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**Restructuring practices in Russian provincial companies and their impact  
on the east gas programme**

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## **Abstract**

Using data for the period 1991 - 2004, this study investigates the strategic priorities of senior management in provincial Russia. The study is based on interviews with top management in twenty former state owned provincial companies and a number of external respondents. It analyses managerial decision making patterns during the transition and post-transition periods. A strong tendency for Russian provincial managers to pursue operational restructuring with a very little attention to strategic planning was identified. We also argue that managerial attitude toward strategic decision making appears to be a key success factor of large national projects of strategic importance.

As there was a lack of prior studies in this geographical area and a general bias towards areas with a high economic activity index, this study employed a phenomenological approach to study strategic managerial priorities and presents qualitative data which enriches understanding of enterprise transformation in the Russian province.

Data gathered during the study demonstrate how managerial priorities relate to the Russian companies' transformational patterns. The study identified a number of pivotal areas which were prioritised by Russian directors as crisis-management strategies. The study suggests that the primary objectives of the top managers in provincial Russia are based around preserving production level, employees, status quo, and personal benefits. The data suggest that in the given underdeveloped institutional environment managers often use corporate objectives for their own benefit. This paper also suggests that an authoritarian model of enterprise management and autarky can be an effective mechanism to combat serious problems of transitional instability.

## **Introduction**

In this article we examine the factors affecting managerial decision making and the role of the latter on the development of the Russian provincial regions in the context of large national projects. Siberia makes up more than three quarters of the Russian Federation. Development potential of Irkutsk region is high enough for making it the driving force in the economic development of East Siberia and Far East. According to TNK-BP Executive Director for Gas Business Development Viktor Vekselberg<sup>1</sup>, development of the Irkutsk region is momentous for the development of the whole Baikal area and entire East Siberia. Recent ambitions of the Russian Gazprom Company to launch an Eastern gas programme until the year 2030<sup>2</sup> can become a turning point in the economic growth of Irkutsk region and its business segment. However, with the strategy of development of East Siberia

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<sup>1</sup> 'Eastern route of Siberian gas', *Rossiiskaya Gazeta*, 10 April 2008, Moscow.

<sup>2</sup> 'Gazprom company gets down to launching its Eastern gas programme', *Voice of Russia*, 5 June 2008, available at: <http://www.ruvr.ru>, accessed 20 August 2008.

being still unclear, it is potentially risky that such mega projects may clash with serious resource and infrastructure limitations, energy deficiency, shortage of infrastructure facilities, and decline in quality and quantity of labour resources.

The problems of Eastern Siberia stem from the social legacy of the turbulent transition period. Slow growth, obsolescence of assets, a colonial type of development, general poverty, huge social disparity by regions and lack of transportation infrastructure leave the regions behind the more economically developed Western and Central Russia. It is in this context that the article argues that strategic thinking and dynamism at a corporate management level is a vital ingredient for economic growth and development of the Russian regions.

Strategic change may involve decisions regarding corporate structures, employees, company finance, customers, products, manufacturing processes, as well as expansion or closure of facilities. All of these decisions have a long-term impact on the profitability and competitive position of the company. However, they are often based on limited knowledge of the projected conditions on the ground (Goetschalckx 2002). In the emerging markets, the high rate of change in the business environment, lack of knowledge of the market and the high levels of uncertainty and risk, may postpone a vitally needed change.

There is evidence that Russia occupies a dominant position among other CIS members (Michailova and Liuhto 2000) and the period of Putin's presidency has stimulated this interest even more. The one element which international studies often omit is how companies have been undergoing a transformation process in the remote provincial parts of Russia. 'Thanks to Soviet economic policies, Russia has a severely distorted economic geography. In particular, a huge proportion of modern Russia – cities, factories, and people – is lost in the distance and cold of Siberia' (Hill and Gaddy 2003, p. 23). Either due to methodologically underdeveloped studies or renowned climatic conditions very few researchers attempted their studies in Siberia. The accent of Russian energy complex is gradually shifting towards Eastern Siberia which makes this region a focal point of this article. The East Gas Programme, with a budget of RUR 2.4 trillion, ratified by the Russian Government in summer 2007 puts several regions on the Russian energy map with Irkutsk region being one of the key ones. This emphasises the significance of the Siberian region in the whole of the Russian economy and makes research in this region critical to understanding corporate management practices and priorities. Table 1 demonstrates strong position which Russia occupies in the table of other BRIC countries and G7 members also suggesting that Russian strong financial position has been achieved due to high oil and gas prices which in 2007 and 2008 proved to be very volatile. Owing to its geographical proximity to Russia and a dominant position of Russian gas, the European gas

market continues plays an important role in the export policy of Gazprom. In 2006 Gazprom's natural gas sales to European countries accounted for RUR 161.5 bln giving an increase of 3.5 per cent as compared to 2005.

< Table 1 here >

There are multiple factors that impinge on the enterprise transformation; however, CEOs and top management were defined by multiple researches as a key element of corporate restructuring and development. Vickerstaff et al. (1998) argue that the changing role of managers (particularly middle managers), the changing significance of the economic bureaucracies of the state and their relations to the enterprises are even more central to understanding the changing role of enterprises than is privatisation.

Emerging economies provide a new context in which to understand the relative strengths and weaknesses of the different perspectives of corporate restructuring. Wright et al. (2005) emphasised the importance of research in the emerging economies. There, however, until now was a limited focus on the strategic priorities of the top management which forms the direction of enterprise transformation. How companies restructure in the Russian province depends on the management and their agenda. According to Hoskisson et al. (2000) transition economies present distinctive settings and hence research results on the relationship of corporate governance and enterprise transformation from developed Anglo-American studies are not always applicable.

To elaborate this argument further, this paper develops a discussion on the methods prioritised by the top management in Russian provincial former state owned enterprises.

This paper focuses at the following two areas:

1. *Priority objectives for undertaking restructuring in Russian provincial companies.*
2. *Restructuring methods, mechanisms and strategies.*

The first question explored how managers in the former SOEs perceived corporate change, i.e. how different elements of their business activities were prioritised, and the interaction of this process with their personal objectives.

The second question expanded on earlier discussion and focused on the processes of enterprise transformation and how companies have undergone various phases of change. This question dealt with the process of transformation from a more mechanical perspective and explored how typical Western methods of restructuring were employed in the sample companies. At the same time other methods and approaches to transformation were also investigated where those existed. Here the commonly used schemes of enterprise restructuring unveiled.

## **Theoretical foundation**

During the past decade considerable attention was given to corporate restructuring, turnaround and transformation worldwide and particularly in transition countries. Multiple theories and frameworks were developed using political approaches (Pettigrew 1987; Quinn and Cameron 1988), sociological approaches (Miller and Friesen 1980; Hinnings and Greenwood 1988), cognitive approaches (Bartunek 1984; Barr et al. 1992), and the role of top management (Hales 1986; Goodstein and Boeker 1991; Chirikova 2003; Peng 2004).

A number of researchers (Huse 1980; Beckhard 1992; Thornhill et al. 2000) define transformational change as organisational change aimed at changing existing culture, resulting in conflict and implications for use of human resource strategies. On another hand, according to Aghion et al. (1994) restructuring policies in Central and Eastern Europe imply closing firms judged unprofitable or laying off workers reorganising the production process as a whole; recapitalising the enterprises; pursuing an anti-monopoly policy and splitting up the enterprises (Charap and Zemplerova 1993) – a radical enterprise transformation driven economically by market necessity.

The essence of enterprise transformation was interpreted in a number of ways, including turnaround strategies (Slatter and Lovett 1999; Peng 2000), organisational change (Gitelman 1999; Dyck and Kleysen 2001; Bornstein, 2001; Lizal et al. 2001), financial restructuring (Bartlett 1991), asset portfolio change (Hoskisson and Turk 1990), management restructuring (Culpan and Kumar 1995; Peng et al. 2003), activity related structural change (Carlin and Mayer 1992), and exit strategies (Hill and Jones 1998). An interesting argument was developed by Bloodgood and Morrow (2003) who raised a concern with regard to the differences between corporate transformation and organisational development.

All the above mentioned approaches are neatly linked to path dependency theory (Coase 1937; Williamson 1975; North 1990; Stark 1996; Vromen 1995; David 1997; Lamberg and Parvinen 2003), agency theory (Mabey and Salaman 1995; Sharma 1997; Markides 1999), and resource based theory (Barney 1986, 1991). All three contribute to decision making and forming priorities for undertaking radical changes in enterprises. Despite well elaborated theories on transition economies few researchers have come to a consensus about the way companies transform during the transition from the planned to market economy. Some grey zones still exist in the area of top managerial priorities in these economies. Are they generally in line with the frameworks which were developed in the West or represent a different agenda which guides the transformation of their companies?

Normally corporate restructuring occurs when the present structure of the corporation is not providing the value expected by the market, shareholders or the management (Hillman and Keim 2001) or when a part of a company

no longer fits into management's plans. Russian economic and political changes created environment where all subjects of economic activity had to make substantial adjustments.

Extensive enterprise restructuring has been widely accepted as essential to successful transition in Central and Eastern Europe (Barrell and Holland 2000). It is defined as a complex process to constantly increase profitability and retain a strong position in the face of a changing economic environment, technological progress and competition from other firms (Anderson et al. 1996; Akimova and Schwödiauer 2001).

When discussing enterprise transformation, Slatter (1984) considers it as a corporate turnaround and divides it into two types, crisis and non-crisis recovery. Both cases normally involve managers in implementing corporate change with the purpose of improving corporate performance. Therefore the pre-restructuring situation can determine the way changes are to be implemented. This takes the discussion to path dependency theory (Coase 1937) which is focused on inherited resources, dynamic capabilities and the consequent evolution of the firm (Teece et al. 1997; Barnett and Burgelman 1996) and has been seen as a means of coping with complex organisational contingencies through time.

Particularly important was the size of the companies (Shaw and Barrett-Power 1997, p. 109) because communist industrial structures were characterised by the dominance of large enterprises (Ehrlich 1985; Estrin and Takla 1993). For this reason, among the major changes which occur during economic transition is the strategic and operational reorientation of assets, networks, and thinking in every stage of the value chain (Ullmann and Lewis 1997). Standing (1996) suggested that enterprise transformation can be either natural or forced. According to Adam (1996, p. 61) the latter can be directly applied to the Russian transition, 'A good manager ... was one who was able to squeeze from the authorities an easily fulfillable plan with the allocation of sufficient inputs, including labour, and increase in the wage bill which would guarantee an increase in the real wage without the need of much greater intensity of labour'.

Bondnar's (1996, p. 634) study suggests that CEE privatisation '...while placing some in the ownership of great wealth, traps others in their very private misery and despair'. In this way the ownership of large enterprises was concentrated in the hands of those close to the central apparatus. However, Aghion and Carlin (1997) argued that changes in ownership were not essential to elicit changes in corporate behaviour.

Peng (2000) identified three types of possible strategic direction, i.e. muddling through (Puffer and McCarthy 2002), raising capital from financial markets and corporate restructuring and probed leading Western theories into emerging economies of Central and Eastern Europe (Meyer and Peng 2004). However, whereas business

restructuring is known in the West as an efficiency turnaround strategy in contrast to the entrepreneurial/strategic stage (Bibeault 1982; Robbins and Pearce 1992), Russian variant of restructuring was likely to be defined as 'stopping bleeding' or emergency actions (McMahon 2002) which enabled only a lethargic survival of the former SOEs rather than strategic development.

### **Research methodology**

This paper is based on an extensive phenomenological study (Saunders et al. 2000) conducted in 2001-2002 in a provincial city located five thousand kilometres away from Moscow. It relies on material from interviews (Bryman 1989; Kvale 1996) with the directors of 20 medium and large former state owned enterprises, former directors and independent outsiders. In addition the study used a multi-source data collected from statistical bulletins, companies' financial and managerial data (Dale et al. 1988; Yin 1991), observations (Webb et al. 1966; Stewart 1967) and information provided by outsiders.

For the purpose of the study opportunity stratified sampling and convenience sampling were applied. The companies were segmented on the basis of several criteria, i.e. their current ownership (private or largely in private Russian ownership), size (medium and large) and location (Bratsk city and surrounding territories). However, despite Hoover and Donovan's (1995) statement that avoiding sample bias is one of the most important issues of sample selection, it was ignored in this thesis due to the inductive and exploratory nature of this research. Convenience sampling was used in the view of the research subject sensitivity and the need for collecting in-depth qualitative data. Hence, this study does not have the intention to generalise to a wider population.

Condensing of the data was enhanced through thorough work on the fieldwork materials in printed and audio form. All the data were coded according to the generic corporate restructuring types, leaving space for new strategies which could occur during this research. Content analysis (Bardin 1993) was used in this thesis for descriptive, explanatory and exploratory purposes. It was used to analyse the interviews, newspaper articles and political speeches. Content analysis allowed the analysis to go beyond plain description of the content of the restructuring process and to discover the reasons for certain strategies or behaviours. The technique which was applied comprised therefore both mechanical and interpretative components (Krippendorf 1980). The mechanical aspect involved physically organising and subdividing the data into categories whilst the interpretative component involved determining what categories are meaningful in terms of the questions being asked.

In the process of study some difficulties were experienced with identifying corporate goals of sample companies. The reason was that enterprises could have covert goals in addition to the formally stated ones, and normally had a

number of hidden goals; as well as the fact that the directors of the companies consistently exhibited high risk-aversion and despair with regard to the conditions of their companies. Hence, focus on a single corporate objective would neglect the variety of goals that different sections of a company may have pursued. Different agents of restructuring can also have different perception of corporate goals and their effectiveness (Friedlander and Pickle 1968). As a result, a range of outside sources was used during the study to support the interview data.

The fieldwork included several lengthy visits to Siberia. Those took place primarily in winter to ensure that all respondents were available (summer tends to be a popular holiday season in the region). The second visit complemented the first through verification of the available data by means of conducting a survey (Fink and Kosecoff 1998; Schuman and Presser 1999) with the same respondents.

Using a multi-method approach enabled triangulation (Campbell and Fiske 1959; Hammersley and Atkinson 1983) of the data and helped to overcome the bias inherent in a single-method approach. To avoid overestimating the importance of data from sources that are clear, well informed and generally have a higher status while underestimating the value of data from sources that are difficult to handle, more confused, or of lower status, all information sources were treated critically and have been analysed consistently (Jick 1979; Kane 1985).

Analysis of the collected data has some generalisation limits due to the small convenience sampling employed in this study. On the other hand, it brings a number of quality suggestions for the existing Western restructuring model and generates a number of areas to be investigated in the further studies.

### **Research findings**

Three forms of enterprise restructuring identified by Slatter (1984) were observed during the fieldwork, those were defensive, strategic and structural changes. Based on the empirical data five key elements of enterprise transformation were evaluated in the Russian context. These elements, i.e. financial, production, management, and marketing represent five main restructuring areas in the sample companies.

*Financial* transformational methods included changes of bank connections, new loans from banks and rescheduling old loans, receiving new loans from non-bank sources, reduction of outstanding receivables and lengthening period for payables.

*Production* focused actions consisted of changes in inventory policies, energy savings, improvement in the product quality, change of the product mix within the traditional strategy, reduction of material input and change of the sector of activity.

*Management* change in the frame of structural restructuring was seen in the change in composition in board of directors, management personnel change and change of management structure.

*Marketing* related transformation included change in distribution network, increase on export efforts, seeking new domestic markets and foreign investors.

And lastly, but not the last in priority order, *strategic* change came from new investment or changes in technology, disposal of social and non-social assets and often closure of the workshops or plants with the primary goal of survival.

It is not surprising that enterprises in the post Soviet economy placed their priorities on production as the main aspect of economic activity. From 1992 central planning no longer provided companies with five-year plans and targets in production that had to be met. Nevertheless, more than a half of enterprises maintained their production levels despite the rapid decline in solvent demand and continued supplying their 'share in social production' (Kornai 1992). The plan implied a focus on output whereas new market conditions required more efficient production and production of goods responsive to market needs.

A clear symptom of the aggravating crisis was overproduction and overstocking. Inventories almost doubled in the mid 1990s, but it was a sign of decline rather than recovery because all enterprises without exception reduced their production by at least 50 percent. In spite of this, companies were reluctant to reduce their inventories, hoping that demand would increase and they would be able to dispose of all their goods.

Production in the region was at large extent supported by barter, which could fulfil corporate short-term survival objectives. Barter transactions were possible at an unprecedented scale in Russia's transition economy. Noguera and Linz (2005) also confirm in their work that barter was 'increasing from 10 percent of total transactions in 1992, to a high of 50-60 percent in 1998'. Barter was used by potentially viable enterprises as a way of avoiding closure and acted as a substitute for short-term credit. Indebted enterprises also financed increasing inventories through barter transactions and bank credit. Such companies preferred the accumulation of arrears to costly restructuring. Thus, barter was used to avoid restructuring when it might lead to shutting down potentially viable assets.

The cost of production at the enterprises was extremely high. This is explained by the enormous size of enterprises and the cold climate which raises the cost of energy consumed for heating purposes. It was also an outcome of having the complete production cycle at the enterprise and lack of specialisation. Hence, energy saving was vital

for the enterprises despite having a large supplier of cheap energy in the city. Many companies accumulated further debts because of the need to keep idle workshops heated throughout Siberian severe winters.

Low quality of products (due to physically obsolete technology) resulted in high levels of returns by customers, additional decline of sales, increased inventory volume and increased work in progress. Some companies responded to this with technological investment and a high commitment to product quality (Bornstein 2001) improvement. This was also one of the main types of post-privatisation restructuring of output in Eastern Europe (Brada 1998). However, in a number of cases companies pay no attention to improving their product quality because of the way they were prioritised by their customers, i.e. when 'the service of competitors was of a slightly lower quality this criterion was of lesser importance as compared to the price of the services and products'.

Lack of solvent demand and increased competition significantly reduced product mix at enterprises (for example, one company was offering 20 types of products but were capable of producing up to 63 types) and resulted in moving assets to a different location taking company to the next stage of transformation, i.e. strategic restructuring, which is discussed further.

According to Russian law, the tax authorities and various public utilities are entitled to take money they consider owed to them from the tax payer's bank account without prior permission of the account holder. This forms a significant disincentive for businesses to operate in the legal sector or for holding substantial funds in domestic deposits (Ellman 2000). Yasin (2000) argues that 40 percent of Russian enterprises were loss-making and were burdened with huge debts. At the same time these enterprises had the only choice – to survive, primarily, for social considerations, because many of these enterprises were the only employers in hundreds and even thousands of Russian cities.

'Tax authorities focus on the hefty penalties that can be gained from targeting large enterprises' (Aidis & Adachi 2007, pp.408) and while budgetary tax arrears were the major component of overall corporate debts, changes in interest rates significantly influenced the cost of production which was reflected by respondents. It was emphasised that increased credit risks hampered enterprises' essential long-term borrowed capital and made unprofitable long term investment.

Almost total insolvency among the enterprise population made achievement of a positive outcome rather difficult. The majority of enterprises were willing to improve their cash flow even to the detriment of their long-term viability. Moreover, making the overall financial situation worse by delivering products to insolvent clients enterprises could obtain, at least before 1993, cash credits from the bank to pay wages to their employees.

Interviewed CEOs emphasised that the most crucial was [...] *deterioration of the main fixed assets, in particular equipment and machinery that require complete renovation which in turn calls for considerable changes in the banking system [...]*.

Cost reduction strategies were not always 'invariably a characteristic of successful turnaround situations' as it was argued by Slatter (1984, p. 168). On contrary, asset reduction strategies were more common among the companies. Cost reduction strategies involved reviews of inventory policies, energy savings, cuts in material spending and overhead costs, and a major focus on unit labour costs. The level of inventories was a common problem in certain Bratsk companies (85 percent of the companies). On the other hand, majority of the companies were reluctant to reduce their inventories, hoping that demand would increase and they would be able to dispose of all their goods. Yet, intensified foreign product competition forced some enterprises to set up new companies and divest inventories to the new companies as start-up capital. Even in these conditions few enterprises in cancelled their outstanding orders. They tent not to return goods to suppliers and order with the same frequency which negatively affected inventory levels.

A majority of the sample companies had negative working capital and lacked the funds needed for growth. Some decided to use borrowed capital and pursue a multiple segmentation strategy. Having developed several separate marketing mixes for each market segment companies faced new difficulties associated with additional production, promotion, inventory and administrative costs. Companies that had substantial working capital were more successful since they could expand and improve their operations. However, there was no attempt at development and companies were reducing their current assets, which simultaneously increased their share of liabilities.

However, the main reason for failure was a lack of financial planning. Few managers used financial forecasting is developing a series of projected, or pro forma financial statements, which would assist anticipation of the future levels of receivables, inventory, payables, profits and borrowing requirements.

Either for objective or subjective reasons companies did not make serious efforts in forecasting and strategic planning. It can also be that the companies simply could not separate the 'vital few' from the 'trivial many'. A majority of the sample companies were run largely on intuition.

Thus, corporate transformation was often associated with reducing inventories, reducing number of debtors and on the other hand extending creditors. Yet, reduction of capital was mostly justified by the lack of demand in the local markets.

Lack of solvent domestic demand pushed many companies to cease production of low-profit products which in turn was accompanied by reducing working capital because no investments or capital transfer to profitable divisions were made. It was commented that net current assets in province happened to be barely liquid during the period of transition.

Management attention was often biased towards the provision of production and accounting whereas strategic planning, investment policy, innovations, HRM and marketing are often relatively neglected. As a result, at almost all companies the management structure became inadequate for the current market situation.

Due to the complexity of corporate strategy as an organisational process which links the structure, behaviour and culture of the company in almost all restructuring cases, there is an urgent need for a complete reorientation of the business, in many cases requiring the replacement of management (Frydman et al. 1996, p. 40).

As long as companies could maintain positive balance sheets, they did not have to go through the arbitrage process and in these cases in a majority of companies management was changed either at the beginning of the 1990s. It is important that multiple changes of top management did not contribute to corporate recovery and it was recognised by managers that higher efficiency could not be achieved just by changing directors, and juggling with executives was particularly destroying for companies when they were in the decline stage.

Management personnel change was one of the most progressive (but not necessarily effective) restructuring methods following massive lay-offs that were the first and, for many managers, the only saviour of a company's position in the market. Many top managers lost their places for the reason that they had an old mentality, not mentioning the complete absence of entrepreneurial ways of thinking of Soviet top managers who simply could not believe that the old times would never come back or those who simply were not used to running enterprises independently, having relied upon the government and central planning system. Many business links were reshuffled and companies had to build them from new, often with new partners.

Most of the CEOs claimed that management change played a crucial role in the enterprise transformation. In addition, theft was one of the elements of CEOs' daily routine which was rarely overlooked. Some companies, which could not survive independently in the volatile environment or became victims of corrupt executives, had to go through an arbitrage process.

Generally, companies became more responsive to environmental changes and realised the need to reshape their structures and, most importantly, became managed by the owners or managers who were directly interested in the results of their work. This resulted in unexpected outcomes of the enterprise transformation which do not fit

Western conceptual framework of corporate restructuring. As a result, many companies found it easier to operate as two companies working under one management.

Some companies did attempt enhancement of their export activities, however, high export levels did not always go along with higher profitability of the CEE companies, at least for some years (Major 1999). This could be explained by the fact that private companies had to enhance and stabilise their market position first, which could imply tremendous costs.

Very few of them could hope to find foreign investors because of their current conditions and mostly only regional area of expertise. However, they did reinforce their search for new domestic markets within the same spectrum of products or services. At this instance, recovery of the Socialist giants was like a miracle which saved number of companies whose products and services happened to be of a satellite nature for the new customer.

Strategy is another element of the Russian transformation dimensions. Research data showed that the sample companies generally pursued passive defensive strategy, e.g. where the hardening of budget constraints forces firms to shed excess labour. Similarly, defensive approach was taken when some companies used spin-offs as a means of defence against hostile takeovers. However, reasons for the passive restructuring were not limited by the above. In a significant number of cases it was serving as an umbrella for gradual assets tunnelling involving substantial asset reduction strategies.

Many large industrial enterprises temporarily closed down their workshops. However, the cost of closure was often perceived as unacceptably high. Those who argued against closures were generally aware of the direct costs of closure, but failed to perceive the indirect and ultimately more damaging, costs of non-closure.

Strategic horizons of the companies were often limited by the resistance of a local administration when the later had an interest in companies affiliated with their competitors. From this respect, one third of respondents expressed their discontent with the local Mayor. Following the collapse of the old system many large SOEs and former SOEs resisted serious restructuring and secured diverse forms of support from the government. Often, reactive government responses to a restructuring 'crisis' served merely to delay the exit of non-viable firms with no realistic prospects of profitable production.

Empirical findings show that a majority of sample enterprises accounted for a huge number of abandoned workshops. This type of reducing total costs dominated over other restructuring approaches. Despite enterprise ownership and management of various social assets importance in the relationship between large enterprises and their workers, one of the significant steps of restructuring was divestment of social assets, i.e. housing, child care,

and health facilities from enterprises to government to shift the burden of social protection from enterprises to government, thus facilitating strategic restructuring.

Following the declaration of enterprises as bankrupt, a launch of a new company was normally put in place. All social facilities were then transferred to the municipal authorities to lighten the balance sheet of the companies which were overwhelmed with budgetary debts. However, there were situations when companies had socially important objects on their balance sheet (e.g. boiler-house), which could not be stopped and the local administration did not always take them. This in general resulted in large debts due to non-payments for the heating.

Unfortunately for the enterprises in transition federal law was constantly changing and added to already highly elevated uncertainty. In addition, 'the government does whatever it wants whenever it wants, increasing uncertainty and lawlessness of the business environment. [...] given the strength of regional authorities in Russia, regional government agencies can play a critical role [...] for further business development and growth' (Aidis & Adachi 2007, pp.392). This becomes a serious obstacle for technological upgrades and new investments. Another reason why companies still experience significant lack of a long-term strategy is that together with abandonment of the planning system and entering a long decade of uncertain transition, no thorough attempt was made to assess existing risks and pursue organisational development using existing resources and competences. This led a large share of businesses to choosing a short-term strategy, highly relying on autarky and having focused on a mere survival.

## **Discussion**

After 1991 Russia went through series of privatisation and gradually began to nationalise many large enterprises (Yukos, Domodedovo airport etc.). Table below illustrates that 80.7 percent of all companies in the Russian Federation by 2007 were in private ownership.

*< Table 2 here >*

Table 3 below presents a positive trend of relatively stable enterprise population after 2000 with a noticeable downturn between 2005 and 2006 in Russia as a whole and in the Siberian Federal district. Irkutsk region, where the study was undertaken demonstrated a slow growth in the enterprise numbers, which is overall, is a more positive trend comparing with the rest of the country.

*< Table 3 here >*

The number of private enterprises by 2007 accounted for 12.6 percent of all private enterprises in the Siberian Federal district. This indicates a relatively low enterprise activity at first glance but the real picture is different as Irkutsk region has a high proportion of large industrial enterprises, former Soviet giants. Not surprising that the share of privately owned companies in Irkutsk region is lower than the average across Russia amounting to 77.8 percent. This represents slower transition process intrinsic to provincial regions.

When the system changes began, the advantage to the enterprise managers was not so much that they became private owners of the assets they managed, but that they escaped many restrictions on their operations that they still experience within the state sector (Cox and Mason 1999, p. 72). Transferring control to new companies gave them freedom to seek new markets and develop new product lines, and in some cases avoid government intervention in their decisions. If the former state enterprise was in debt, there was an added advantage as those debts could be left in the old holding company, keeping the new company free to make a fresh start (Voszka 1995, p. 288).

Despite massive privatisation there was little evidence of any fundamental restructuring in the newly privatised Russian enterprises (Frydman et al. 1996) until after the financial crisis of 1998. The crisis of 1998 was required to accelerate the process of restructuring of Russian enterprises. However, the conditions, which allowed a significant share of the economy to remain uncompetitive and loss-making in real terms, to spend resources of the rest of the economy and to restrict the economic growth, continue to exist even now.

In 2007, there was 42.5 percent of loss making enterprises in Irkutsk region with overall loss amounting to R716 million (Goskomstat, 2007). This is a negative side of the economic performance in the region. However, looking at the net profit achieved by the companies in the first quarter on 2007 a significant increase of 382.9 percent to the first quarter of 2006 can indicate that economic potential of the region is growing rapidly.

As a result of the conducted in Irkutsk region research positive restructuring index was assigned only to 40 percent of the sample companies. 'According to Goskomstat practically every third enterprise or organisation is loss-making' (Rileev 2001, p. 145) and it was proved by the study that this was due to the large amount of obsolete physical assets inherited from the Soviet era and colonial type of the regional development. Looking at the Table 4 it can be seen that the number of enterprises in Russia overall and in Siberian Federal district was growing with exception of 2006. This is a second warning signal since the study was carried out highlighting that the transitional processes in Russia are far from smooth.

Ultimately, different approaches to restructuring depend upon the view one takes on the nature of the restructuring activity facing firms in different localities. Corporate objectives of the Russian provincial enterprises are very diverse, with a large number of firms needed fairly radical downsizing or even liquidation. However, significant number of companies would benefit from strategic restructuring through expansion and investment in new methods of production as well as new business lines. In Bratsk this group was represented by 45 percent of companies, one third of which also decided to change the sector of their activity. However, in almost all cases, there is a need for injection of expertise in marketing, planning and risk management. Table 4 below presents the current breakdown by the type of economic activity in Russia and Irkutsk region. The high percentage of enterprises engaged in the wholesale, retail and property business is a positive indication of growing economy but in the light of this study results it is not a deserved achievement of the ‘red directors’ of large enterprises in the region.

*< Table 4 here >*

Companies by and large strengthened their marketing efforts. Similar restructuring approach largely applies to the Czech Republic, Hungary and Poland in Central and Eastern Europe and majority of the former Soviet Union nations (EBRD 1999, pp. 210-213, 226-229, 250-253). This was largely done through the enhancement of their distribution chains. Large proportion of the sample companies took this service ‘in house’ and established a chain of own sales outlets, by these means ensuring a sustainable distribution process.

The very notion of ‘survival’ had different meanings to different state enterprise directors. The overwhelming majority of the old directors considered preserving their work force and maintaining the level of earnings as primary goals. Very few senior managers mentioned their main aim as stabilising production and strengthening the position of their enterprise on the market. But in enterprises with old management structures these intentions usually are only measures to reach the same aim – to keep their employees which can be seen as a management culture applicable to many enterprises in Russia. On the other hand, the word ‘market’ was hardly mentioned by the surveyed directors which indicated that Russian province is lagging behind central Russia in its economic reforms.

Data collected through this study suggest that majority of the companies use a wide range of strategies to survive. Almost all sample companies had to change managerial personnel and re-organize the boards of directors as a first priority. This was often associated with the replacement of incapable managers and change of directors of different levels, thus building a new top management team. Another favoured strategy was represented by change of the inventory policies which can be explained by the lack of solvent demand and consequently substantial

overstocking. This was often combined with reduction of material inputs, a largely defensive strategy, and a key focus on cutting costs rather than increasing productivity. Change of the price relative to competitors was another way to withstand competitive pressure from imported goods. However, one particular strategy was mentioned by 65 percent of companies, which is energy saving that became an imperative for industrial enterprises with their massive physical assets and thousands of square metres of workshops and administrative buildings.

Because many enterprises were loss making, and as large inter-enterprises arrears had built up, a strict implementation of bankruptcy procedures would have had a domino effect and generated a chain of bankruptcies. The business climate was especially hostile due to predatory nature of many regulatory authorities and inspectors. This situation is currently perpetuated through state capture, especially at the regional levels (Aidis & Adachi 2007, pp.392). Hence, one of the favoured policies for many companies was a quick asset divestiture. Taking into account that directors together with the rest of the top management have virtually complete discretion in business operation of the enterprise this was one of the most convenient forms of restructuring for them.

The reason for this was that many decades of the planned economy left their imprints on individuals' habits, attitudes, and behaviour – this formed a national culture with a strongly inherited socialistic mentality. Survey results consistently hint at the prevalence of certain mental residues ranging from high-risk aversion and the inclination toward grab-and-run behaviour to negative egalitarianism, as was also discussed by Mason (1996).

From this point of view, Carlin et al.'s (1999) suggestion that the managers' incentive to restructure is supplemented by the hardening of budget constraints which can be seen as increasing the penalty on passive behaviour appears to be either of low significance in the given circumstances or requires a thorough review of the agents involved in this process.

However, it is true that old directors choose between restructuring and the status quo, where restructuring entails a cost now but offers the prospect of benefits in the future. From a managerial point of view a characteristic of restructuring is that it is costly in the short-run but offers the prospect of gains in the future. Nevertheless despite all the improvements at corporate level some directors, both those carried over from the SOE, or newly appointed, were still reluctant to make decisions, to take responsibility, to delegate authority to subordinates and to use leadership and teamwork rather than operate hierarchically.

Not very large number, but nevertheless some companies, used autarky as a survival strategy. It was inherited from the old Soviet system when everything was produced in house, and this, in fact, helped them to go through transition without suffering severe losses and to retain their main production assets. The degree of operational

independence positively contributed to the transformation process in Bratsk companies, freeing them from contractual obligations with economically unstable suppliers.

These companies kept highly qualified staff and had engineering specialists and staff development personnel; they could design and carry out such types of work which very few companies could fulfil. The same strategy was found in a number of companies which did not employ contractors and produced all work themselves. Companies applying autarky to their production methods showed signs of larger potential.

Despite the economic slowdown, 16 percent year-on-year real growth of fixed capital investments of large and medium enterprises was reported in the first quarter of 2001. On this background, few managers seemed to appreciate the true opportunity costs of investment in such intangible resources as managerial skills and engineering talent. Misled by conflicting priorities, they often minimise risks by not taking them. Unfortunately, doing so, they fail to understand that they take an even higher risk by not attempting to transform their companies.

## **Conclusions**

This study formalises transformational practices in the Russian provincial companies through analysis of the managerial objectives and organisational priorities during 1990-2004 and through the qualitative study of corporate approaches to restructuring and common mechanisms and strategies.

It is not possible to treat all companies in transition economies and emerging markets alike. Although Russia had market system examples available, it took different route to it. Although the study confirmed that companies in the Russian province generally follow similar strategies to those popular in the West, however, how the patterns of corporate transformation in the Russian province depends on the top management and their agenda.

Top management in the Russian province is largely focused on passive defensive restructuring and short-term planning in order to achieve mere survival. Directors of the former SOEs perceived corporate change as an intrinsic element of self-enrichment in one case and as a fundamental evil when it comes to the old following social moral directors. There is still a sharp deficit of understanding of the need for enhancement of corporate competitiveness which is mixed with ballooning corruption taking place in all layers of Russian business and government.

More than a third of the sample companies were achieving long term survival through rescue of assets by means of tunnelling. This finding illustrates that Russian provincial experience of enterprise transformation differs not only from the Western conceptual model of corporate restructuring but even from the pattern which was observed in the administrative centre of the Russian Federation.

It should be acknowledged that the social and economic indicators in Siberia are now lower than those in all Russia. Siberia lags behind in economic development, living standards of the population, birth rate, and employment. The question which remains unanswered is whether hydrocarbons mega projects is a suitable solution for changing mentality of provincial directors who inherited their plants from the Soviet era.

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Table 1 Comparison between selected countries

	GDP according to PPP, billion USA \$	Country share in total GDP according to PPP World = 100	GDP per capita		PPP, national currency for 1 USA \$
			USA \$	USA = 100	
<b>G8 Members</b>					
Germany	2514,8	4,57	30496	73,2	0,9
Italy	1626,3	2,96	27750	66,6	0,9
Canada	1133,0	2,06	35078	84,2	1,2
Great Britain	1901,7	3,46	31580	75,8	0,6
USA	12376,1	22,51	41674	100,0	1,0
France	1862,2	3,39	29644	71,1	0,9
Japan	3870,3	7,04	30290	72,7	129,6
<b>BRIC Countries</b>					
Brazil	1583,2	2,88	8596	20,6	1,4
Russian Federation	1697,5	3,09	11861	28,5	12,7
India	2341,0	4,26	2126	5,1	14,7
China	5333,2	9,70	4091	9,8	3,4
<b>World total</b>	<b>54975,7</b>	<b>100</b>	<b>8971</b>	<b>21,5</b>	<b>-</b>

Source: adapted from Goskomstat (2008), available at: <http://www.gks.ru>, accessed 01 August 2008.

Table 2 Types of enterprise ownership in Russia, as of 1 January 2007

	Total	Type of ownership				
		State	Municipal	Private	Public and religious organisations	Other
Russian Federation	4506607	149285	264317	3638823	239189	214993
Siberian Federal District	510804	19414	42972	404173	26843	17402
Irkutsk region	65351	2455	5684	50869	2951	3392

Source: adapted from Rosstat (2007, p. 390)

Table 3 Number of enterprises and organisations in Russia and Irkutsk region

Years	1995	2000	2001	2002	2003	2004	2005	2006
Russia, total	2249531	3346483	3593837	3845278	4149815	4417074	4767260	4506607
Growth, % of previous year	780	149	107	107	108	106	108	95
Siberian Federal district	288276	385222	410805	433511	460020	482465	519567	510804
Growth, % of previous year	703	134	107	106	106	105	108	98
Irkutsk region	34676	46041	49542	52724	56566	59127	63414	65351
Growth, % of previous year	678	133	108	106	107	105	107	103

Source: adapted from Rosstat (2007, p. 384).

Table 4 Enterprises and organisations by type of economic activity, as of 1 January 2007

Type of economic activity	Russia	%	Irkutsk region	%
Total	4,506,607	100.00	65,351	100
Agriculture, hunting, forestry	261,487	5.80	6,421	9.83
Fishing	7,832	0.17	25	0.04
Mining	14,806	0.33	370	0.57
Processing industries	409,742	9.09	6,352	9.72
Production and distribution of energy, gas and water	21,840	0.48	400	0.61
Construction	351,751	7.81	5,149	7.88
Wholesale, retail; repair centres of automobiles, motorcycles, household items	1,724,292	38.26	20,391	31.20
Hotels and restaurants	80,928	1.80	1,173	1.79
Transport and communication	193,474	4.29	3,137	4.80
Financial activity	94,213	2.09	2,339	3.58
Estate agencies and estates services	658,983	14.62	8,111	12.41
State administration; national security provision; compulsory social insurance	100,455	2.23	1,909	2.92
Education	167,525	3.72	3,369	5.16
Healthcare and social services	73,263	1.63	1,367	2.09
Council services, social and personal services	338,105	7.50	4,255	6.51

Source: adapted from Rosstat (2007, p. 386).