI.

Table 4. The results of incorporation of the state-owned enterprises (SOE) in the RF in line with the order N721 of 1 July 1994.

	Compulsory conversion (large SOB)		Voluntary conversion (medium SOB)		Structural divisions' conversion	
	1.01.1993	1.07.1994	1.01.1993	1.07.1994	1.01.1993	1.07.1994
Number of SOE subject for conversion into joint stock companies	4979	7129	-	-	-	-
Number of committees' decisions for conversion	2520	5437	2545	17738 /*	547	1784
Number of adopted privatization plans and acts of assets valuation	1326	4982	1546	17042	283	1053
Number of registered joint stock companies	674	4368	737	15936	139	997
The charter capital (bln. roubles)	116.5	834.8	28.6	247	2.7	23
Value of assets, transferred by benefit options to employees and managers	24.5	231.5	10.0	56	0.44	10

*/ In this case the working commissions on privatization are created by 1 Jan 1993 - at 6565 enterprises, and by 1 July 1994 - at 21256 enterprises.

Source: data base of the GKI.

Table 5. The results of the cheque auctions in the RF by months, by 1 July 1994

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)*
December 1992	18	9	3.0	42	0.51	16.9	0.16	3.2
1993:								
January	107	26	5.7	184	0.60	10.6	0.15	4.0
February	195	40	6.4	174	1.49	22.9	0.54	2.7
March	436	56	22.5	525	5.27	23.5	2.25	2.3
April	618	69	30.1	811	7.03	23.4	4.43	1.6
May	577	72	23.3	519	4.60	19.7	3.62	1.2
June	878	79	27.8	767	6.36	22.8	4.28	1.5
July	895	81	35.0	690	8.14	23.2	6.64	1.2
August	871	81	33.0	737	6.80	20.6	4.45	1.5
September	792	83	37.8	792	7.39	19.6	4.71	1.5
October	961	83	45.2	896	8.35	18.5	4.41	1.9
November	934	83	46.3	805	8.64	18.7	2.78	3.0
December	1021	83	48.1	976	8.70	18.1	3.38	2.5
1994:								
January	733	84	46.0	635	9.07	19.7	3.09	2.9
February	779	86	60.8	1266	13.6	22.5	4.51	3.0
March	967	86	109.8	1017	16.6	15.1	8.90	1.9
April	1057	86	96.6	1206	16.4	17.0	13.2	1.2
May/**	1119	86	69.3	1070	16.0	23.2	8.0	1.8
June/**	2621	86	386.3	3234	55.4	14.3	23.7	1.9
All in all by all auctions/***	15779	86	1151	16816	202.8	18.9	104	1.8

*/ (1) the number of enterprises;

(2) the total number of regions where the auctions are held in line with the date;

(3) the total authorized capital, billion roubles;

(4) the number of people employed at the enterprise, thous.;

(5) total sold authorized capital, billion roubles;

(6) average weighted sold authorized capital, in %;

(7) the number of cheques accepted, mln (By the start of July 104 mln cheques have been accepted through the cheque auctions and 40 mln cheques have been accepted through a closed subscription for the workers of the joint-stock companies. Thus by the official date of the end of the cheque privatization all in all it has been collected at least 97 per cent of the cheques issued);

(8) the average weighted rate at the auction (the number of 1,000-rouble shares per one cheque at the auction).

**/ The data not full.

***/ The aggregate data on all auctions may disagree with the sum of the results by months since the data base was updated all the time.

Source: Data base of the GKI and of the Russian Centre of Privatization.