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Reference Manual for Russian Joint Stock Companies



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-In Cooperation With the Russian
Chamber of Industry and Commerce
-Presented by CFED, Inc.

☆ **Russia**

**Corporate Governance
A Training Workshop for Russian Joint-Stock Company Managers**

Workshop Schedule

Day One

- 9:30 - 10:00 *Registration*
- 10:00 - 11:30 *Zoya Kaitova*
Introduction to Corporate Governance
Corporate Governance Model of Russian JSCs
- Legal Basis and Common Practice
- 11:30 - 11:45 *Coffee Break*
- 11:45 - 13:15 *Zoya Kaitova*
Test on Disclosure Requirements
Issue-based Guidelines on Corporate Governance Structure of Russian
JSCs
- Disclosure Requirements
- 13:15 - 14:15 *Lunch*
- 14:15 - 15:45 *Pavel Volichenko*
Case Study - Uralsvyazinform
- 15:45 - 16:00 *Coffee Break*
- 16:00 - 17:30 *Pavel Volichenko*
Case Study - "How To Handle Corporate Governance Situations"

End of Day One

Evening Assignment: Participants will be asked to read the articles "Governance Model of Russian Joint Stock Companies" and "Three Models of Corporate Governance from Developed Capital Markets" (Appendix 5) to prepare for Day Two. Participants will also be invited to prepare written questions on legal and regulatory aspects of governance to be discussed during the morning session of Day Two.

Day Two

- 10:00 - 11:30 *Zoya Kaitova*
Test on Compliance
Issue-based Guidelines on Corporate Governance Structure of Russian
JSCs
- Compliance
- 11:30 - 11:45 *Coffee Break*
- 11:45 - 13:15 *Zoya Kaitova*
Case Study - Bratsky Aluminum
Discussion of Written Questions Submitted by Participants
Presentation of Sample Corporate Governance Documents
(Springboard for Wrap-up of Legal Discussions)
- 13:15 - 14:15 *Lunch*
- 14:15 - 15:45 *Ilya Frank*
Russian JSC Profiles
- TsUM
- Klebny Dom
- 15:45 - 16:00 *Coffee Break*
- 16:00- 17:30 *Ilya Frank*
Relationship between Good Governance and Market Valuation
- Evidence from Developed Capital Markets (Germany, UK, US,
Sweden)
- Case Study - Failed Merger of Volvo and Renault
- Evidence from Transition Economies (Slovakia)
- Evidence from Russia

End of Day Two

Evening Assignment: Participants will be asked to read materials for the Red October case study.

Day Three

- 10:00 - 11:30 *Ilya Frank*
Russian JSC Company Profiles
- LUKoil
- Mosenergo
- 11:30 - 11:45 *Coffee Break*
- 11:45 - 13:15 *Ilya Frank*
Russian JSC Company Profile
- VimpelCom
- 13:15 - 14:15 *Lunch*
- 14:15 - 15:45 *Pavel Volichenko*
Case Study - Red October
- 15:45 - 16:00 *Coffee Break*
- 16:00 - 16:30 *Pavel Volichenko*
Case Study - Red October (continued, if necessary)
Case Study - JSC Heavy Industry (time permitting)
- 16:30 - 16:45 Distribute and Collect Workshop Evaluation Forms
Distribute Certificates
- 17:30 - 18:00 Press Conference
- End of Workshop

Effective Corporate Governance - A Prerequisite for Raising Capital A Reference Manual for Russian Joint Stock Company Managers

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Foreword

In today's business world, managers of joint stock companies face numerous problems in their daily activities striving to manage efficient and profitable organizations. Corporate governance, the system for interaction among all of the interests represented in a joint stock company (JSC), identifies practical problems for managers and points towards concrete solutions.

In the past, many managers viewed legal, organizational, public relations and financial duties separately. As a result, they often failed to develop an overall governance concept. This manual provides an interdisciplinary handbook for managers, explaining the importance of corporate governance and its practical utility in one particular area, namely raising capital. Thus the title, "Corporate Governance - A Prerequisite for Raising Capital."

Our methodology combines an analysis of market characteristics, presentation of company-specific data and situation-specific case studies. Throughout, the manual presents both negative examples "What managers should not do!" and positive examples "What managers should do!"

The manual begins with an outline of the governance structure of Russian JSCs. Then it provides "Issue-based Guidelines for Russian JSC Managers," focusing on compliance and disclosure requirements. To support and complement this regulatory framework, it cites a wealth of evidence from the Russian market, other transition economies and developed capital markets demonstrating the relationship between governance and market valuation of a JSC's shares. It underscores this point with profiles of successful Russian JSCs, outlining chronologically their capital-raising activities. Finally, it presents case studies that require participants to analyze and resolve corporate governance situations.

We will demonstrate that establishing effective corporate governance mechanisms, complying with regulatory requirements, creating and maintaining sound disclosure and keeping abreast of good corporate practices is not only relatively easy, but also rewarding. Good governance enables cooperative relationships among managers, the board of directors and shareholders, and results in a more stable valuation of a JSC's shares over the long term.

Obviously, the focus of analysis is recent experience of Russian joint stock companies. However, in certain instances it proves useful to compare Russian experience with experience from other transition economies and/or developed capital markets.

This manual and accompanying training program are financed by the United States Agency for International Development (USAID) and developed in cooperation with the Federal Commission for the Securities Market and the Chamber of Commerce and Industry of the Russian Federation.

We would like to acknowledge the assistance and contributions of the following individuals and organizations, without whom this manual would not have been possible: Dmitri V. Vasiliev, Federal Commissioner for the Securities Market; Sergei S. Bednov, Vice President, Chamber of Commerce and Industry of the Russian Federation; regional offices of the Chamber of Commerce and Industry in Nizhny Novgorod, Kazan, Irkhutsk and Vladivostok; Sergei Shishkin, Deputy Director, and Yevgeny Kulkov, Legal Advisor, International Institute for a Law-Based Economy Foundation; Ares Associates; Arthur Andersen; Bank of New York; Booz, Allen & Hamilton; British Know How Fund; Burson Marsteller; Carana; CentreInvest Group; CS First Boston; Dialog Bank; European Bank for Reconstruction and Development; Harvard Institute for International Development; ING Barings; KPMG; OLMA Investment Company; Patterson, Belknap, Webb & Tyler; Price Waterhouse LLP; *Russia Portfolio*; Salomon Brothers; Skate Press; and The Recovery Group.

Moscow, January 1997

Introduction to Corporate Governance

What is Corporate Governance?

A joint stock company (JSC) embodies numerous parties, each representing its own interests. The parties include employees, management, members of the board of directors, shareholders and other stakeholders (such as bondholders). **Corporate governance is the mechanism or system through which the various interests in a joint stock company represent themselves and interact with each other.**¹

Laws regulating JSCs and the securities industry establish the legal framework for such interaction; they provide the general framework for the governance structure of all JSCs in a given jurisdiction. This framework is further refined by: (1) each JSC's charter; and (2) additional external regulations. Regulations specific to each JSC are defined in the charter; it establishes the basic governing rules for each individual JSC and may define certain issues that are left to the discretion of each JSC. External regulations include rules or requirements established by self-regulatory organizations such as stock exchanges, chambers of commerce and industry, or associations of listed companies. Both types of refinements are significant because they further define duties, responsibilities and relationships which are not prescribed by law.

The above-mentioned aspects of corporate governance reflect the *de jure* structure. This is complemented, and often complicated, by the *de facto* situation, reflecting common practices in a given jurisdiction. Significant *de facto* elements of the corporate governance system include the share ownership structure; the influence and authority of key players in a given jurisdiction; and the common practices of these key players (juxtaposed with their legal rights and responsibilities).

The broadest **definition of corporate governance** would therefore include:

- the rights and responsibilities of, and interaction among parties in a JSC;
- the legal and regulatory framework in which JSCs operate; and
- the *de facto* behavior of key players in a given jurisdiction.

By definition, **corporate governance is a dynamic phenomenon**, because it concerns relationships among parties. As these relationships evolve over time, the system itself constantly changes and adapts to new conditions.

¹ In English, the term "corporate governance" refers to the "governance" or administration of "corporations." By definition, it concerns a specific type of business entity, namely corporations. More specifically, it mostly concerns publicly-owned corporations whose shares are traded on a stock exchange, over-the-counter or informally. It does not refer to the administration of other types of companies. In Russian, we use the term "governance of JSCs."

Why is Corporate Governance Important?

When a JSC borrows money, the relationship between the debtor (JSC) and creditor (bank or bondholder) is outlined in a legal agreement between the parties.

When a JSC raises capital by selling shares, it enters into a more flexible relationship with its shareholders. The terms of the relationship are as follows: By buying shares in a JSC, an investor supplies necessary capital to the JSC and becomes an owner, or shareholder, in the JSC. In return for this capital, the JSC grants rights to the shareholder: information rights, voting rights and financial rights. (See diagram: **Capital Providers in a Market Economy.**)

Corporate governance provides a framework for defining the rights and responsibilities of the various parties within a JSC and understanding their interaction. A sound understanding of corporate governance enables each party to plan and implement a strategy for achieving its goals and representing its interests. It also permits each party to evaluate the behavior of other parties.

Consider, for example, the flow of information related to the annual general meeting of shareholders (AGM). Directors, management and shareholders should be familiar with the legal requirements concerning the announcement, preparation and conduct of the AGM, in order to assure:

- that each party fulfills its legal responsibilities; and
- that each party is able to exercise fully its rights.

Corporate governance allows for the efficient operation of a JSC, by defining responsibilities and assigning tasks. When conflicts arise between parties representing diverse interests, good governance can help manage such conflicts and prevent disaster. In such cases, each party should recognize the rights and responsibilities of all parties involved and understand the framework for interaction. An understanding of corporate governance provides precisely this framework.

As in any organization, the performance of a JSC on an ongoing basis depends upon the skills and efficiency of its members. Internally, the JSC must have an effective organizational structure with functioning controls that enable operation of the business (by employees), business planning and administration (by management) and management oversight (by the board of directors). Externally, the JSC must be able to maintain and enhance its competitive position and the quality of its goods or services, remain cost effective, and interact with regulatory organizations, financial institutions and shareholders. Capital markets evaluate a JSC on the basis of its current performance and its ability to sustain its business activities over the long term. In this regard, issues such as management succession and the ongoing ability of the JSC to attract effective members of the board of directors are crucial.

In transition economies, a knowledge of the *de jure* and *de facto* elements of corporate governance is essential. First, it enables each player to fulfill his role in the system. Second, because the system as a whole is in a developmental stage,

this knowledge may enable players to identify deficiencies and advocate for appropriate improvements to the system.

How does Corporate Governance Affect Market Valuation?

In both developed capital markets and economies in transition a relationship exists between good governance and market valuation.

In developed capital markets, investors make two general assumptions before investing in shares. They assume: first, that the JSC's governance structure will comply with legal requirements; and second, that the JSC will provide detailed information about its activities, financial status, governance and share capital structure. Investors analyze this information in order to make informed investment decisions.

Furthermore, shareholders react to JSC compliance and disclosure in two ways: first, by deciding to buy and sell shares; and second, by voting at general meetings of shareholders.

The process is as follows: **Full, timely and consistent disclosure of information by JSCs leads to market transparency. Market transparency enables potential investors and current shareholders to evaluate JSCs and adjust their valuations of JSCs' shares quickly and continuously. Such continuous fine-tuning promotes fuller market valuation and more stable share prices.**

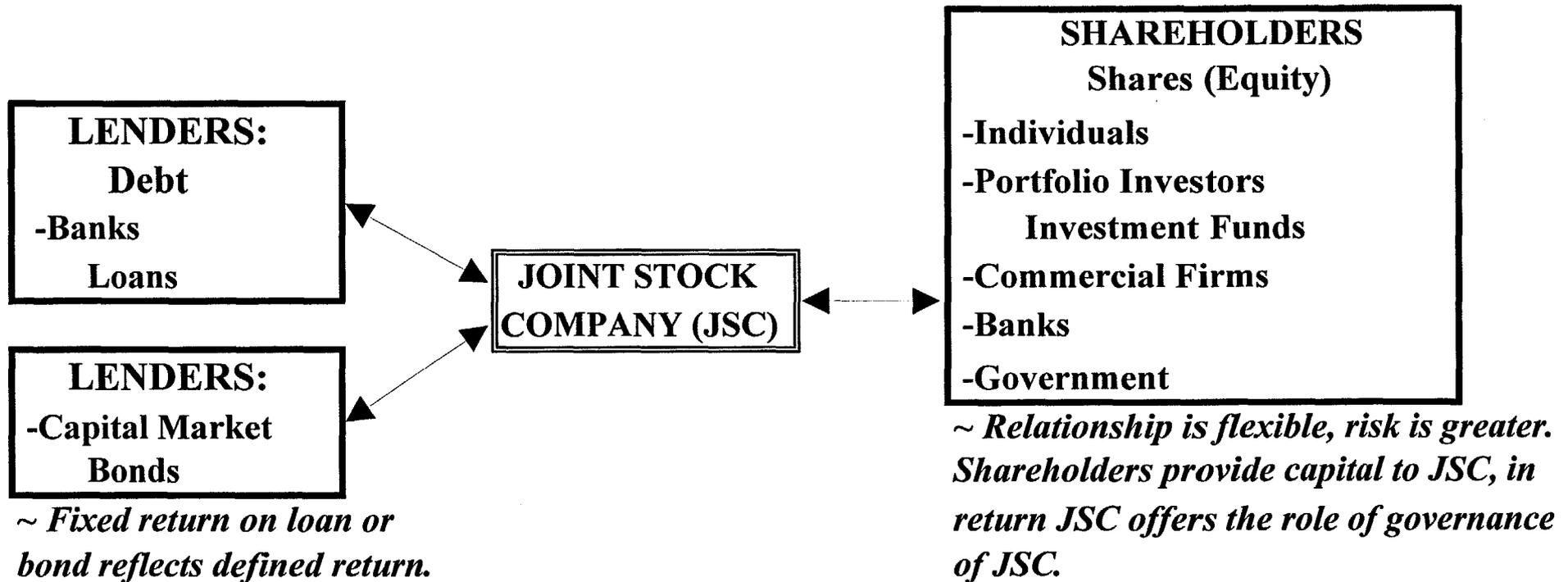
In economies in transition, the legal phase of privatization has been achieved. Formerly state-owned enterprises have been converted into JSCs. However, many players in these newly-formed JSCs are uninformed about their rights and responsibilities, and unaware of their roles as managers, members of the board of directors and/or shareholders. Simultaneously, many JSCs are not yet able to produce, process and provide sophisticated information to investors. This informational deficit creates an additional level of investor risk, because investors are often unable to make informed investment decisions.

As globalization of capital markets continue, a sound understanding of corporate governance is essential for the successful investor, manager, board member and employee. Why? Because capital knows no borders. **Investment is most likely to flow to markets where JSCs comply with legal requirements concerning governance, shareholders are recognized as an integral player in governance, and investors receive timely and useful information from JSCs.**

This manual and accompanying seminar present many concrete examples from developed capital markets, transition economies and Russia that demonstrate how: **poor governance, in terms of compliance and disclosure, leads to financial difficulty; and effective governance can contribute to better performance and market valuation of shares.**

Before proceeding to a discussion of these examples, an outline of the corporate governance structure of Russian JSCs is presented.

CAPITAL PROVIDERS IN A MARKET ECONOMY



*~ Fixed return on loan or
bond reflects defined return.*

*Relationship outlined in a
contract between debtor (JSC)
and creditor (bank or bondholder).*

Shareholders have:

- 1. information rights*
 - right to financial information
and information about AGMs*
- 2. voting rights*
- 3. financial rights*
 - right to trade shares*
 - right to dividends based on
financial conditions of JSC.*

Governance Structure of Russian Joint Stock Companies (JSCs)

Introduction

The governance system of JSCs in a given market develops in response to country-specific conditions. Over the past fifty years, specialists in the fields of corporate law and management have analyzed three major "models" used in the world's most developed capital markets: the Anglo-US model, the Japanese model, and the German model.² Since the early 1990s, a new model has been forming in transition economies in Central and Eastern Europe, Russia and the former Soviet Union.

Each corporate governance model identifies the following constituent elements: key players in JSCs (micro level) and in the securities market of a given country; the share ownership pattern; the composition of the board of directors (management board and supervisory board, in the German model); the regulatory framework; disclosure requirements for publicly-listed JSCs; corporate actions requiring shareholder approval; and interaction among key players.

The following outline of the Russian model introduces issues that will be addressed in further detail in this manual and accompanying seminar.

Key Players in the Russian model

Players in the Russian securities market include managers, shareholders (inside shareholders and outside shareholders), share registrars, auditors, inspection commissions, a Federal Commission for the Securities Market and self-regulatory organizations.

Shareholders include both **inside shareholders** and **outside shareholders**. Insiders are **employees** and **managers** who were given shares or purchased shares under the mass privatization program. Outsiders include: **the State Property Committee, banks, newly-created investment funds, commercial firms (strategic investors), individual investors, and foreign investors (corporate, institutional and individual).**

The key players in internal governance of Russian JSCs are managers, members of the board of directors and shareholders. (See **diagrams: Russian Corporate Governance Model - Theory and Practice.**)

Share Ownership Pattern

A study of Russia's largest JSCs conducted in the last quarter of 1995 concluded that **65% of companies surveyed were majority owned by rank-and-file employees.** However, these employees have not taken an active role in governance. Management ownership tends to be concentrated among top executives.

² See Appendix 6: "Three Models of Corporate Governance from Developed Capital Markets."

The pattern of outside ownership is uneven; in general, Russian commercial firms, individuals and voucher investment funds are the largest groups of outside shareholders.

Over the past two years, the Russian financial press has drawn attention to the emergence of several **Financial-Industrial Groups (FIGs)** in Russia. Each group includes a major bank and a number of large industrial JSCs. The member JSCs of each FIG are connected by a multiplicity of relationships: they buy and sell each others products and services, maintain bank accounts with the same bank or banks, and own each others shares. In many cases, the phenomenon of "interlocking share ownership" is reflected by "interlocking directors": managers from one JSC may be elected to the board of directors of another JSC in the group.

Composition of Russian Boards of Directors

The Federal Law on Joint Stock Companies (FLJSCs), effective January 1, 1996, mandates that **the board of directors of a Russian JSC be elected annually** and that **managers may not constitute a majority**.

In an open JSC with more than one thousand shareholders, FLJSCs mandates a board of at least seven members; in an open JSC with more than ten thousand shareholders, a board of at least nine members.

In an open JSC with more than one thousand shareholders, FLJSCs also mandates election of the board of directors via **cumulative voting**. The charter of a JSC with less than one thousand shareholders may provide for cumulative voting.

Surveys conducted by the FCSM indicate that compliance is improving, but nevertheless many JSCs have yet to institute cumulative voting and elect outsiders to their board of directors. All JSCs must comply with the law by July 1, 1997.

Regulatory Framework in Russia

As noted above, a new Federal Law on Joint Stock Companies (FLJSCs) became effective January 1, 1996. All JSCs must comply with the law by June 30, 1996.

The Federal Commission for the Securities Market is responsible for regulation of the securities industry in Russia. It was created by Presidential Decree No. 163-rp on March 9, 1993. Prior to the passage of a new securities law, the Commission's activities were outline in this and subsequent presidential decrees. A new Law of the Russian Federation No. 39 "On the Securities Market" was adopted by the State Duma on March 20, 1996 and became effective April 25, 1996.

Russian and foreign attorneys contend that the passage of these two laws improves the regulatory environment in Russia. It remains to be seen how

quickly Russian JSCs will comply with the requirements of both of these laws and how the Federal Commission will grow into its regulatory role.

See Appendix 2 for a list of relevant legislation regarding corporate governance and the securities market.

Disclosure Requirements of Russian JSCs

A Russian JSC with more than 1,000 shareholders must publish an announcement or send written notice of its annual general meeting of shareholders no later than 30 days before the date of the meeting. The following information must be included in the notice: date, time and place of the meeting; record date for determining shareholders' voting rights; the agenda for the meeting; and the method by which shareholders may obtain information (materials) on the meeting. These materials include: the annual report; report of the Inspection Commission or auditor; information on nominees to the board of directors and inspection commission; and draft amendments to the charter (if any are to be presented at the meeting).

From the investor/shareholder perspective, disclosure is one of the most important corporate governance issues in Russia. Disclosure is discussed in detail in the **Issue-based Guidelines on the Corporate Governance Structure of Russian JSCs**.

Corporate Actions Requiring Shareholder Approval in the Russian model

Shareholders in Russian JSCs enjoy the following powers at the annual general meeting: election of the board of directors; approval of allocation of net income (including dividend(s)); election of the inspection commission; and approval of the auditor.

Non-routine corporate actions which also require shareholder approval include: setting compensation of the board of directors; restructurings; and amendment of the articles of incorporation (such as changes in authorized capital, capital increases).

A shareholder or group of shareholders owning at least 10 percent of a JSC's share capital may convene an extraordinary general meeting of shareholders (EGM).

Shareholders in Russian JSCs enjoy preemptive rights, unless a decision of the annual general meeting of shareholders votes to waive them.

These issues are discussed in greater detail in the **Issue-based Guidelines on the Corporate Governance Structure of Russian JSCs**.

Interaction among Key Players in the Russian model

The framework for interaction among the three key players in internal governance of Russian JSCs may be diagrammed as a triangle. The so-called corporate governance triangle is the same one that exists in the Anglo-US

corporate governance model. (See diagrams: **Russian Corporate Governance Model - Theory and Practice.**)

In Russia today, as in any market, an investor's or shareholder's strategy or behavior depends upon market conditions. In the current Russian environment, many inside and outside shareholders are not very interested in corporate governance, for a variety of reasons. However, given that some of them may not have an opportunity to sell their shares, they should at least consider the potential benefits of becoming involved in governance.

In other words, all shareholders should consider their corporate governance options. As this manual and seminar will demonstrate, research in many markets points to a direct relationship between good governance and financial performance. (See diagram: "Exit" vs. "Voice.")

In Russia today, as in many emerging markets, some investors' strategy is to buy a sufficient number of shares in order to obtain "control" of a JSC. The rationale of a manager, that is, an "inside shareholder," might be to acquire control in order to protect his position as manager. Conversely, it might be to acquire control of a majority of the shares in order to undertake necessary restructuring while simultaneously selling sufficient shares in order to raise necessary capital. The important point here is the trade-off between control and capital inflow.

In developed capital markets there are also situations where investors (specialized investment funds that target specific companies or industries) purchase shares in order to gain control of certain JSCs. In many cases, however, strategic investors or portfolio investors buy shares in order to realize a long-term financial return on their investment, in the form of dividends or the market appreciation of the shares.

At present, investors geared towards financial return in Russian JSCs focus on large JSCs with American Depositary Receipt (ADR) programs. The shares of these Russian blue-chips are more liquid and they present less risk and greater potential for long-term share appreciation. (See diagram: "Control" vs. "Return.")

A "corporate governance culture" is still in its infancy in Russia. A cadre of well-informed and motivated professional participants has emerged in Moscow and many larger cities. Nonetheless, many players (investors, managers, directors, and others) are uncertain about their rights and responsibilities. In this environment, both official regulation by the Federal Commission for the Securities Market and market self-regulation are necessary to protect both issuers and investors.

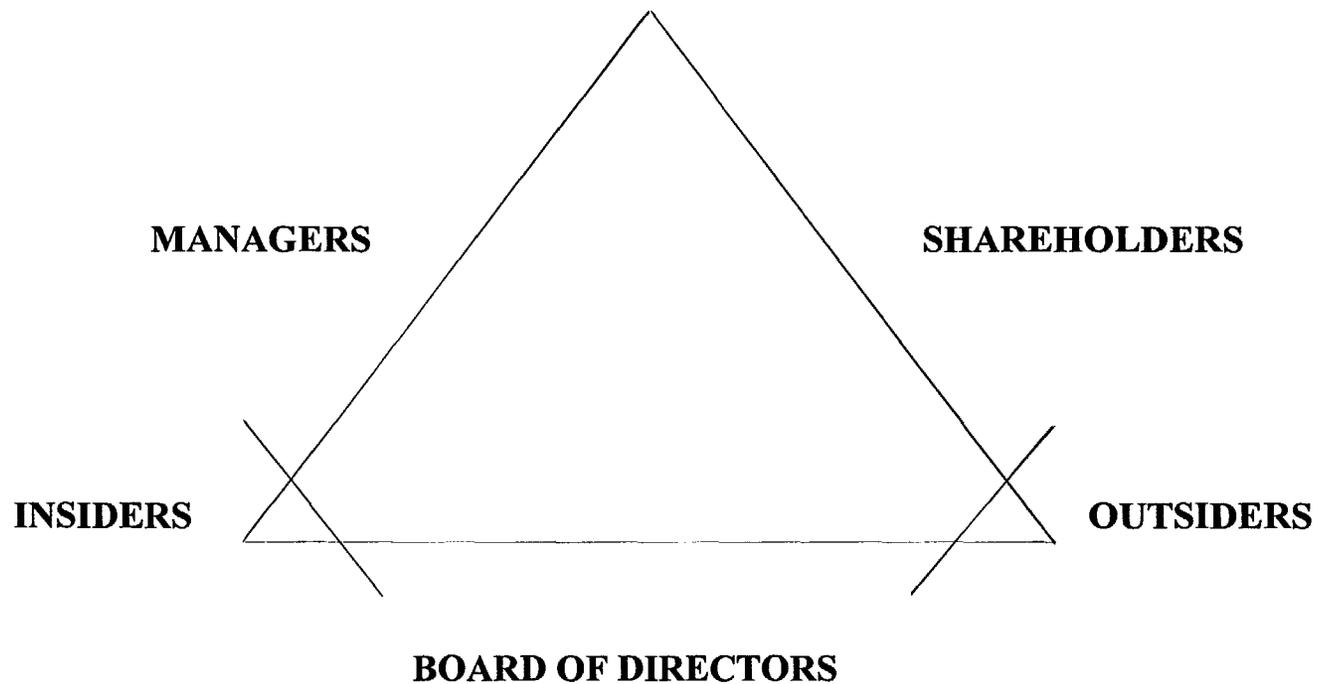
In mid-1994, shareholders' associations took early initiative by publishing a Declaration of Shareholders' Rights. By the end of that year, over 500 Russian JSCs agreed to voluntary compliance with the declaration that called for, among other things, equal treatment for all shareholders. With the passage of the new Federal Law on Joint Stock Companies, a new phase of corporate governance has begun.

Comparison of Russian Governance Model with Developed Capital Markets

The diagram at the end of this section compares and contrasts the Russian model with each of the three models from developed capital markets.

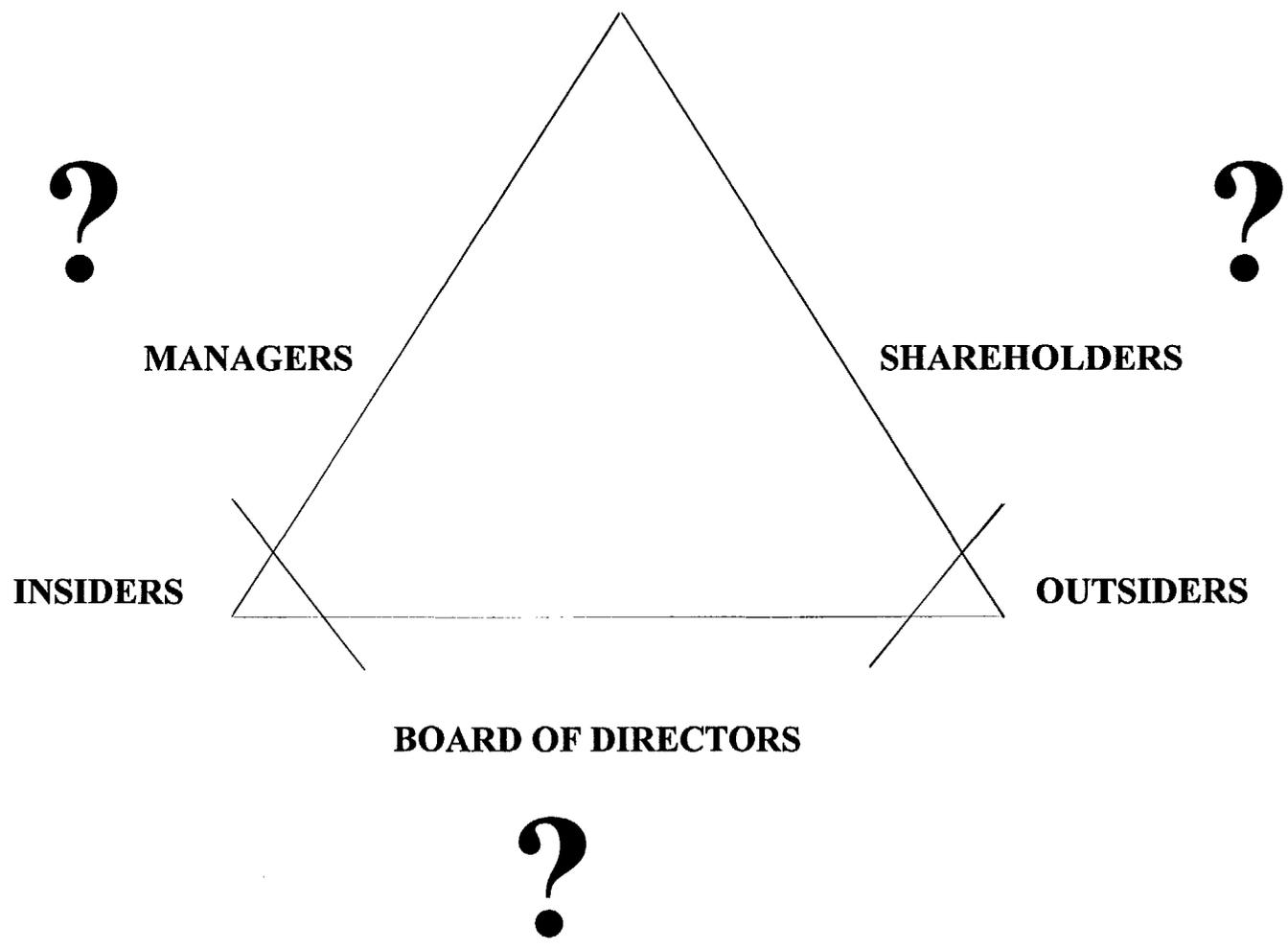
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RUSSIAN CORPORATE GOVERNANCE MODEL - LARGE JOINT STOCK COMPANIES
THEORY



- Members elected annually (Article 66, 1 JSC Law)
- CEO may not simultaneously be Chairman of the Board (Article 66, 2 JSC Law)
- Managers may not constitute a majority of board of directors (Article 66, 2 JSC Law)
- Cumulative voting (Article 66, 4 JSC Law)

RUSSIAN CORPORATE GOVERNANCE MODEL - LARGE JOINT STOCK COMPANIES
PRACTICE



13

"EXIT" vs. "VOICE"

Monitor management
Analyze JSC's governance and financial performance
Study market regulation
Communicate with other investors

"LOOK"

"EXIT"

"VOICE"

**Liquid market
and / or
directors
Little interest in corporate governance
directors**

**Vote at AGMs
Propose nominees to board of
Gain representation on board of**



"CONTROL" vs. "RETURN"

"CONTROL" ————— "RETURN"

- Illiquid market
- "Exit" not possible
- Investors interested in gaining control package of JSC shares, in order to restructure or perhaps sell to strategic investors

- Liquid market
- Pricing mechanism functions
- "Voice" can have a positive effect on governance and financial performance of JSC
- Investors do not need to gain control, they can instead focus on return in form of dividend or long-term appreciation of shares

Comparison of Russian Governance Model with Developed Capital Markets

Similarities between the Russian model and Anglo-US model

- Corporate governance "triangle"
- Minority shareholder protection (i.e., cumulative voting)
- Diversification of monitoring roles (i.e., audit commission and inspection commission)
- Directors' personal contacts play a role in choosing director nominees
- Domestic investment funds are major outside shareholders in both countries

Differences between the Russian model and Anglo-US model

- Role of State Property Committee in Russia vs. no state ownership of US JSCs
- Emergence of financial-industrial groups (bank-led *keiretsu*-type networks) in Russia
- Russian banks are universal banks; US banks are not
- By law, Russian CEO may not simultaneously serve as chairman of board of directors; no such legal requirement in US or UK

Similarities between the Russian model and German model

- Managers' emphasis is on long-term control of the JSC rather than short-term return
- Banks play dual roles of lender and shareholder (so-called universal banks)
- Share ownership pattern is somewhat similar - Russian companies are among the largest outside shareholders in Russian JSCs; German companies are the largest shareholders in German JSCs

Differences between the Russian model and German model

- Russian JSCs use corporate governance "triangle" vs. German two-tiered board
- Russian JSCs may change size of board of directors; size of German supervisory board is set by law
- Although foreign ownership of Russian shares is minimal, foreigners play a governance role in some Russian JSCs looking for specific management or board expertise; Foreigners own 19% of German stock, but have not had much impact in German governance
- Domestic investment funds are major shareholders in Russia, but not in Germany

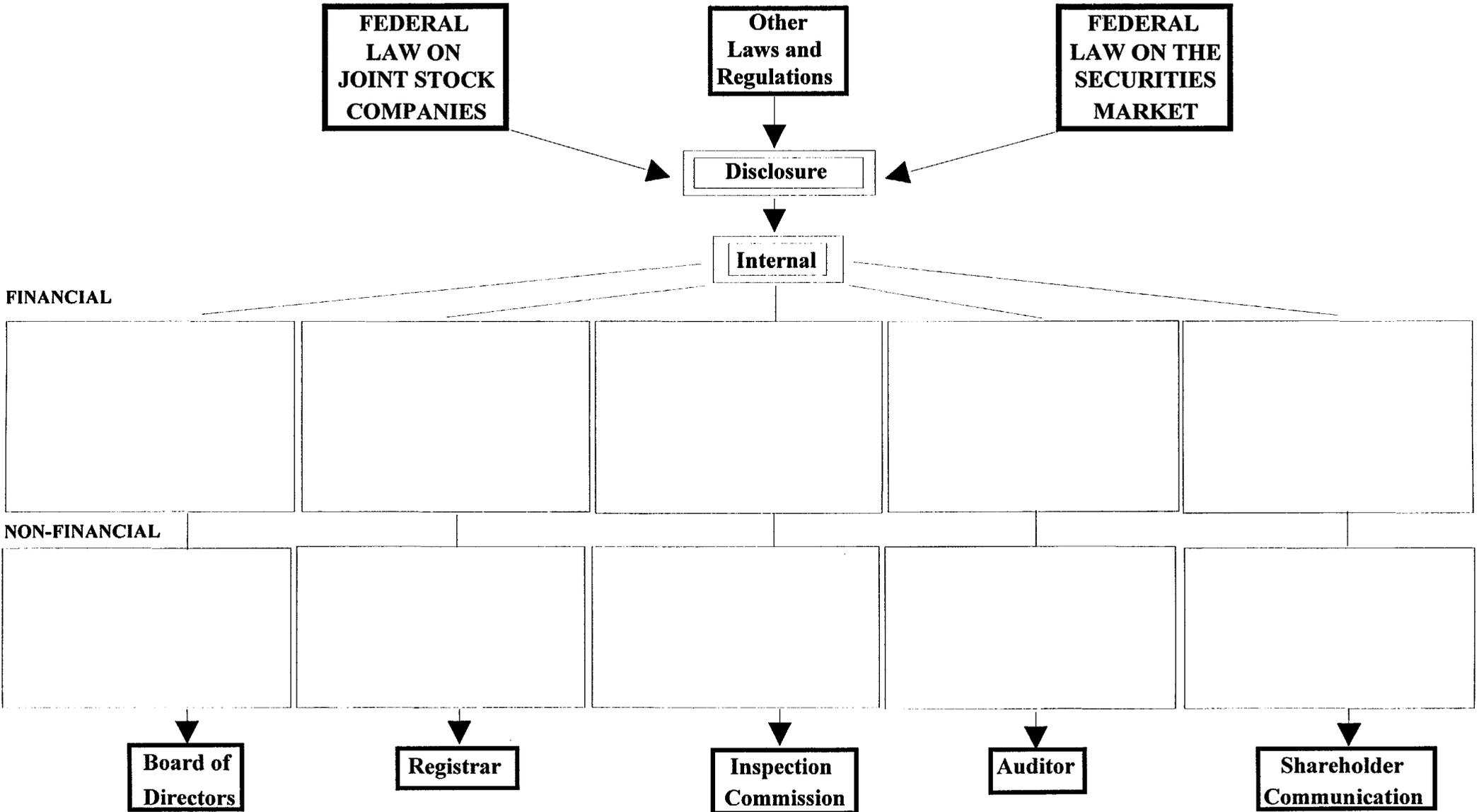
Similarities between the Russian model and Japanese model

- Corporate governance "triangle"
- Managers' emphasis is on long-term control of the JSC rather than short-term return
- Banks play dual roles of lender and shareholder (so-called universal banks)
- Financial-industrial groups (bank-led *keiretsu* networks) exist in both markets

Differences between the Russian model and Japanese model

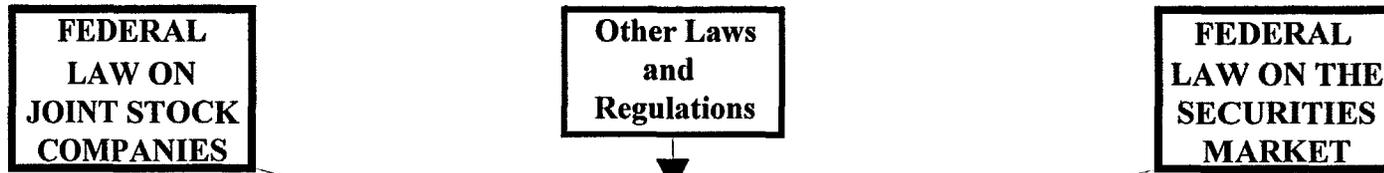
- Company executives may not constitute a majority of the board of directors of a Russian JSC; most Japanese boards contain only insiders
- Although foreign ownership of Russian JSCs is minimal, foreigners play a governance role in some Russian JSCs seeking specific management or governance expertise; Japanese JSCs have created informal barriers limiting foreign shareholders' governance activity
- Domestic investment funds are major shareholders in Russia, but not in Japan

DISCLOSURE REQUIREMENTS OF RUSSIAN JOINT STOCK COMPANIES



01

DISCLOSURE REQUIREMENTS OF RUSSIAN JOINT STOCK COMPANIES



Disclosure

External

FINANCIAL

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NON-FINANCIAL

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**Local
Government**

Media

FCSM

Banks

**Stock Exchanges/
Russian Trading
System**

Listing

Secondary

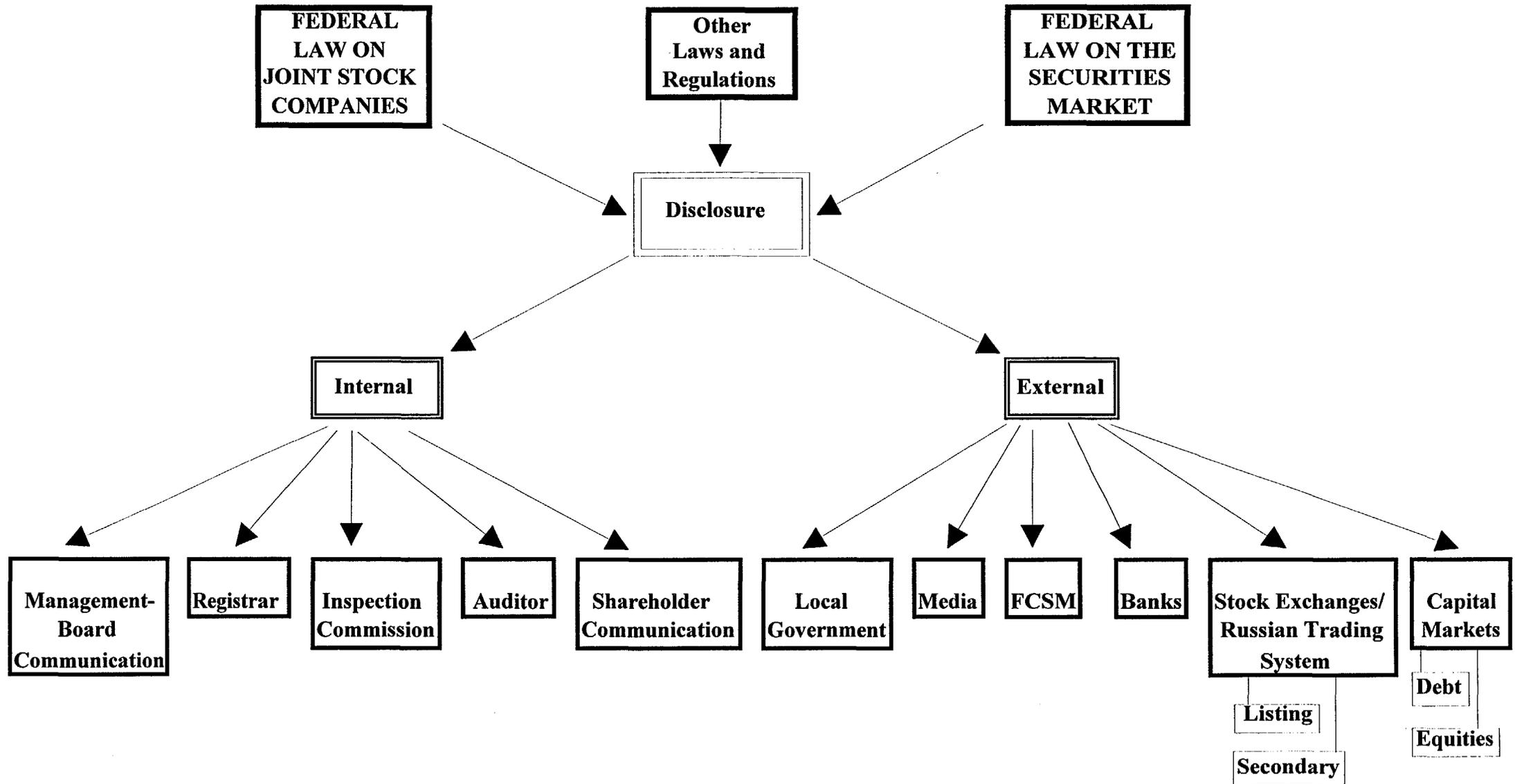
**Capital
Markets**

Debt

Equities

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DISCLOSURE REQUIREMENTS OF RUSSIAN JOINT STOCK COMPANIES



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Issue-based Guidelines on Corporate Governance Structure of Russian Joint Stock Companies (JSCs): Disclosure Requirements

The following topics will be discussed at the seminar: issue-based guidelines on corporate governance of Russian JSCs (corporate governance structure, rights and responsibilities of members of the Board of Directors, rights of shareholders, role and responsibilities of Inspection Commission and auditors of a JSC) and disclosure requirements.

Each topic will be covered as follows:

- 1. Legal Requirements*
- 2. Common Practice (references to specific legislation, specific examples, participants will be asked to share their relevant experiences)*
- 3. Legislation and common practice in other countries*

We will discuss in detail the topics covered in the manual and consider other corporate governance issues not discussed in the manual.

While discussing disclosure, the following issues will be covered:

- 1. Concept of Disclosure.*
- 2. Disclosure of Information to Shareholders*
- 3. Disclosure of Information to Various Entities and Individuals, including Potential Investors*
- 4. Disclosure Procedures during Share Issues*
- 5. Trade Secrets. Information that does not constitute a Trade Secret, according to Law.*
- 6. Disclosing Information to State Agencies*
- 7. Liability for Failure to Disclose Information*
- 8. Laws on Disclosure and Common Practice of Disclosing Information in Foreign Countries.*

The participants will also be asked to complete two diagrams related to "Disclosure Requirements of Russian JSCs."

Issue-based Guidelines on Corporate Governance Structure of Russian Joint Stock Companies JSCs¹: Disclosure Requirements

Disclosure Requirements

Announcement convening the Annual General Meeting of Shareholders (AGM)

Shareholders must be notified about an upcoming AGM no later than 30 days before the date of the meeting, by a written notice or an announcement published in the press. The JSC's charter determines the method for notifying shareholders.

If a JSC's charter does not specify the form of notification, it should be sent by registered mail, according to Article 52, Paragraph 1 of the Federal Law on Joint Stock Companies ("the JSC Law").² This clause serves to protect shareholders' rights. Ballots for voting are also sent to shareholders by registered mail.

The notice about an AGM should contain the following information:

- The JSC's name and location;
- Date, time and location of the meeting;
- The agenda for the meeting;
- Procedures for shareholders to obtain access to the information that will be discussed at the AGM, in order to prepare for it; and
- The date on which the list of shareholders eligible to participate in the meeting was compiled.

Shareholders have the right to obtain access to the following information before the AGM:

- The JSC's annual report; report of the inspection commission and auditor on the JSC's financial performance; information on nominees to the board of directors and inspection commission; and draft amendments and modifications to the charter.

This list is not final, and may be amended by the Federal Commission on the Securities Market (FCSM).

Agenda of the Annual General Meeting of Shareholders (AGM)

A shareholder or shareholders owning no less than two percent of the JSC's voting stock has the right to present no more than two proposals for inclusion on the agenda of the AGM. A proposal must be submitted in writing, stating the reason for its submission. A shareholder presenting a proposal must also state his/her name and the class and number of shares belonging to him/her. Shareholder proposals must be submitted within 30 days after the end of the fiscal year, unless otherwise provided by the JSC's Charter.

¹ This section was prepared using the literature specified in the bibliography and materials provided by International Institute for Law-Based Economy Foundation (ILBE).

² The Federal Law on Joint Stock Companies ("the JSC Law") of November 24, 1995. All references in this section are to the JSC Law, unless noted otherwise.

All issues requiring the approval of the AGM should be included in the agenda of the AGM.

Extraordinary General Meeting of Shareholders (EGM)

The procedures for convening an extraordinary general meeting of shareholders (EGM) are similar to those for convening an AGM. There are, however, certain special rules for convening an EGM. For example, if the request to convene the meeting is initiated by the inspection commission, the auditor or a shareholder, the number of proposals on the agenda is not limited. The board of directors does not have the right to change the agenda of an EGM.

A previously-announced agenda is mandatory for every general meeting. At the meeting, the agenda may not be changed and participants may not discuss any issues outside the agenda. This protects the rights of the shareholders who are not present at the meeting, especially if the issues discussed directly concern them.

Agenda of the Annual General Meeting of Shareholders: Allocation of Profit

Depending upon the charter, either a resolution of the AGM or the board of directors (outside of the AGM) declares the amount of the dividend(s) and establishes a payment date. Dividends are paid on shares acquired no later than 30 days before the official declaration of the payment date.

The board of directors' decision regarding the amount of dividends and payment date shall be regarded as a liability of the company to pay dividends.

Agenda of the Annual General Meeting of Shareholders: Election of the Members of the Board of Directors

The vote tabulation commission draws up a protocol of the results of the voting for the board of directors. After the protocol is signed, the members of the commission are liable for the authenticity of the information. The protocol of voting results should be attached to the minutes of the general meeting of shareholders.

The voting results should be announced to the shareholders:

- At the meeting;
- By publishing a report on the voting results;
- By sending the report to shareholders.

The report should be published in a national publication, in order to make it available to all shareholders who could not attend the AGM.

Agenda of the Annual General Meeting (AGM): Election of the Inspection Commission

A shareholder or shareholders owning in the aggregate no less than 2% of the company's stock have the right to propose candidates for the Inspection Commission. The number of the proposed candidates may not exceed the established membership of such bodies.

Agenda of the Annual General Meeting (AGM): Increase of the Charter Capital

In accordance with the Federal Law on the Securities Market ("the Securities Law"), charter capital may be increased by increasing the nominal value of the shares and/or by issuing additional shares.

The AGM has the right to delegate to the board of directors the authority to increase the JSC's charter capital, if the JSC's charter permits this (Article 28).

The board of directors should register the increase of charter capital (including the amended charter) with the state registration agency (Presidential Decree from July 31, 1995 # 31 "On Additional Measures Aimed At Securing Shareholders' Rights.")

Agenda of the Annual General Meeting (AGM): New Share Issue

The terms "to issue shares" and "share issue" are very often used interchangeably. But there is an important difference between them. The term "to issue shares" means the process undertaken by an issuer (JSC) to place shares. The term "share issue" means a block of shares of one issuer (a JSC), all with the same terms and equal rights. All shares of one issue have the same state registration number.

The AGM has the competence to approve new share issues, although it may delegate this authority to the Board of Directors (Article 28). The resolution of the AGM and other necessary documents related to the new share issue must be registered in accordance with the Securities Law. The JSC must then inform shareholders about the resolutions approved by the AGM.

Agenda of the Annual General Meeting (AGM): Issue of Bonds

The JSC Law establishes the right of a JSC to issue bonds. The Law also establishes the characteristics of a bond. The decision to issue bonds should also specify the form, maturity and other terms for redeeming the bonds. The nominal value of the bonds issued by a JSC shall not exceed the amount of the security provided to the JSC by third. A JSC may issue unsecured bonds only at the end of the third year of the JSC's operations, provided that the JSC's balance sheets for the previous two years have been approved (Article 33).

According to Regulation 19 of the FCSM, "Standards for Share Issues and Issues Prospectus During the Founding of the Joint Stock Companies and Additional Issues and Bonds," in certain cases the state registration of the issue and the registration of the prospectus should be done simultaneously. In these cases, it is necessary to take the necessary steps to prepare the prospectus.

The prospectus for a bond issue contains general information on the bonds:

- Series and form of the bonds;
- Total amount of issued bonds (nominal value);
- Number of bonds to be placed;
- Nominal value of each bond;
- Rights associated with the bond (including the priority of payment to owners of bonds in the event of liquidation of the issuer); the prospectus for convertible bonds should specify: type, category, or series of securities and conversion ratio, as well as all rights of the securities into which these bonds are convertible and the procedure and conditions for such conversion;
- Term of redemption of the bonds; and
- Conditions and procedures for redemption of the bonds.

In the case of a public offering of bonds or other securities, a JSC should publish the following information:

- The JSC's decision to place the bonds. This information should be disclosed within five days after such decision was made;
- The name of the corporate organ (board of directors or other organ) which made the decision and the date.

Following the state registration of bonds or other securities, the following information should be published within five days:

- Name of the issuer;
- Type and form of placed securities;
- Number of placed securities;
- Term and conditions for placement;
- Date of state registration and registration number;
- Location where the prospectus is available for interested parties to review.

After a JSC approves the results of the placement of bonds or other securities, it should provide the following information, within one month of the placement:

- Name of the issuer;
- Body that approved the results and date of approval;
- Type and form of placed securities;
- Number of placed securities.

These requirements are stipulated for in Regulation 8 of the FCSM, dated May 7, 1996. This regulation also requires that said information be published in the "*Prilozhenie k Vestniku Federalnoy Commissii*" ("Supplement to the Bulletin of the Federal Commission"). A JSC may also publish this information in other newspapers or publications

The authority to issue bonds and other securities is the exclusive jurisdiction of the board of directors, unless otherwise provided by the company's charter (Article 65, Paragraph 7).

Agenda of the Annual General Meeting (AGM): Changes and Amendments to the Charter

Changes and amendments to the charter are the exclusive jurisdiction of the general meeting of shareholders, with the exception of those related to the increase of the charter capital, which falls within the jurisdiction of the board of directors (Articles 12, 27, 28, 48).

Salary and Compensation of Members of the Board of Directors

According to the decision of the AGM, members of the board of directors (supervisory board) may either be paid compensation for the execution of their duties or may perform their functions free of charge (Article 64, Paragraph 2). The JSC's charter may include details about compensation of the board of directors.

The Federal Law on Joint Stock Companies does not require JSCs to disclose salaries and compensation of the members of the board of directors.

According to Regulation 19 of the FCSM, a JSC should include in its prospectus, among other required information, the amount of compensation paid to members of the board of directors. This information must be disclosed when the prospectus is registered. The prospectus must outline all types of compensation paid by the issuer to members of the board during the three months before the decision to issue securities was made (including salaries, bonuses and commissions).

Salaries and Compensation of Members of the Executive Body (Management)

If stated in the JSC's charter, the board of directors determines the salary and compensation to be paid to members of the executive body (Article 65, Paragraph 10).

Each member of management shall sign a labor contract with the JSC that outlines his/her rights and responsibilities within the JSC. Such acts shall be signed on behalf of the company by the chairman of the board of directors or his nominee. The AGM (or the board of directors, depending upon the charter of the respective JSC) shall have the right to terminate the contract with each member of management at any time.

The Federal Law on Joint Stock Companies does not require JSCs to disclose the compensation or remuneration paid to management. However, Regulation 19 of the FCSM requires that every JSC include in its prospectus information on all compensation paid to members of the board of directors, the individual or collective executive (general director or management) and other managers.

Agenda of the Annual General Meeting (AGM): Reorganization of a JSC

A decision on a company's reorganization needs to be made by $\frac{3}{4}$ of votes of shareholders attending the AGM or by the court as envisaged by the Law. Appropriate changes should then be made to the company's Charter and State Register.

The reorganization of a company involves the transfer of rights and responsibilities of the company to its successor.

See the section on Forms of Reorganization in Chapter 5, "Issue-based Guidelines on Corporate Governance Structure of Russian JSCs: Compliance".

In accordance with the JSC Law, a JSC shall be considered reorganized from the moment of state registration of newly-founded legal entity or entities; in the case of a reorganization in the form of a takeover, from the moment of registering the liquidation of the acquired company in the State Register.

Annual Report

The board of directors (supervisory board) should approve the annual report no later than 30 days before the AGM. The annual report should be presented to shareholders at the AGM.

The inspection commission should confirm the reliability of data contained in the annual report. A JSC should submit the annual report to the founders of the JSC (according to the charter), to the tax authorities and to other organizations as required by law.

Management bodies (collective management or general director) are responsible for any penalties incurred when the annual report is not submitted to the appropriate organizations in time.

Report of the Board of Directors

The board of directors must report to the AGM on a regular basis. Resolutions of the AGM must be obeyed by the board of directors. The AGM has the right to request from any member of the board of directors any reports or documentation related to the JSC's activity.

The AGM's resolution on the report of the board of directors should be published so that shareholders who did not attend the meeting can review it.

Major Shareholders

In theory, any shareholder owning no less than five percent of voting shares is considered a major shareholder, but there is no requirement to publish this in the annual report or agenda for the AGM.

However, in accordance with Regulation 19 of the FCSM, a JSC's prospectus should contain information on all shareholders who own not less than five percent of the JSC's voting shares.

A JSC's prospectus should also contain information on major shareholdings of each shareholder owning more than five percent of the JSC's shares, as follows: each shareholder owning more than five percent of a given JSC's shares must report its significant holdings (over 25%) in other JSCs to the given JSC. This information should include the full company name, location, postal address (or full name) and the share of charter capital (or share of the total number of voting shares of each shareholder) at the time of the share issue of the given JSC.

Each JSC should include in its prospectus information on legal entities in which it owns no less than five percent of the charter capital. This list shall contain company's full name, location and postal address and share of charter capital of the legal entity, including the names of subsidiaries and affiliates.

Affiliates

The term "affiliated entities" is taken from the English (meaning "to associate" or "combine") and is a comparatively new term for Russians. The meaning of this term is to unite with an entity.

According to the JSC Law and other legislation (such as Presidential Decree # 1186 of October 7, 1992 "On Measures for Reorganization of the Securities Market in the Process of Privatization of State and Municipal Enterprises, and "Guidelines on Investment Funds") the following conclusions can be made:

- 1) an affiliated entity can be either an individual or a legal entity;
- 2) a legal entity may be affiliated with another legal entity or an individual (i.e., may be dependent on somebody else);
- 3) an individual may be affiliated only with a legal entity (the individual has more "relative power" over the legal entity);
- 4) the main characteristic of an affiliate is its dependence on a legal entity or an individual.

The following institutions can be affiliates of a JSC:

- A company on which the JSC is dependent (Article 106 of the Civil Code);
- The parent company, in relation to which the JSC is a subsidiary (Article 105 of the Civil Code)
- A shareholder controlling more than 20% of the JSC's voting shares.

A JSC should maintain a register of its affiliates and be prepared to submit required reports on said affiliates. Affiliates should notify the JSC in writing of the number and type of shares they own within 10 days of share acquisition date. (Article 93).

Financial Data

The Civil Code, JSC Law, other legislation and the JSC's charter outline procedures for disclosing financial data. According to the first two laws, a JSC should present annual financial statements to its corporate organs and shareholders, and, in certain cases, publish the reports.

Annual financial statements shall be submitted to the AGM for approval (Article 103, Paragraph 1, Part 4 of the Civil Code; Article 88, Paragraph 3 and Article 48, Paragraph 1, Part 11 of the JSC Law).

Prior to the AGM, the board of directors should review and provide its initial approval of the financial statements. The inspection commission should confirm authenticity of the information.

Every closed-type or open-type JSC making a public offering of its securities should publish its annual financial statements.

Prior to publication, an independent auditor, (i.e. an auditor who is unrelated to the company by property interests) should approve this data (Article 97, Paragraph 1 and Article 103, Paragraph 5 of the Civil Code; Article 88, Paragraph 3 and Article 92 of the JSC Law).

Shareholders should receive:

- Annual financial statements;
- Report of the inspection commission;
- Report of the auditor;
- Reports of state and/or municipal financial agencies proving the authenticity of the financial data.

Shareholders do not have the right to demand the following documents:

- Backup accounting documentation;
- Minutes of meetings of management.

In order to comply with these disclosure requirements, each JSC should establish a system for disclosure and distribution of these documents, in other words, to identify a corporate organ or appoint an individual who will be responsible for such disclosure. It is also necessary to develop a system for providing shareholders, outside investors, and/or state organizations with answers to their requests and a system which will allow a member of the JSC's corporate organs or a shareholder to provide information on his/her interests in a particular transaction. It would also be beneficial to appoint a "public relations specialist" responsible for dealing with the mass media.

Accounting Standards

Legislation of the Russian Federation established general accounting rules that are mandatory for all JSCs, with the exception of insurance companies and banks, which have their own rules. The "Regulation on Accounting in the Russian Federation" is still effective. The latest draft of this regulation was approved by the Ministry of Finance of the Russian Federation, Resolution #170 on December 26, 1994. This new draft was adopted when the first part of the Civil Code came into force. (There is also a new law "On Accounting" # 129-Russian Federation dated November 21, 1996).

The Ministry of Finance adopted Resolution # 11/04, on January 8, 1991, which provides instructions for JSCs on accounting and record keeping of securities. Accounting data should reflect the property and financial condition of a company as well as results of its economic activity during said accountable period. Standard accounting forms and instructions for completing them are prepared and approved by the Ministry of Finance.

Each JSC is responsible for preparing accounting documentation which should describe the current status of the JSC's assets, including the assets (property) of divisions, branches or representative offices which are not independent legal entities. If a JSC has subsidiaries or dependent companies, it has to prepare not only its own balance sheet but also an accounting

report which will include key financial characteristics of the subsidiaries and dependent companies.

Annual accounting reports should be submitted to the founders of the JSC as well as to the tax authority. Legislation on taxation or other issues may contain clauses that describe how to submit accounting information to other parties.

JSCs (with the exception of banks and insurance companies) should comply with the "List of Accounts of Enterprises and Instruction for its Use", approved by the Ministry of Finance on November 1, 1991, Resolution # 56. A new draft of this Resolution {# 173} was adopted on December 28, 1994 and another draft {# 81} was adopted on July 28, 1995.

The resolution on accounting "Accounting Standards" 1/94 (approved by the Ministry of Finance on July 28, 1994, Resolution #100) establishes a set of accounting rules and conventions. Generally accepted accounting standards/principles should include official standards employed by the respective JSC and of the "uncodified" practices and procedures of the accounting profession.

Listing Requirements

In accordance with Regulation # 23 (dated December 19, 1996), the "Temporary Ordinance on Requirements to Trading Supervision at the Securities Market," trading supervisors (of a given Stock Exchange) should prepare the following documents and have them approved by the Federal Commission on the Securities Market (FCSM):

- Instructions for a trading supervisor;
- Regulations for securities' listing and "delisting";
- Disclosure requirements;
- A disciplinary code developed for handling violations of trading rules, the Securities Law or other acts of the FCSM;
- Regulations on the disciplinary committee of the trading supervisor.

In order list securities, the JSC should apply to the trading supervisor. It should prepare all documents specified by the trading supervisor and required to begin trading of the securities.

Only an issuer of securities (JSC) has the right to apply for a securities' listing and place them on the Level One Quotation List. In contrast, both the issuer and a broker/dealer may place securities on the Level Two Quotation List.

In accordance with the rules of securities' listing and delisting, the trading supervisor should take the following steps in order to place securities on the Level One Quotation List:

- Trading supervisors as well as issuers and dealer's firms should take certain responsibilities to disclose information on: the issuer's types of activity; the issuer's securities; and other facts and events important for making decisions on transactions;
- Dealers and their clients should be treated equally in terms of obtaining access to information which should be disclosed in accordance with the rules of listing and delisting;
- Securities of issuers who fail to comply with listing requirements should be removed from the list;
- Measures should be implemented in order to avoid price manipulation.

An issuer (JSC) must meet these requirements for a Level One Quotation:

- The amount of the JSC's equity should not be less than 10 million ECUs (European Currency Units);
- The JSC was established not less than three years ago;
- The JSC complies with disclosure requirements on securities, in accordance with the Securities Law, and disclosure of information about the JSC in general, in accordance with the Federal Law on Joint Stock Companies.

The following requirements must be met for a Level One Quotation:

- The JSC's securities should be issued and registered in accordance with Russian legislation;
- The report on the results of the issue should be registered in the appropriate manner;
- The JSC's securities should be freely transferable;
- The number of shareholders of the JSC should not be less than 1,000;
- other terms.

In order to place securities on the Level One Quotation List, an issuer must accept the disclosure regime established by the trading supervisor.

There are also similar requirements for placing securities on the Level Two Quotation List.

Depository Receipts

A Depository Receipt is a negotiable certificate that usually represents a joint stock company's publicly-traded shares or bonds. Depository Receipts are created when a broker purchases a JSC's shares in the JSC's home market (i.e., Russia) and delivers them to the depository bank's custody bank in that market. The custody bank then instructs the depository bank in the United States or another country to issue Depository Receipts.³

American Depository Receipts (ADRs) and Global Depository Receipts (GDRs) are identical from a legal, operational, technical and administrative standpoint. "Global" is usually used when the receipts are traded outside the United States.

Most non-US JSCs entering the US market use ADRs instead of common shares. The use of ADRs enables the broker trading the shares and the investor to overcome operational, legal and administrative difficulties encountered when investing in non-US shares.

ADR prices are quoted in US dollars and dividends are paid in US dollars, although the price of the ADR and the dividend rate are based on the actual trading price and dividend rate of the JSC in its home market.

JSCs have a choice of several types of Depository Receipts: unsponsored and different levels of sponsored Depository Receipts. Unsponsored Depository Receipts are issued by one or more depositories in a home market, but without a formal agreement. Today, few, if any, JSCs permit such situations because of the lack of control.

³ This information is taken from "Global Offerings of Depository Receipts. A Transaction Guide," published by The Bank of New York.

In contrast, sponsored Depositary Receipts offer control, the flexibility to list on a national stock exchange in the US and the ability to raise capital.

These are the disclosure requirements for the various categories of Depositary Receipts:

Rule 144A Depositary Receipts- Prescribed by Rule 12g3-2(b) (1934 United States Exchange Act)

An JSC (referred to as an "issuer" of shares) qualifying for the Rule 12g3-2(b) exemption need not materially change its current reporting process. To qualify for this exemption the issuer must furnish the U. S. Securities and Exchange Commission (SEC), on a continuing basis, information which would be material to investors which the issuer:

- (a) makes public in its own country;
- (b) files with a stock exchange on which its securities are traded and is made public by the exchange; or
- (c) distributes to securities holders.

Joint Stock Companies can raise new capital by issuing new shares for this type of Depositary Receipt program, but the Depositary Receipts are not freely-traded in the US. Instead, they are sold to qualified US institutional investors through a private offering.

At the end of a three-year period, however, Rule 144A depositary receipts may be converted into Level I depositary receipts and publicly-traded in the US without SEC registration.

Regulation S

No disclosure requirements since the shares are for sale outside the United States.

Joint Stock Companies can raise new capital by issuing new shares for this type of Depositary Receipt program, but the Depositary Receipts are not freely-traded in the US.

At the end of a 40-day restricted period, however, Regulation S Depositary Receipts may be publicly-traded in the US without SEC approval and combined with a Level I Depositary Receipt program.

Sponsored Level I Depositary Receipts

As prescribed by Rule 12g3-2(b).

The same disclosure requirements apply as for the Rule 144A, but these ADRs represent only already-issued shares of an issuer. Therefore, Level I ADRs may not raise new capital for a company.

Unlike Rule 144A ADRs, these ADRs are freely traded. Since they are traded, the issuer must satisfy SEC requirements regarding share registration and custody.

Sponsored Level II Depositary Receipts

An issuer sponsoring Level II Depositary Receipts is subject to full SEC disclosure, plus adherence to US Generally Accepted Accounting Principles (GAAP). The issuer registers the Depositary Receipts under the Exchange Act by filing a registration statement on SEC form 20-F, whose principal requirements are summarized below:

- Detailed description of the business, including general developments over the past five years, principal products, markets and distribution methods, breakdown of revenue over the past three years by category of activity and by geographical markets, etc.
- Description of facilities, plant and resource reserves and production, if applicable;
- Selected financial data for each of the last five years;
- Audited financial statements for three years (US GAAP or reconciled to US GAAP);
- Management discussion of financial condition, changes in financial condition and results of operations over the past three years;
- Material information (for example, legal proceedings, control of the registrant by parent or others, shareholders owning 10% or more of the issuer's stock, interest of management or controlling shareholders and certain associated persons in material transactions with the registrant, etc.);
- Copies of contracts material to the business (sensitive portions kept confidential);
- Description of securities to be registered.

The issuer must meet the requirements of the national exchange (New York Stock Exchange or American Stock Exchange) or NASDAQ, whichever it chooses.

A Level II ADR may not be used to raise new capital. It seems to be a less interesting option for Russian JSCs, because the disclosure requirements are high, but there is no opportunity to raise new capital.

To date, no Russian JSC has issued Level II ADRs.

Sponsored Level III Depositary Receipts

An issuer sponsoring Level III Depositary Receipts is subject to full SEC disclosure, plus adherence to US Generally Accepted Accounting Principles (GAAP). The issuer registers the Depositary Receipts under the Exchange Act by filing a registration statement on SEC form 20-F, whose principal requirements are summarized below:

- Detailed description of the business, including general developments over the past five years, principal products, markets and distribution methods, breakdown of revenue over the past three years by category of activity and by geographical markets, etc.
- Description of facilities, plant and resource reserves and production, if applicable;
- Selected financial data for each of the last five years;
- Audited financial statements for three years (US GAAP or reconciled to US GAAP);
- Management discussion of financial condition, changes in financial condition and results of operations over the past three years;
- Material information (for example, legal proceedings, control of the registrant by parent or others, shareholders owning 10% or more of the issuer's stock, interest of management or controlling shareholders and certain associated persons in material transactions with the registrant, etc.);
- Copies of contracts material to the business (sensitive portions kept confidential);
- Description of securities to be registered.

The issuer must meet the requirements of the national exchange (New York Stock Exchange or American Stock Exchange) or NASDAQ, whichever it chooses.

A Level III ADR can be used to raise new capital. This is the difference between Level II and Level III.

Russian JSCs issuing ADRs and GDRs

In October 1995, Mosenergo was the first Russian JSC to sell its shares in international capital markets through its \$22 million 144A/Reg S offering to institutional investors. The procedure was as follows: Mosenergo appointed Bank of New York (BoNY) as its Depository, and BoNY established custody arrangements with a local Moscow-based bank. Upon delivery of the Mosenergo shares to BoNY's local custody bank, BoNY issued American Depositary Receipts for these shares and sold them to institutional investors. Each ADR comprised 30 Mosenergo shares.

In addition to Mosenergo, the following Russian JSCs have issued 144A or Reg S ADRs as of February 1997:

<u>Company</u>	<u>Type of ADR</u>	<u>Issue Date</u>
Lukoil	144A	March 1996
Tatneft	144A and Reg S	May 1996
Gazprom	144A and Reg S	October 1996.

Level I ADRs

Share custody was perhaps the most difficult issued that delayed the SEC's approval of the first Russian ADR (Lukoil in December 1995), because of problems with share registers in Russia. This problem relates both to governance (the relationship between management of a JSC and the share register) and disclosure (shareholder access to the register).

As of February 1997, the following Russian JSCs have issued Level I ADRs: Lukoil (December 1995), Seversky Tube Works (February 1996), Chernogorneft (March 1996), GUM (June 1996), Tatneft (June 1996), Irkutsenergo (January 1997) and Surgutneftegaz (January 1997).

In January 1997, Inkombank became the first Russian bank to issue Level I ADRs. Menatep Bank and Bank Vozrozhdeniye have also received SEC approval and permission from the Russian Central Bank, but have not yet issued ADRs.

Level II ADRs

To date, no Russian JSC has issued Level II ADRs.

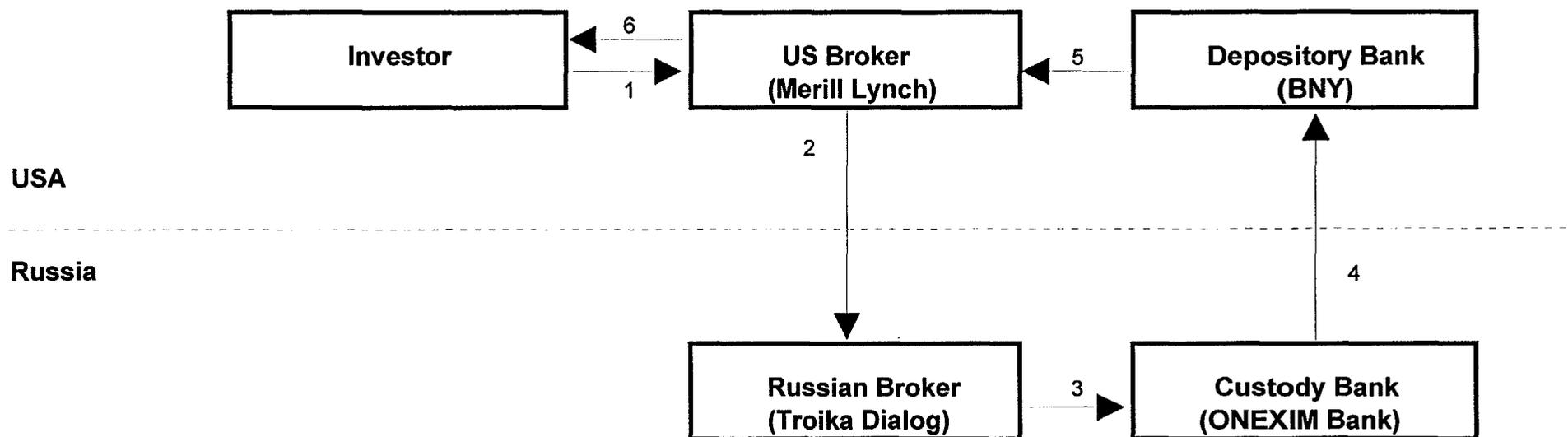
Level III ADRs

In October 1996, VimpelCom issued a Level III ADR. (See article in Appendix 8 entitled, "VimpelCom is Russia's NYSE Debut." *The Moscow Times*. November 16, 1996.)

GDRs

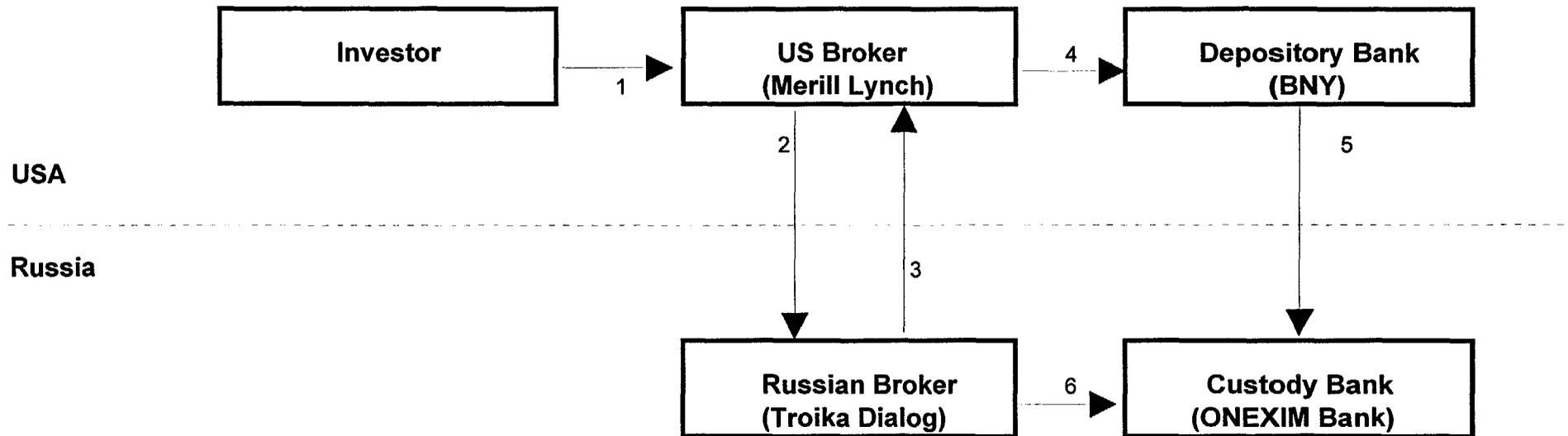
Many of the above-listed Russian ADRs also trade on European stock exchanges (London, Luxembourg, Berlin) as Global Depositary Receipts. This makes the shares accessible to a wide range of investors, thereby increasing liquidity.

ADR CREATION SCHEME



1. The US Investor places the order with its Broker to buy ADRs.
2. The US Broker places the order with a local Russian Broker to buy the original shares on the Russian market and deposit them in the American Depository Bank account with the Russian Custody bank.
3. The Russian Broker executes the order.
4. The Russian Custody bank reregisters the shares into the American Depository Bank nominee's name and notifies the Bank about it.
5. The American Depository Bank issues ADRs and transfers ADRs to the US Broker's account with DTC
6. The US Broker writes the ADRS in the Investor's account in its internal books and records

ADR CANCELLATION SCHEME



1. The US Investor-owner of ADRs places the order with its Broker to cancel ADRs.
2. The US Broker gives the order to a local Russian Broker to sell the original shares deposited in the American Depository Bank account in the local Russian Custody Bank.
3. The Russian broker sells the shares and notifies the US Broker about this.
4. The US broker notifies the Depository Bank that the shares deposited in the Custody Bank have been sold and gives the order to the Depository Bank to cancel ADRs. If the ADRs are issued in paper form, the Broker submits the certificates to the Depository Bank for cancellation.
5. The Depository Bank cancels the ADRs and gives the order to the Custody Bank to release the shares and register them in the name of the new owner.
6. The local Russian Broker through the Custody Bank registers the shares in the name of the new owner

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**DISCLOSURE OF INFORMATION
BY JOINT STOCK COMPANIES**

ANNUALLY:

List of Documents	Under Which Circumstance (s)	Whom	When
Annual Report	End of fiscal year	Publication in mass media; submitted to the tax authorities, shareholders, Government Statistics Agencies and FCSM	Annually
Balance Sheet	End of fiscal year	Publication in mass media; submitted to the tax authorities, shareholders, local statistics agencies	Annually, no later than June 1
Profit and Loss Account	End of fiscal year	Publication in mass media; submitted to the tax authorities, shareholders, local statistics agencies	Annually, no later than June 1
Prospectus, including: ■ data on the issuer; ■ information on financial condition; and ■ information on the issue	Securities issue	Publication in mass media; in the event of a public offering - in a periodical with a circulation of no less than 50 thousand	Annually
List of affiliated persons, specifying number and type of shares they own	If there are affiliated persons	Publication in mass media	Annually
Ratio of net asset value to charter capital	End of fiscal year	Publication in mass media	Annually
Number of shareholders	End of fiscal year	Publication in mass media	Annually
Information on specialized registrar (for each type of securities), including: ■ name; ■ organizational and legal form; ■ location; ■ postal address; ■ telephone number; and ■ # of license from the FCSM	End of fiscal year	Publication in mass media	Annually

ANNUALLY:

List of Documents	Under Which Circumstance (s)	Whom	When
Form # 1-T "Information on number of employees and their salaries during the year"	Every legal entity and its independent branches	Government Statistics Agencies	Annually
Form #1-T "On conditions of labor, benefits, and compensation for work under unfavorable conditions"	Every enterprise and industrial organization	Government Statistics Agencies	Annually, beginning with the report for 1996
Form 12 -F "Information on spending monetary funds"	Every legal entity	Government Statistics Agencies	Annually
Form 5-3 "On expenditures on production and product (services, goods) sales"	Every legal entity and its independent branches	Government Statistics Agencies	Annually
Form # 11 "State statistical control over availability and flow of the fixed assets (funds)"	Every legal entity and its independent branches	Government Statistics Agencies	Annually

QUARTERLY:

List of Documents	Under Which Circumstance (s)	Whom	When
Quarterly report	End of quarter	Tax authorities, shareholders	Within 30 days after the end of quarter
Information on: <ul style="list-style-type: none"> ■ bank accounts (current) as well as loan, depository and other accounts in banks and other credit institutions located within the Russian Federation; ■ accounts in foreign currency in banks and other credit institutions located within the Russian Federation and abroad 	End of quarter	Tax authorities	Before the 20 th day of the month following the reporting period
The joint stock company presents: <ul style="list-style-type: none"> ■ its balance sheet; ■ profit and loss account 	Open joint stock companies which have completed or are in the process of a public offering	Publication in mass media; submitted to FCSM	Every quarter
Report on securities	When any securities have been issued	FCSM	Every quarter
Form # 1-T "Information on number of employees and their salaries during the year"	Every legal entity and its independent branches	Government Statistics Agencies	Every quarter
Form 5-3 "On expenditures on production and sales of the products (services, goods)"	Every enterprise and industrial organization	Government Statistics Agencies	Every quarter

MONTHLY:

List of Documents	Under which circumstance (s)	Whom	When
Form # 1-T "Information on number of employees and their salaries during the year"	Every legal entity and its independent branches	Government Statistics Agencies	Monthly
Form 1-F "Information on terms of payment at the enterprise"	Every legal entity	Government Statistics Agencies	Monthly

AD HOC (FROM TIME TO TIME):

List of Documents	Under which circumstance (s)	Whom	When
Report on major transaction	Public offering	Publication in mass media; reported to FCSM	No later than 5 days after the event
Report on the decision made, specifying the date and the name of the body which made the decision	A joint stock company decides to place bonds and/or other securities	Publication in "Приложение к Вестнику ФКЦБ" "Appendix to the Official Magazine of the FCSM"	Within 5 days of decision
Information disclosed includes: <ul style="list-style-type: none"> ■ name of the issuer; ■ type and form of the issued securities; ■ terms and time of placement; ■ date and number of the state registration; and ■ place and procedures for looking at the prospectus 	State registration of bonds and/or other securities	Publication in "Приложение к Вестнику ФКЦБ" (Appendix to the Official Magazine of the FCSM)	Within 5 days from the date of registration
Information disclosed includes: <ul style="list-style-type: none"> ■ name of the issuer; ■ name of the body which approved results of placement and date of approval; ■ type and form of the placed securities; and ■ number of the placed securities 	Approval of the results of placement of bonds and/or other securities	Publication in "Приложение к Вестнику ФКЦБ" (Appendix to the Official Magazine of the FCSM)	Within one month
Information disclosed includes: <ul style="list-style-type: none"> ■ data on the JSC which acquired more than 20% of another company; ■ data on the JSC voting shares of which have been purchased; and ■ results of preliminary agreement with the Anti-Monopoly Committee for such purchase 	Acquisition of more than 20% of the voting shares of another company (Note: This does not apply to purchases of shares in the process of formation of a new JSC)	Publication in mass media	Within one month

AD HOC (FROM TIME TO TIME):

List of Documents	Under which circumstance (s)	Whom	When
Information disclosed includes: <ul style="list-style-type: none"> ■ data on the JSC itself; ■ data on the other JSC the voting shares of which have been purchased; and ■ results of preliminary agreement with the Anti-Monopoly Committee for such purchase 	A JSC increases its ownership of voting shares of another company above 20%, and every additional increment of 5 thereafter	Publication in mass media	Within one month
Auditor's report	Independent audit	Shareholders and all interested parties	Any time
Report of the Inspection Commission	Inspection	Shareholders and all interested parties	Any time
Reports of Federal and municipal financial agencies	Reports of Federal and municipal financial agencies which confirm authenticity of the financial documentation of the JSC	Shareholders	Any time
Documents include: <ul style="list-style-type: none"> ■ application form on opening a bank account; ■ document on state registration; ■ notarized copy of the charter; ■ a card with signature samples and the seal; ■ and other documents 	When opening a bank account	The respective bank	Every time
Copy of the charter, balance sheet, profit and loss account and other documents	When preparing an application for a loan from a bank	The respective bank	Every time
Various documents of a JSC	Upon the request of respective government agencies (for example, tax inspection)	The respective government agency	From time to time

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AD HOC (FROM TIME TO TIME):

List of Documents	Under which circumstance (s)	Whom	When
<p>Documents of a JSC:</p> <ul style="list-style-type: none"> ■ Charter (changes and amendments to it); ■ documents certifying the JSC's right to property on its balance; ■ guidelines on establishing a subsidiary or representative office; ■ annual financial report and other financial documents submitted to respective organizations; ■ prospectus; ■ minutes of AGM, meeting of the Board of Directors (Supervisory Board) and Inspection Commission; ■ reports of the Inspection Commission, Auditor; ■ list of affiliated persons, specifying type and number of their shares; and ■ other documents in accordance with Russian legislation or the charter of the JSC 	<p>Shareholders would like to review these documents</p>	<p>Shareholders</p>	<p>From time to time</p>
<p>Information on the AGM's decision to increase charter capital and issue additional shares, due to a reevaluation of fixed assets</p>	<p>Every open-type JSC with more than one thousand shareholders</p>	<p>Publication in a periodical with a circulation of not less than 10 thousand</p>	<p>No later than 15 days from the date of the AGM</p>
<p>A JSC:</p> <ul style="list-style-type: none"> ■ discloses information which is important for the investor and which it publishes in its country, registers at the stock exchange where its securities are sold (so-called "public information") and presents to owners of securities; and ■ fills in Form F-6 	<p>A JSC issues Level I ADRs</p>	<p>United States Securities and Exchange Commission (SEC)</p>	<p>Upon SEC request, periodically</p>

AD HOC (FROM TIME TO TIME):

List of Documents	Under which circumstance (s)	Whom	When
<p>An issuer of Level II ADRs must complete Form 20-F, including:</p> <ul style="list-style-type: none"> ■ detailed description of the company's activity; ■ description of production capacity; ■ financial data on one of the five years of operation; ■ financial reports certified by an auditor for the last 3 years; ■ information on the company's management; and ■ other (for details, please refer to chapter on ADRs in "Disclosure" section); ■ and complete Forms F-6 and 6-K 	<p>A JSC plans to issue Level II ADRs</p>	<p>SEC</p>	<p>Upon SEC request, periodically</p>
<p>An issuer of Level II ADRs must complete the following forms:</p> <ul style="list-style-type: none"> ■ F-1; ■ F-6; ■ 20-F; ■ 6-K 	<p>A JSC plans to issue Level III ADRs</p>	<p>SEC</p>	<p>Upon SEC request, periodically</p>

Uralsvyazinform
Liquidity Development Program (LDP)¹

CASE STUDY

- Who? Managers who want to improve their share price and attract investors, in preparation for raising capital through new share issues
- What? Liquidity Development Program
- When? Immediately and on an ongoing basis
- Where? Within the JSC, in Russia and major capital markets abroad
- Why? Help medium sized companies raise capital in Russia and on international capital markets
- How?
- Create proper information disclosure documentation on the company
 - Make the shares of the company more easily available to investors
 - Disseminate information about the company to investors

¹ Liquidity in the equity markets is defined as the ability of a share to absorb a substantial amount of buying and selling without disturbing the price significantly. Please refer to the Equity Market Notes, Appendix 1. These notes were produced by CFED as an integral part of this manual and accompanying workshop. Participants should refer to these notes when reviewing the accompanying profiles and case studies.

SP

URALSVYAZINFORM IN APRIL 1996
A VERY GOOD SECOND-TIER, BUT UNKNOWN COMPANY

A very good company -

Revenue : \$80,000,000 (1995)
Profit : \$16,000,000
Growth : 30% - 40% annually
Dynamic management
Active investment policy
Good financial condition

But not well known -

Not traded in Russia's OTC market
Appeared only rarely in the local sharemarket

=> SHARE TRADING HELD BACK BY LACK OF SUPPLY OF SHARES
=> SHARE PRICE STOOD AT LOW LEVEL : 15 ROUBLES

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**URALSVYAZINFORM IN DECEMBER 1996
A SUCCESS STORY OF THE RUSSIAN SHARE MARKET**

Strong interest from investors in Russia and abroad

Share price increase from 15 Roubles to 180 Roubles

Market capitalisation from \$30,000,000 to \$250,000,000

Quoted by major brokerage houses in Russia and recommended as an outstanding investment opportunity

Traded in London

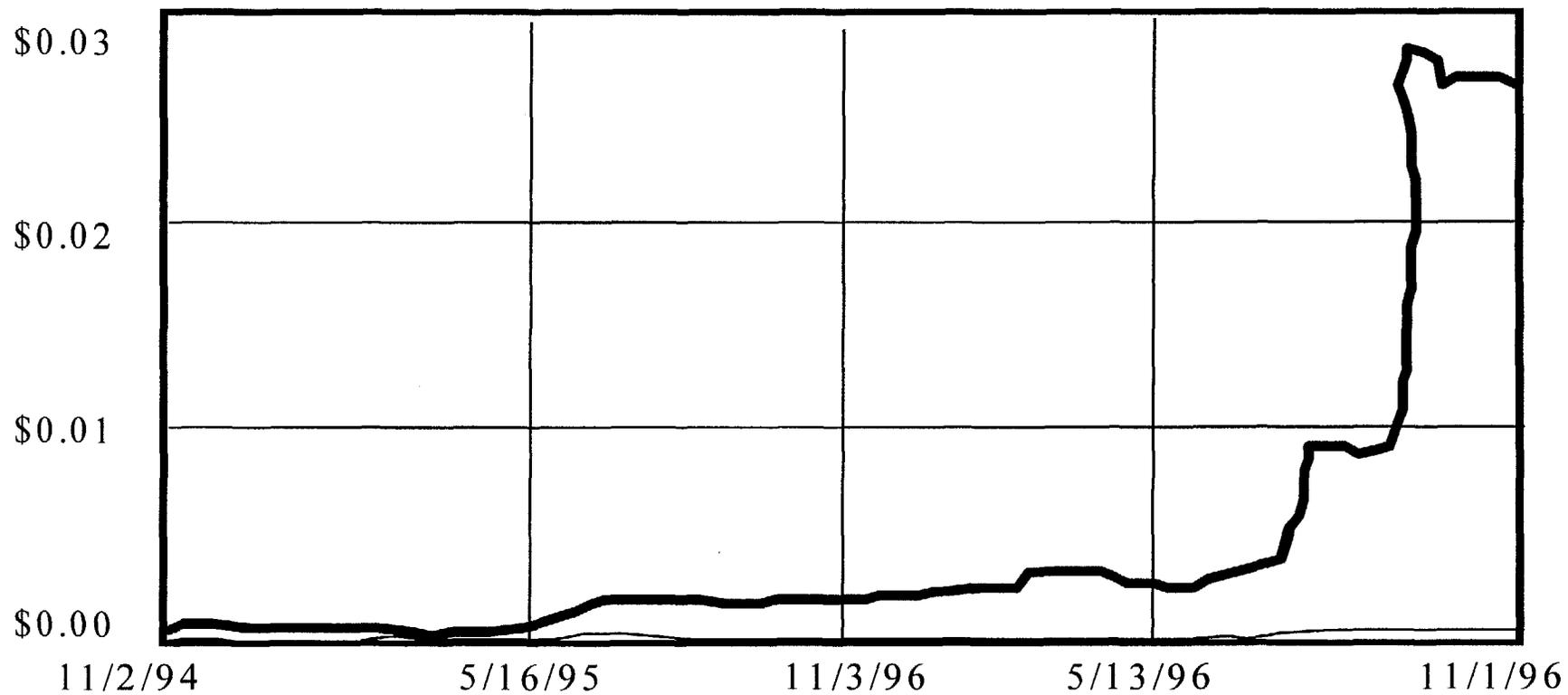
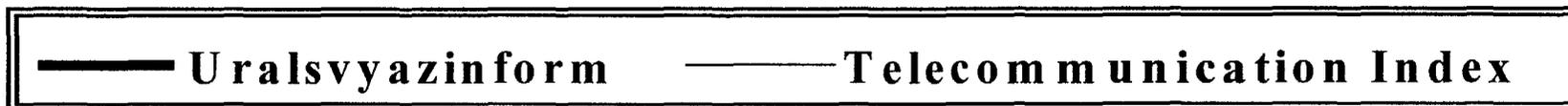
Planned ADR in 1997

Liquidity much improved, and getting better

Supply remains limited. Market observers believe the price of the company's shares is approaching the level at which present shareholders will offer their shares for sale in greater numbers. Some observers believe the catalyst for this may be the planned Level I ADR in early 1997.

=> AN INCREASE IN CAPITAL IS NOW POSSIBLE UNDER BETTER CONDITIONS : URALSVYAZINFORM PLANS TO RAISE BETWEEN \$10,000,000 AND \$20,000,000.

Price V. Industry Index (US\$)



** Representation based on Skate Press Source

Uralsvyazinform
Key Financial Characteristics

Income Highlights (R mlns)	1994	1995	9 months 1996
Total revenue	142,507	361,839	427,981
Net income	25,300	71,791	85,465
Net profit margin	17.75%	19.89%	19.97%
Balance Sheet Highlights (R mlns)			
Current assets	55,302	108,441	149,298
Accounts receivable	36,599	73,278	92,200
Non-current assets	402,173	501,834	1,157,178
Total Assets	457,475	610,275	1,306,476
Current liabilities	47,690	146,429	181,745
Accounts payable	17,835	64,233	99,370
Non-current liabilities	4,551	33,294	49,257
Total liabilities	52,241	179,723	231,002
Shareholders' equity	405,234	430,552	1,073,467
Current assets/Current liabilities	1.16	.74	.82
Tot. liabilities/Shareholders' equity	.13	.42	.22
P/E ratio	not traded	2.34	11.82

Source: Skate Press

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Who?

Managers who want to improve their share price and attract investors, in preparation for raising capital through new share issues

Criteria? The LDP -- which can help a company whose shares are virtually not traded to become well known to investors and, ultimately, actively traded at higher price levels – works best with companies meeting specific requirements:

- Dynamic and qualified management, open to disclosure and external investors
- Good financial condition and prospects
- Sufficient size

**Even if your company does not meet the sufficient size criterion for the LDP, you can still learn an important lesson from Uralsvyazinform.
The point is that investors will pay for disclosure.**

Disclosure and Attitude to Investors

A company wishing to improve its share performance must be ready to disclose a significant amount of information, including some that is usually considered a “commercial secret” in Russia. Information that should be disclosed includes:

- Detailed description of activity;
- Investment plan;
- Business plan;
- Description of existing and planned technical equipment;
- Pricing policy
- Financial statements, including quarterly balance sheets, and where possible, accounts presented according to IAS.

More generally, the management should be open to external investors and aware of investor rights.

Financial Condition and Prospects

Prospects are linked to the attractiveness of the company itself as well as its line of business:

- Profitability and a stable financial condition are the main indicators of success;
- A company is more attractive if it has a significant competitive advantage, or outstanding operational performance;
- A high growth rate is an advantage – provided it does not create instability in the financial structure of the company;
- Certain industries such as telecommunications and energy have always been attractive to investors.

Sufficient Size

Best for companies with annual sales of \$100,000,000 or more; threshold as low as \$30,000,000 if the company meets one or more of the following requirements:

- Very high growth rate (40% a year or more);
- Exceptional profitability (net profit/revenue greater than 20%)
- Very attractive area of business (telecommunications or food processing, for example);
- Unique strategic position (quasi monopoly of specific equipment in a high growth industry, for example)

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What?
Liquidity Development Program (LDP)

LDP

LDP was proposed to the FCSM by Ares Associates, the LDP's implementer; and is financed by the European Union through TACIS.

The LDP in the first instance is an **information disclosure** program, designed to raise a share's price by creating **market awareness and confidence**, leading to increased demand and higher pricing. A successful share with a favorable price history is a better vehicle for raising fresh capital. Such a new issue will be met by investor enthusiasm and the company will have to sell a smaller percentage of ownership to raise a given amount of fresh capital.

Liquidity

Liquidity in the equity markets is defined as the ability of a share to absorb a substantial amount of buying and selling without disturbing the price significantly. It is the result of good investor demand and significant trading, which tends to reduce the spread between bid and ask prices (stimulating still more trading).

Liquidity / Pricing

Liquidity is primarily the result of increased demand, which raises bid prices and causes more shares to be made available for sale. The process is self-reinforcing, since investors are attracted to a share because it is liquid (reducing their risk of loss due to volatility).

Increased demand =>
Higher bid prices =>
More seller interest =>
Reduced spread between bid and ask prices =>
Increased likelihood of transactions =>
Increased trading =>
Increased liquidity =>
Increased demand.

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How?

LDP² – Step 1 : Documentation Creation

WHAT	WHY	BY WHOM	HOW LONG	HOW MUCH
<p>Information Memorandum In English and Russian describing:</p> <ul style="list-style-type: none"> ■ The company, and its ■ Activities ■ Equipment ■ Investment and business plans ■ Strategy ■ Management 	<p>Basic document required by any institutional investor</p>	<p>Independent financial advisor, but signed and checked by the company, and prepared on the basis of materials provided by the company.</p>	<p>1 to 2 months</p>	<p>\$10,000 - \$25,000</p>
<p>Newsletter Quarterly newsletter in English and Russian, sent to existing and prospective investors containing:</p> <ul style="list-style-type: none"> ■ Latest company information ■ Update of financial events ■ Upcoming Events 	<p>Necessary to keep institutional investors informed and to avoid misunderstandings</p>	<p>The company</p>	<p>Every three months</p>	<p>Production and distribution costs</p>
<p>Videotape Describing the company</p>	<p>Not necessary, but useful and impressive during conferences</p>	<p>Specialised production company.</p>	<p>1-2 weeks</p>	<p>Approximately \$ 5,000</p>
<p>IAS Accounting</p>	<p>Gives comfort to investors and is evidence of openness. Due to cost, it should be done only in anticipation of issue of shares or bonds.</p>	<p>International audit firm</p>	<p>6 months</p>	<p>\$100,000 - \$200,000</p>

Source: Ares Associates

² This is a general discussion of the LDP, and not a company-specific discussion.

LDP - Step 2 : Make the shares easily available for investors

WHAT	WHY	BY WHOM	HOW LONG	HOW MUCH
Improve registration system	A Moscow based independent and computerised registration system of shares is required by institutional investors	By the company, through organising a competition among the best Russian registrars	Several months	Depends on the registry chosen
Select an international investment instrument for the shares (ADRs, RDCs)	For many international investors, it is difficult to buy Russian shares directly.	Independent advisor	One month	\$5,000 - \$10,000
Create international instruments		Depends on the instrument. Usually a depository and an international lawyer are required.	Several months	Depends on the instrument. ADR Level 1 may cost \$20,000 - \$50,000
Choose market maker in Moscow and London	Necessary in Moscow to be on RTS or RTS2, and in London to make placements and represent the company's interests	Under advice from an independent advisor or lawyer.	Several weeks of negotiations	Percentage for placements in London : 3% - 5%

Source: Ares Associates

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LDP - Step 3 : Disseminate information about the company among investors

WHAT	WHY	BY WHOM	HOW LONG	HOW MUCH
Conferences in Moscow and London introducing the company and its strategy	Effective way to introduce a company and its strategy to investors	Specialised public relations company	Two hours	\$5,000 for one conference
Mailing the Information Memorandum to investors, journalists, etc.	Useful to make sure all institutions have relevant information about the company	The company	Every year	Cost of mailing
Press releases and contacts with media	-To inform investors on company developments -Keep media interest on company	The company	Every month	
Customised communications with major investors : One to one meetings	It is important to cultivate a stable base of large portfolio investors who will support future issues of shares or bonds	The company, in coordination with market makers		

Source: Ares Associates

LDP – Step 4 : Going further

After completion of steps 1, 2, and 3, which should take approximately 6 months, the company, provided it is accepted by the market should be traded in Moscow and London. The company should maintain the momentum established by:

Continuing to cultivate the market:

- Update the Information Memorandum annually
- Maintain regular communications with investors and the media
- More generally, continue the actions set out in Steps 1, 2, and 3.

Using the existence of an active market for the shares to raise funds under favorable conditions: One or several new issues of shares would allow the company to raise substantial amounts of money, due to better pricing of the shares and the interest of investors.

- Once the company has successfully placed shares, it will be realistic to consider an issue of bonds or convertible bonds.

Using this capacity to raise money to develop its business, perhaps by acquiring other companies, and lower financing costs.

SUMMARY

**ATTRACTIVE COMPANY
GOOD DISCLOSURE MATERIAL
ACTIVE MARKETING**

=> => =>

**HIGHER PRICE
AND
LIQUIDITY**

=> => =>

**EASIER TO RAISE
MONEY;
MORE FAVORABLE
CONDITIONS**

Uralsvyazinform
Discussion Topics

Please work with your team to evaluate:

- How the LDP's implementation activities are related to achieving a higher share price – be as specific as possible;
- How achieving a higher share price will help the company raise capital at better terms;
- In a hypothetical new share issue, what percentage of ownership would have had to be sold to raise \$10,000,000 in April 1996; same question for December 1996;
- How changing the registrar and auditor are connected to improving the share price;
- How a Level I ADR program is connected (albeit indirectly) to the ultimate goal of raising fresh equity;
- The effectiveness of the LDP (for Uralsvyazinform and other, potential participants).

Uralsvyazinform¹

CASE STUDY²

Uralsvyazinform (hereinafter referred to as the "company") is a telecommunications industry regional leader, considered financially stable, with plans to expand and diversify its activities. The company intends to finance a portion of its capital requirements by raising new equity through the sale of new shares. In connection with its equity raising strategy, the company has taken successful steps to improve its shares' liquidity and increase its share price, which, in the opinion of industry analysts, has been held down due to a lack of supply of stock available for sale in the market. There has been a lack of supply of shares available for sale because demand for the shares has not been sufficiently robust to lift the bid prices (indicated by potential buyers) to a high enough level to motivate enough current owners -- who have confidence in the company and believe it is worth more based on its fundamentals -- to sell. As a result, fewer transactions have taken place, and the shares have not yet had the opportunity, in spite of notable recent progress, to rise to their full potential.

Company Background

Uralsvyazinform is a dynamic telecom company servicing the Perm region in the Western Urals, an area of 160,000 square kilometers with a population of 3.1 million. The company employs 7,830 workers and provides a wide range of services. The company has a monopoly position in a heavily industrialized environment.

The company provides telephone, radio and television services and expects to use installed fiber-optic cables to develop cable TV in Perm. There is great opportunity for expansion since telephone penetration in the region is low and demand for other telecommunications services is also high. The company is developing several new businesses, including mobile cellular telephony and paging services, and is actively implementing a number of modernization programs using fiber-optic lines.

The company was privatized in April 1994. Its initial charter capital of R346,436,000 has since been increased to R912,096,700,800 in connection with revaluation of fixed assets. Ownership structure is:

Svyazinvest	51%
Employees	26%
Management	12 %
Crawford Holdings	3%
Other	8%

¹ This case has been prepared by CFED as of December 15, 1996 using information and exhibits provided by Ares Associates and Skate Press. The information has not been independently verified but is believed to be accurate.

² Please refer to the Equity Market Notes, Appendix 1. These Equity Market Notes were produced by CFED as an integral part of this manual and accompanying workshop. Participants should refer to these notes when reviewing the accompanying profiles and case studies.

The company has recently changed its registrar to Central Moscow Depository. The AGM on May 26, 1996, appointed Coopers & Lybrand as the company's auditor.

The company has placed four bond issues in the Perm region over the past three years and is the recipient of many financial proposals from international financial institutions.

Demand for Shares

The company's shares trade on the nationwide OTC market. Earlier in the year, the shares were virtually untraded: the stock was not yet traded in Russia's OTC market and the shares appeared only rarely in the local market. Stock liquidity was hampered by lack of supply. Since the share price (as reflected by the bid price) stood at low levels, owners held on to their shares.

Capital Needs

To support its growth strategy, the company's development plans assume \$53mn invested in 1996, \$83mn in 1997, \$60mn in 1998 and \$40mn in 1999. Other capital needs include \$4mn to \$6mn annually to repay loans and bonds.

Corporate Actions

As part of its strategy to meet a portion of capital raising requirements through the sale of new equity, the company decided to take steps to prepare for new share issues by creating a ready market for its shares and raising its share price. Accordingly, the company in April 1996 became the pilot project for the Liquidity Development Program ("LDP"), sponsored by TACIS and implemented by Ares Associates. The company was selected as the pilot project by the Russian Federal Commission for the Securities Market, based on criteria including the company's dynamic management, good financial condition and prospects, and openness to investors. The company is also involved with Skate Press in its Information Disclosure program. The company's immediate objectives in joining LDP and Skate's program were improving stock liquidity and performance, preparation of large blocks of shares for sale and preparation for an international facility (Level I ADR or Russian Depository Certificate).

With a view to develop and maintain a liquid, actively traded market for the company's shares, the LDP implementation methodology included the following activities - conceived to generate interest and trust among, and accessibility to, investors:

Step 1 -- Documentation Creation

- Information Memorandum, a basic document required by institutional investors, prepared and distributed at conferences and to all major players in the Russian securities market;
- Company video produced for conferences and presentations.

Step 2 – Improvement of the Accessibility of Securities

- Recommendation of change of registrar and organization of competition to select a new, independent registrar (Moscow Central Depository selected);
- Preparation for Russian Depository Certificate and Level I ADR programs;
- Organization of competition to select a leading law firm dealing with ADRs (Clifford Chance selected);
- London placing agent proposed (Williams de Broe selected) to introduce the company to international investors and develop a systematic program for placing the company's shares with them;
- Moscow brokers introduced - two-side (buy and sell) quotations now open from a number of brokers in periods of normal market activity;
- The company's shares included in all indices calculated by Skate (MT-Index, ASP General, ASP Telecommunications) - company awarded its own ticker in the Bloomberg information system.

Step 3 – Communication with Investors

- Communication strategy developed;
- Newsletter designed;
- Mailing list of key investment firm executives and investors prepared (for newsletter, Information Memorandum, etc.);
- Company profile published in Capital Markets Russia, Russia X-Tension and Skate Blue Chips -- distributed via Reuters, Bloomberg and Datastream electronic services and mailed to interested potential investors;
- Company presentations held in Moscow, London and Frankfurt;
- Internet Web Site created;
- Series of meetings arranged with potential investors and the company's General Director;
- Dissemination of basic information (news, press-releases, background materials) through various channels.

To get full, continuing benefit from the program, the company will have to update the Information Memorandum each year and continue the actions set out above. The result should include new issues of shares allowing the company to raise substantial amounts of money, helped by better pricing and investors'

interest in the shares. This enhanced capacity to raise money will help the company develop its business, perhaps make acquisitions and generally lower its finance costs.

Results of the Program

The company's shares are quoted by major Moscow brokerage houses and share prices have gone up from R15 in April to R180 as of December 11, 1996. Spreads between bid and asked prices (see accompanying Equity Market Notes -- Share Demand and Supply) have narrowed dramatically, from as much as 50% at the beginning of the LDP to approximately 7%-10% now. The company has become the highest priced Russian telecom by the usual comparative measures (price/earnings ratio, price per access line and price/cash flow). Market capitalization has reached \$250mn, up from \$30mn at the start of the program.

On the international side, Williams de Broe is preparing blocks of shares - mostly treasury stock -- for closed auctions in London. The firm's plan is to sell to a stable base of institutional investors, with the idea of creating a group of core investors who will support new issues of securities. Williams de Broe and the company are thinking in terms of a \$20mn international issue of new shares later in 1997 (144A/Reg S ADR).

Liquidity, however, continues to be held back by limited supply. Still, significant progress has been made and analysts are recommending the stock as an outstanding investment opportunity. The company intends to follow independent investment and fund raising policies, rejecting a number of proposals from British and Korean companies to create joint-ventures. The company's board approved a Level I ADR facility in August. The facility is expected to cover 4% of the company's stock and is planned for January or February, 1997. Market observers believe that the price of the company's shares is approaching the level at which present shareholders will in greater numbers offer their shares for sale -- some observers believe the catalyst for this increase will be the planned Level I ADR in early 1997.

Exhibit

The Skate Press Blue Chips summary of the company.

Company **Uralsvyasinform**
Ticker **UINF**
Industrial Group **Telecommunications**

P/E Ratio (E) **12.80**
Price Change 31-Dec-96 to 31-Mar-97 . + **50.00%**
Market Capitalization, US\$. . . **451,487,867**
Price per Share, US\$ **0.05**

Corporate Action Update

Uralsvyasinform has raised RR 54.6 bln, or US\$ 10.7 mln, in the local market through bond issues (of which RR 33.2 bln was raised from telephone bonds and RR 21.7 bln was raised from interest bearing bonds). The company plans to issue further interest bearing bonds for a total sum of RR 20.0 bln in the first half of 1997.

In early April, the general director of Svyazinvest, Nail Ismailov, reported that a leasing company called Rosleasingsvyaz Ltd would be established jointly by a pool of companies, including Uralsvyasinform, Samarasvyasinform, St Petersburg MMT, Nizhegorodsvyazinform and Svyazinvest. The pool owns 51% of the new company, with 49% owned by banks and insurance companies, Rosstrakh and Ingosstrakh among them. The company is to lease telecommunication equipment to regional operators.

In the second half of February, Permcombank, the authorized administrator of a DM 110.0 mln tied credit to the company for equipment supplies, stopped clearing and cash servicing of accounts.

The company currently has 16 signed contracts with foreign suppliers worth US\$ 86 mln, of which only three were conducted through government agencies. The rest were directly negotiated.

Uralsvyasinform plans to bring digitalization levels up to 45% for the entire region, and up to 60% for the city of Perm. 60,000 new access lines are to be installed in the region: 37,000 in Perm; 7,400 in Berezniki; 7,300 in Solikamsk.

The company intends to launch a new GSM-900 cellular network for 5,000 subscribers in Perm, Berezniki, Solikamsk and Krasnokamsk. Also, an NMT-450 cellular network will be expanded to service 10 small towns. A mobile version of AMPS-800D will also be introduced. The company plans to install equipment for an SDH regional primary network in 1997-2000.

A level-1 ADR issue backed by approximately 10% of Uralsvyasinform's charter capital is being delayed due to increased requirements from the US SEC but is expected later in Summer.

General information

Full Company Name JSC "Uralsvyasinform"
Main Office 68, Lenina St., Perm
Registered Address 68, Lenina St., Perm
Telephone (7-3432) 34-1984
Fax 36151984
Director General Rybakin V.I.
Number of employees 7,384
Date of registration 18-Sep-93
Date of AGM 7-Jun-97
Web site <http://www.uralsviainform.ru>

Key Financial Characteristics

INCOME HIGHLIGHTS (R mln)	1994	1995	1996
Total Revenues	142,507	361,839	650,351
Income Before Taxes	40,838	91,930	200,309
Net Income	25,300	71,971	181,075
Net Profit Margin	17.75	19.89	27.84
Earnings per share (R thnd)	0.00	0.01	0.02
Number of shares*	9,120,967,008	9,120,967,008	9,120,967,008
Average R/US\$ Rate (R)	2,211	4,567	5,100

CAPITAL HIGHLIGHTS (R mln)	1-Jan-95	1-Jan-96	1-Jan-97
ASSETS	457,475	610,275	1,393,254
Current Assets, of which	55,302	108,441	196,050
Cash	6,200	15,909	24,049
Accounts Receivable	36,599	73,278	138,831
Inventories	6,106	18,278	27,952
Non-Current Assets, of which	402,173	501,834	1,197,204
Intangible Assets	1,113	1,991	3,648
Fixed Assets	386,909	394,117	1,103,293
OWNER'S EQUITY, of which	405,234	430,552	1,153,131
Charter Capital	347	380,040	912,097
Reserve Fund	12,978	42,381	97,313
LIABILITIES	52,241	179,723	240,123
Current Liabilities, of which	47,690	146,429	203,736
Short-Term Debt	11,690	28,231	45,885
Accounts Payable	17,835	64,233	116,977
Non-Current Liabilities, of which	4,551	33,294	36,387
Long-Term Debt	1,917	33,294	36,387

RATIOS			
Equity Ratio	0.89	0.71	0.83
Current Liquidity	1.16	0.74	0.96

VALUATIONS			
P/E Ratio	n.t.	2.34	9.23
Book Value per share (R thnd)	n.a.	0.05	0.13
MC/BV	n.t.	0.35	1.45
MC/employee (R mln)	n.t.	22.77	226.44

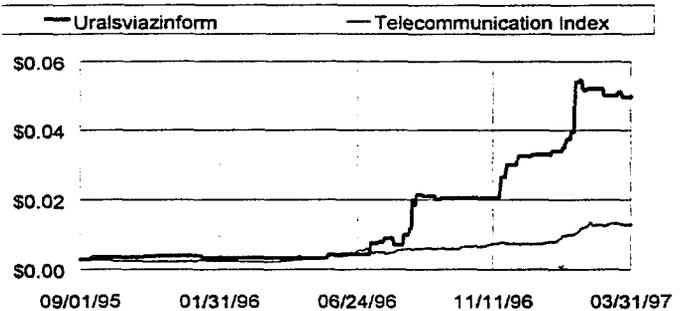
R/US\$ Exchange rate	3,550	4,640	5,554
Financial Data standard	UFI	IAS	RAS

* - current number of shares outstanding

Equity Positions in Other Companies

Name	Stake %
Perminform Ltd.	100.00
Permtelekom Ltd.	100.00
Ural-Inform	100.00
Business-Consulting Perm	60.00
Infininvest	52.00
United Telecom Ural	50.00
Pochtobank	35.00
Habbad College	27.20
Parma	25.00
Zapaduralfond	10.00

Price v Industry Index (US\$)



Secondary Market Remarks

Moderately traded on the OTC market and on RTS-2. An ADR issue pending. Following the compilation date of this issue, Uralsviainform was transferred to RTS on April 14, 1997.

Common stock volume on RTS-2 for February-March, 1997 period amounted to US\$4,326,000 (2.09% of total volume on RTS-2).

Included in the following stock indices:

Index	Weightings, %	Date of inclusion
ASP-General Index	0.67	16-Sep-96
MT-Index	1.07	31-Mar-97
Telecommunications Index	6.95	16-Sep-96

Share Price Gain (Loss), %

Period/Index	31-Dec-96	31-Mar-96	31-Dec-95
	31-Mar-97	31-Mar-97	31-Dec-96
UINF US\$	50.00	1,400.00	731.45
R	54.62	1,668.74	894.34
Index* US\$	78.11	572.19	269.96
R	83.59	692.62	342.44
Market** US\$	79.52	474.94	190.54
R	85.04	577.94	247.46

* - Telecommunications Index ** - ASP-General Index

Major Shareholders

Name	Stake %
Svyazinvest	51.00
Employees	25.00
Management	12.00
Treasury Fund	4.00
Crawford Holdings	4.00
Non-State Pension Fund Parma	3.00
JC "Ermak"	0.68
VIF "Detstvo-1"	0.10
Free Float (% of common stock)	49.00

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The Skate Blue Chips
Compiled on April 1, 1997 263

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Stock Changes

Events	Date	Type of shares	Par Value, R	New No. of shares
First issue	18-Sep-93	common	500	692,872
Bonus issue	25-Dec-95	common	500	760,080,584
Increase of par value	11-Jul-96	common	1,200	760,080,584
Split	11-Jul-96	common	100	9,120,967,008
Total	1-Apr-97	common	100	9,120,967,008

Dividend History

Year	Dividend	Type of shares	Pay Date	Record Date
1993	n.p.	none issued	-	n.a.
1994	1,500	none issued	17-Jul-95	16-Aug-95
1995	208.3	none issued	27-Apr-96	27-May-96
1996	1.1	none issued	n.a.	n.a.

Production Overview

Production Volume

Product	Measure	1994	1995	9M96
Number of access lines	thnd access lines	333.40	362.20	381.22
Penetration Rate	%	25.02	15.80	n.a.
Per Household Penetration Rate	basic residential a.l. per 100 households	27.80	30.72	n.a.
Outgoing ILD calls	thnd calls	20,293.00	20,784.00	49,678.00
City Telephone Network				
Capacity Utilization	%	80.53	85.86	n.a.
Penetration Rate	%	17.04	18.32	n.a.
Per Household Penetration Rate	basic residential a.l. per 100 households	31.79	35.55	n.a.
Access lines with ILD access	%	93.29	91.13	n.a.
Automatic switches	as % of total capacity	30.12	33.41	n.a.
Percentage of digital transmission facilities	%	96.25	97.63	n.a.
Rural Telephone Network				
Access lines with ILD access	%	0.00	42.26	n.a.
Automatic switches	%	0.00	9.79	n.a.
Percentage of digital transmission facilities	%	50.79	54.31	n.a.
ILD Telephone Network				
Capacity utilization rate of ILD switches	%	20.94	41.87	n.a.
Percentage of digital transmission facilities	%	5.73	6.63	n.a.
Percentage of ILD calls	%	75.44	85.49	n.a.
Installation Volumes				
Installation, total	access lines	10,715.46	28,771.00	22,335.00
Installation, residential	access lines	14,168.70	31,061.00	25,378.00

Operations Summary

Uralsvyasinform provides telecommunications services to the Perm Region. In 1995, several new exchanges were installed, including an S-12 automated long distance exchange in Perm and two TDX automated exchanges in Perm and Kizel. In 1H96 five new local automated exchanges were installed with SDH digital systems. In 1996 it installed a total of 10,000 new lines and it plans to put into operation an SDH transmission system in Perm by the year end. In April 1996 the company began operation of an ISDN system in Perm linking Moscow, Perm and Nizhny Novgorod to the international ISDN network.

The company is engaged in joint projects, which have a total value of

US\$ 70.0 mln. This includes cellular network projects with AMPS, NMT and GSM standards, paging and other services which have begun to generate returns in summer, 1996.

On July 15, a contract between Dresdner Bank and Permcombank was signed in Frankfurt to extend a tied credit of DM 17.0 mln to Uralsvyasinform for the purchase of GSM-900 cellular network equipment from Alcatel SEL.

Management is amenable to outside investors and known for its candour. It is involved in the Information Disclosure and Investor Relations program implemented by Skate.

Registrars

Name	Type of securities	Tel.	Address
Central Moscow Depository	all shares	(7-095) 207-6696	22, Olkhovskaya St., Moscow, 107066, Russia

Auditors

Name	Tel.	Address
Coopers & Lybrand	(7-095) 232-5511, 232-5522	5, Nikitsky Per., Moscow, 103009, Russia

Financial Adviser

Name	Tel.	Address
ARES Associates	(7-095) 941-8148	n.a.
Williams de Broe	(44-171) 588-7511, 588-1702	6, Broadgate, London, EC2M 2RP, UK

Legal Adviser

Name	Tel.	Address
Clifford Chance	(7-095) 258-5050, 258-5051	24/27, Sadovaya -Samotechnaya St., Moscow, 103051, Russia

"How To Handle Corporate Governance Situations"

CASE STUDY

Situation 1

JSC Nizhny Novgorod has announced its upcoming annual general meeting of shareholders. A minority shareholder of JSC Nizhny Novgorod has submitted a shareholder proposal, namely a nominee for the board of directors.

Situation 2

A minority shareholder of JSC Nizhny Novgorod has called for an extraordinary meeting of shareholders to demand the resignation of the board of directors.

Situation 3

The board of directors of JSC Nizhny Novgorod is considering a Sponsored Level I American Depositary Receipt program.

Situation 4

The General Director of JSC Nizhny Novgorod has been seriously injured in an automobile accident.

Situation 5

The market for the shares of JSC Nizhny Novgorod is very small, and there has not been much trading on the stock exchange. Furthermore, the press has reported several times that the JSC is unable to pay its employees in cash. At the same time, a small but successful Russian advertising/public relations company approaches JSC Nizhny Novgorod with a proposal for a public relations campaign.

Discussion Topics

After analyzing one of the above situations, each team should:

- Prepare an outline of the legal framework for the situation;
- State assumptions about references, if any, in the JSC's charter regarding this situation;
- Prepare a list of the rights/responsibilities of the following parties: shareholders, management and the board of directors;
- Prepare a timetable of the necessary actions to be taken in response to the situation;
- Prepare a list of the documents that management and the board of directors must complete in order to effectively resolve the situation.

Questions to Participants on Corporate Governance - Compliance

You should choose one answer to each question:

1. What is the name of the supreme management body of a JSC?

1. Management
2. Board of Directors
3. Inspection Commission
4. General Meeting of Shareholders

2. Which body has right to make a decision on amendments to the Charter of a JSC?

1. General Director
2. Management
3. Board of Directors
4. General Meeting of Shareholders

3. If a shareholder or shareholders want to convene an extraordinary general meeting of shareholders (EGM) what percentage of shares must they own?

1. Any
2. Not less than 5%
3. Not less than 10%

4. When should an annual general meeting of shareholders be held?

1. There is no specific time of the year for holding an annual general meeting: it can be held any time.
2. Not later than one month after the end of the fiscal year.
3. Not earlier than two months and not later than six months after the end of the fiscal year.

5. Which percentage of shareholders attending an AGM represents a quorum?

1. Over 50%
2. Over 30%
3. Over 75%

6. In which cases is keeping a shareholders' registry delegated to a specialized registrar?

1. The JSC may decide this.
2. Number of shareholders who own ordinary stock is more than 500.
3. Number of shareholders who own ordinary stock is more than 1000.
4. Number of shareholders who own ordinary stock is more than 10 000.

7. Who does not have the right to have access to the minutes of the meetings of the Management?

1. Shareholders of the JSC
2. Members of Board of Directors
3. Members of Inspection Commission
4. Auditor of the company

8. The Annual General Meeting of Shareholders (AGM) did not take place because there was no quorum. Is it possible to discuss, at the following meeting, several issues that were not on the original agenda?

1. Yes, if shareholders vote for it.
2. No.

9. Is there a time frame for convening an extraordinary meeting of shareholders (EGM) by the Board of Directors upon shareholders' request?

1. No.
2. Not later than 30 days from the date of submitting the request
3. Not later than 45 days from the date of submitting the request

10. Is it possible to put an item "Miscellaneous Business" on the agenda of the Annual General Meeting of Shareholders (AGM)?

1. Yes.
2. Sometimes
3. No.

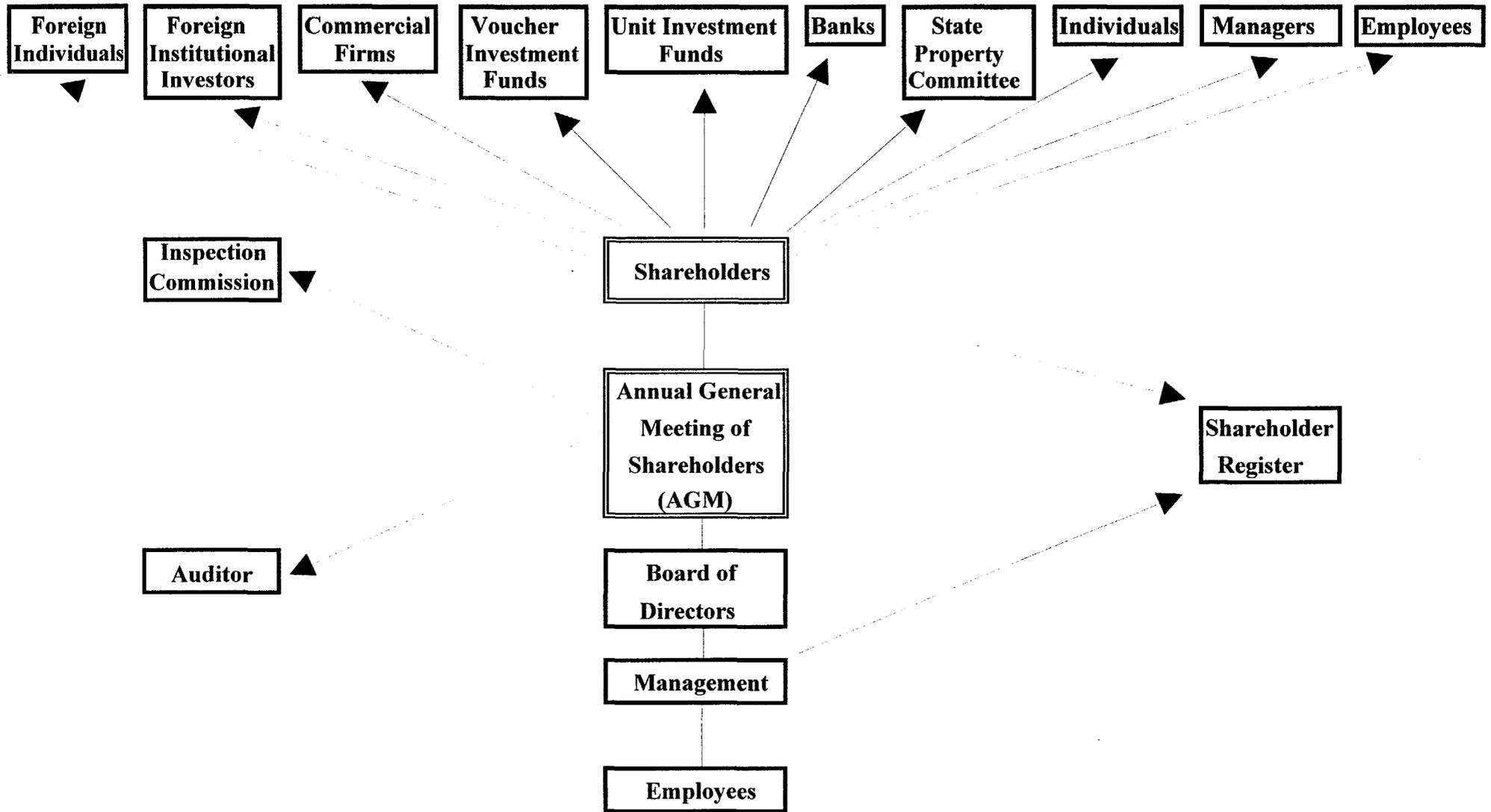
11. Does a shareholder have the right to make two proposals to the agenda as well as propose nominees to the Board of Directors and Inspection Commission?

1. Yes
2. No

12. May the General Director of a JSC simultaneously be the Chairman of the Board of Directors of that JSC?

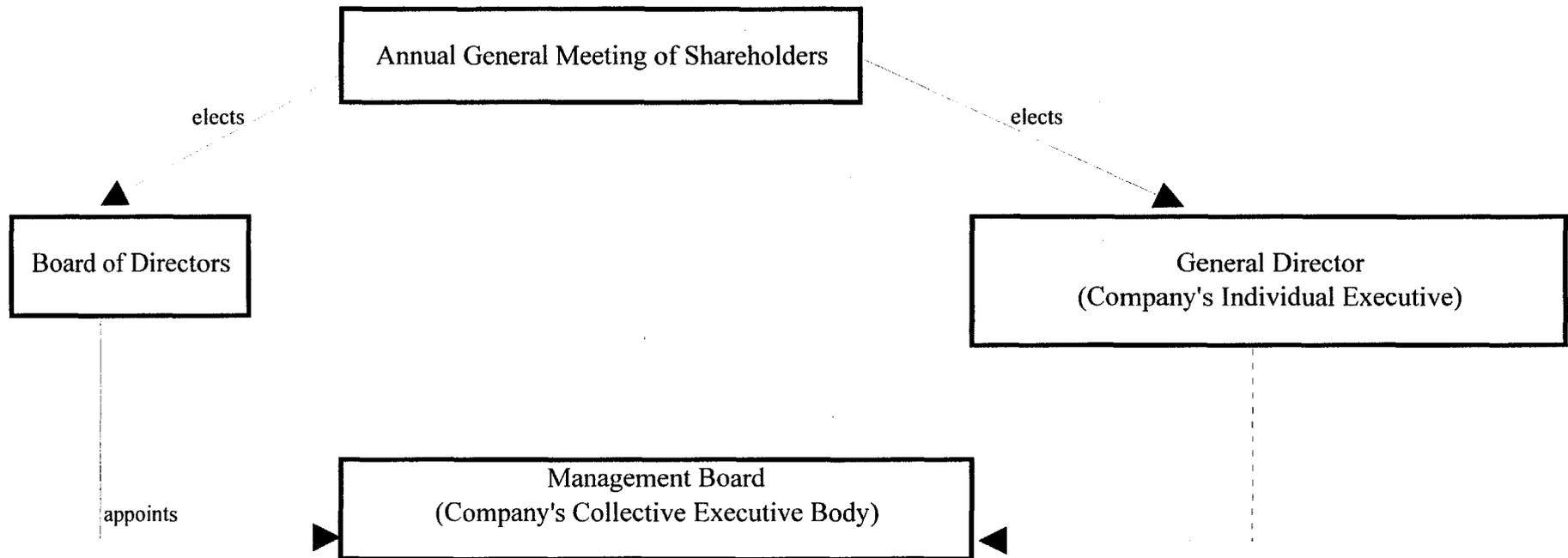
1. Yes.
2. No

INTERNAL GOVERNANCE OF RUSSIAN JOINT STOCK COMPANIES



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Corporate Governance Structure Depending on Various Factors

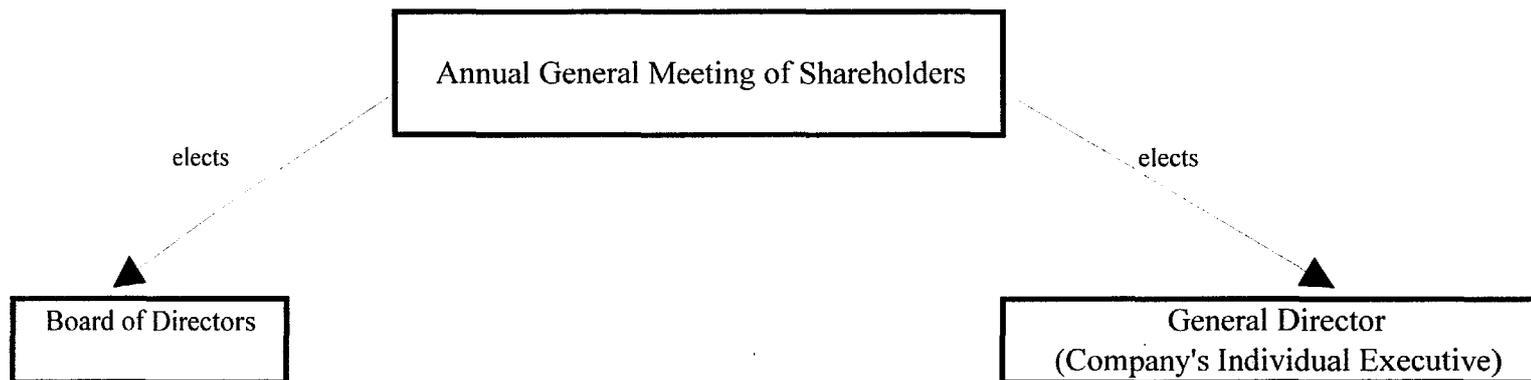


A lot of activity. Outside investors with large stakes.

1. Outside investors with large stakes have seats on the Board
2. Company's current activity is effectuated by the company's collective executive body
3. "Strong" General Director

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Corporate Governance Structure Depending on Various Factors

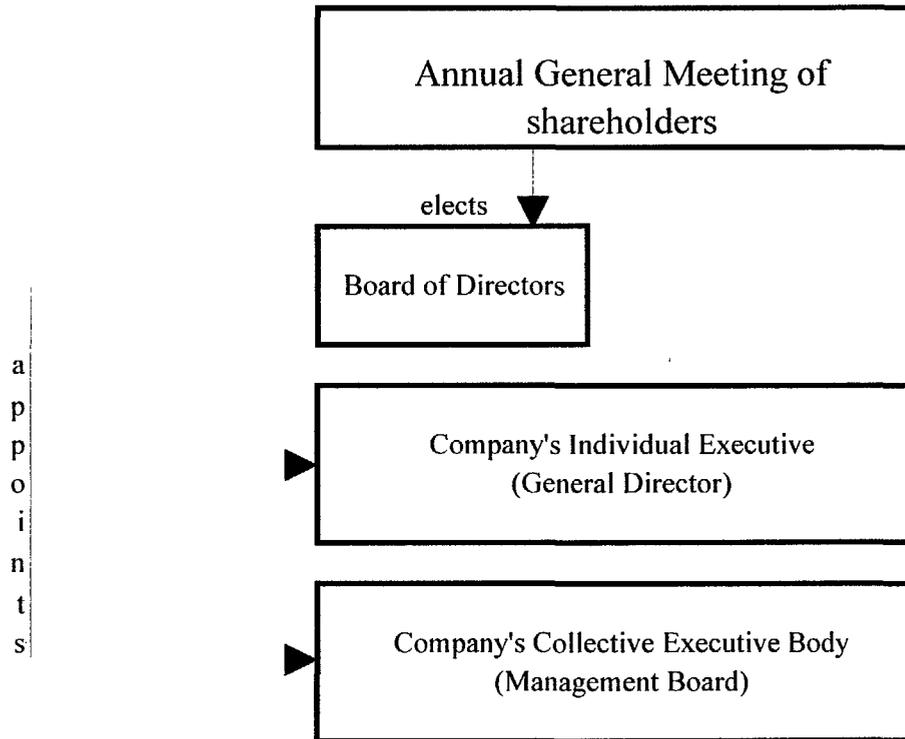


Administration officials hold controlling interest
They are the largest shareholders ("insiders")

1. "Strong" General Director
2. The company's Board of Directors consists of "insiders"
3. The Board of Directors
develops strategic decisions
effectuates company's current activity
fulfills all functions of General Meeting of Shareholders, excluding its exceptional jurisdiction

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Corporate Governance Structure Depending on Various Factors



One of the founders owns controlling interest, when the JSC is established
While establishing subsidiaries or daughter companies
The founder wants to establish ,, control over the executive body

1. Chairman of the Board of Directors (largest shareholder) instead of "strong" General Director
2. General Director - employes as a manager, appointed by the Board of Directors
3. Collective Executive Body (if needed) is appointed by the Board of Directors

Issue-based Guidelines on Corporate Governance Structure of Russian Joint Stock Companies (JSC): Compliance

The following topics will be discussed at the seminar: issue-based guidelines on corporate governance of Russian JSCs (corporate governance structure, rights and responsibilities of members of the Board of Directors, rights of shareholders, role and responsibilities of Inspection Commission and auditors of a JSC) and disclosure requirements.

Each topic will be covered as follows:

- 1. Legal Requirements.*
- 2. Common Practice (references to specific legislation, specific examples, participants will be asked to share their relevant experiences).*
- 3. Legislation and common practice in other countries.*

We will discuss in detail the topics covered in the manual and consider other corporate governance issues not discussed in the manual. For example, the following issues will be reviewed:

- 1. Choice of an optimum corporate governance structure.*
- 2. What should be included in the charter.*
- 3. Share register.*
- 4. Types and forms of general meetings of shareholders. Making decisions. Counting votes. Tabulation Commission.*
- 5. Shareholder appeal of a decision made by the Annual General Meeting of Shareholders (AGM).*
- 6. Refusal of the Board of Directors to convene an Extraordinary General Meeting (EGM) of shareholders.*
- 7. Relations between parties in a JSC during reorganization, liquidation of the JSC or bankruptcy. Consideration of the rights of all parties (including creditors).*
- 8. Liability of corporate organs and the JSC itself.*

Also, the participants will be asked to take a test on corporate governance.

Issue-based Guidelines on Corporate Governance Structure of Russian JSCs¹: Compliance

Compliance

Charter Requirements

According to the Federal Law on Joint Stock Companies (“the JSC Law”)², the **Charter** is the “founding document” of a company. The requirements of the charter are compulsory for the JSC’s board members and shareholders.

The JSC Law specifies what *must* be included in the charter, as well as provisions that, depending on the particular circumstances, might be included in the charter. The charter *must* specify:

- Full and abbreviated name of the company;
- Location and type (open or closed);
- Number, nominal value, share classes (ordinary or preferred) and types of preferred shares issued by the company;
- Rights of shareholders owning shares of each class;
- Amount of charter capital;
- Structure and competence of the company’s corporate organs and procedures for decision-making;
- Procedures for preparing and conducting AGMs, including list of resolutions requiring a qualified majority or unanimously;
- Information on subsidiaries and representative offices of the company; and
- Other provisions stipulated by the JSC Law (Article 11).

The charter, depending on the particular circumstances, *may* also include the following:

- Procedures for exercising preemptive rights to purchase shares offered for sale by shareholders of a closed JSC (Article 7, 3);
- Reference to the rights of shareholders - owners of ordinary stock to participate in general meetings with the right to vote on all issues within its competence, the right to receive dividends, and in the event of company’s liquidation - to receive part of its assets (Article 31, 2);
- The amount of dividend and/or value paid when the company is liquidated (liquidation value) for preferred shares of each type; if the charter provides for preferred shares of two or more types, priority for payment of dividends and the liquidation value of each type of preferred shares (Article 32, 2 and 3);
- Procedures for establishing a reserve fund amounting to no less than 15% of the charter capital and setting the amount of mandatory annual contributions to this fund, amounting to no less than 5% of net profit (Article 35, 1);

¹ This section was prepared using the literature specified in the bibliography and materials provided by International Institute for Law-Based Economy Foundation (ILBE).

² The Federal Law on Joint Stock Companies (“the JSC Law”) of November 24, 1995. All references in this section are to the JSC Law, unless noted otherwise.

- Procedures and time limits for reporting to shareholders the decisions adopted at general meetings and voting results (Article 49, 7);
- Timetable for convening a general meeting (Article 52, 2);
- Procedures for electing members of the Board of Directors (Article 66, 1);
- Procedures for electing members of the Inspection Commission as well as its competence (Article 85); and
- Responsibilities of management in handling the accounts, condition and authenticity of the company's accounting, prompt submission of the annual report and other financial information to the appropriate agencies, and disclosing information to shareholders, creditors and mass media (Article 88, 2);

In addition to these mandatory provisions, the charter may also contain other provisions, as long as they do not contradict the JSC Law and other laws and regulations of the Russian Federation. (See Appendix 4 - Model Charter.)

Capital Structure

At the time of incorporation, the combined financial contribution of all participants in a given JSC is called the Charter Capital. The charter capital must be secured by the assets of the JSC. When establishing a JSC, the founders consolidate their assets according to the terms stipulated in the charter. Following this capital consolidation, they pursue further business activities aimed at making a profit. In order to contribute to the joint capital of a JSC, a person can invest money or other assets (buildings, equipment, etc.), securities (shares of other JSCs, bonds, promissory notes), rights to use natural resources (land, water) and other property rights as well as the right to intellectual property. The value of property contributed by each founder is expressed in monetary form, whose value is determined jointly by all participants in the JSC. The monetary value of this consolidated property constitutes the charter capital (fund) of a JSC. The charter capital is divided into a certain number of equal shares. The monetary expression of said share is termed the nominal value.

Thus, a JSC has charter capital which is split into a number of shares. The total nominal value of all issued shares equals the amount of the charter capital.

In legal terms, the size of charter capital establishes the JSC's minimum liability. The charter capital serves as a means of raising the financing necessary to start business activity.

According to the JSC Law, a JSC has the right to issue shares of two types: ordinary and preferred. The preferred stock in the company's charter capital must not exceed 25% of total share capital (Article 25, 2).

An *ordinary share* (A type share) grants its holder the right to vote at the AGM, the right to receive dividends (the amount is not fixed) from the net profit of the company, and the right to receive part of the company's assets in the event of liquidation. (Articles 23, 31, 75).

A *preferred share* in most cases does not grant its holder the right to vote at AGM, but guarantees the right to receive fixed dividends (not only from the net profit of the company but also from special funds). The dividend is set in the form of a fixed sum or a percentage of the nominal value of the share; this is stipulated in the company's charter. This share also grants the right to receive part of the company's property in case of liquidation (liquidation value). (Articles 23, 32 and 75).

In practice, preferred shares are usually issued in order to attract small investors, this is why they have a low nominal value. Issuing of preferred stock makes it possible to raise necessary financing without issuing bonds (Article 33), and this also gives the owners of large packages of ordinary shares an advantage over the owners of preferred shares in terms of making decisions affecting the company's activity. All shares must be registered. (Article 25, 2).

Bonds. The general rule is that a JSC has the right to issue bonds secured by: (a) a certain share of its assets; or (b) assets provided by third parties specifically for this purpose. A JSC may not issue unsecured bonds before the third year of operations, and then only when the balance sheets for the two previous years have been approved. (Article 33, 3).

Corporate Governance Structure of Russian JSCs

A JSC is one of the most complex types of a legal entity. It may have several organs as well as bodies of internal and external control and a general meeting of shareholders.

The organs of a JSC are:

- General Meeting of Shareholders.
- Board of Directors.
- Management (single or collective).

General Meeting of Shareholders is the supreme management body of a JSC. By participating in general meetings, shareholders exercise their right to participate in the governance of the JSC. The general meeting of shareholders has the right to take decisions only on issues within its competence, as provided for by the JSC Law and each JSC's charter. The charter may not expand the powers of the general meeting beyond those stipulated in the JSC Law, but it can limit them.

If a JSC has less than 50 shareholders owning ordinary (voting) shares, the JSC has no board of directors and the general meeting takes over the responsibilities otherwise assigned to the board of directors.

The JSC Law determines the competence of the general meeting of shareholders, that is, its rights to consider and make decisions on various issues.

Competence of the General meeting can be:

- **exclusive** and
- **alternative.**

Issues that fall within the *exclusive competence* of the general meeting of shareholders may not be transferred to other corporate organs (for example, to the board of directors). Issues of the exclusive competence of the general meeting have the following characteristics: they are complex, their decisions are valid for a long time and these decisions may not be considered outside the meeting. Issues within the competence of general meetings can be *organizational* or *property and legal*.

The following are *organizational* issues:

- Amending the JSC's charter, approving the revised charter (except when related to increasing charter capital) (Article 12, 1; Article 27, Article 48, 1-1);
- Voting on a proposal of the board of directors to reorganize the JSC (Article 48, 1-2); to liquidate the JSC or to appoint a liquidation commission and approve the mid-term and final liquidation balance sheets (Article 48, 1-3);
- Determining the number of members of the board of directors, electing them and terminating their powers (Article 48, 1-4, Article 66, 1);
- Determining the number of members of the inspection commission, electing them and terminating their powers (Article 48, 1-9); and
- Approving the auditor (Article 48, 10, Article 86-2).

Property and legal issues are as follows:

- Increasing or decreasing the charter capital (Article 29, 2; Article 48, 1-7; Article 72, 2);
- Consolidating or splitting shares (Article 48, 1-16, Article 74, 2); and
- Major transactions the subject of which is property whose value exceeds 50% of the book value of the company's assets on the date of the decision (Article 48, 1-18).

Issues that fall within the *alternative competence* of the General Meeting of Shareholders may be transferred to other corporate organs.

The following are *alternative issues*:

- Participating in holding companies, financial and industrial groups and other associations of commercial companies; (Article 48, 1-20; Article 65, 16);
- Paying or not paying dividends, approving the amount of dividends and the form of payment on shares of each type (Article 42, 3), as well as the date of payment (Article 42, 4);
- Approving and amending changes to internal "Regulation on the Board of Directors";
- Setting the compensation of the members of the board of directors (Article 66, 2);
- Approving and amendments changes to internal "Guidelines on the Inspection Commission" (Article 85, 2);
- Setting the compensation of the members of the inspection commission, upon recommendation of the board of directors; and
- Make decisions as necessary following review of the inspection commission's report on the JSC's financial and economic activity (Article 85, 3).

Board of Directors (Supervisory Board) exercises general control over the JSC's activity within the competence established by law. A board of directors is mandatory in every JSC with at least 50 ordinary shareholders (owners of voting shares). The main objective of the board of directors is to develop strategic policy aimed at increasing the JSC's profit, maintain a stable economic and financial portfolio and exercise control over management.

Management is a collective executive body of a JSC. Management exercises control over the everyday activities of a JSC within the competence specified by the company's charter, resolutions of the general meetings of shareholders and internal regulations of the JSC (resolutions and rules) approved by the board of directors.

The general director is the head of management. Management's work is supervised by the board of directors.

The main objective of management is to increase the JSC's profitability. Management acts on behalf of the company in court and while dealing with state organizations, legal entities and individuals. Management also has the right to choose any type of activity within the competence stipulated in the charter and decisions of the general meetings of shareholders.

Management has the right to undertake transactions, provided the amount of the transaction is not more than 20% of the quarterly turnover of the company in the previous quarter. It may also make decisions regarding certain transactions between the JSC and a shareholder, provided the shareholder owns no more than 5% of the charter capital and is not a member of the board of directors or management.

The board of directors signs contracts (or agreements) with management. These contracts specify:

- Rights and responsibilities;
- Form, order and terms of compensation;
- Terms of the contract;
- Terms for terminating the contract;
- Other conditions.

Members of management receive payments or compensation for their work in the amount set by the board of directors, and a share from the net profit in the amount set by the general meeting of shareholders. The general meeting of shareholders may grant management an option to buy the company's shares.

Management consists of the general director, executive directors and managers - heads of the main departments (subdivisions) of the company. The competence of each member of management is specified in a job description approved by the board of directors upon the agreement of the general director. Shareholders and third parties related to the company's activity may be members of management. Management meets when necessary and upon the request of the general director. A quorum is constituted when more than half the members of management are in attendance.

Voting is open. If no consensus is reached, the general director makes his own decision and the disputed issue is referred to the board of directors. Minutes of meetings are signed by all members in attendance. Non-voting members of the inspection commission may attend a meeting of management.

Roles and Responsibilities of Directors

The following issues are the *exclusive competence* of the board of directors:

1. Identifying the JSC's priority activities (Article 65, 1);
2. Convening an annual general meeting of shareholders [AGM] (Article 65,2):
 - Setting date, location and time of the AGM (Article 47, 2; Article 54);
 - Approving the agenda and deciding whether or not to include shareholders' proposals (Article 53,4,5; Article 54, Article 65 3);
 - Approving the list of nominees to the board of directors and other corporate organs (article 53, 4 and 5);
 - Preliminary approval of the annual report and submission of it to the AGM (Article 47,1; article 88);
3. Convening an extraordinary general meeting of shareholders [EGM] (Article 55,1; Article 65, 2):
 - Approving the agenda of an EGM and deciding whether or not to include shareholders' proposals (Article 55, 4);
 - Determining the form of the EGM as well as setting the date, time, and location (Article 55, 1; Article 47, 2);
 - Refusal to convene extraordinary meeting requested by the inspection commission, auditor, or shareholders owning no less than 10% of the voting stock for reasons provided for by the JSC Law (Article 55, 4);
4. Signing contracts with the executive officer (director, general director), and/or collective members of management (Article 69, 3);
5. Proposing members to the tabulation commission and submitting these proposals to the AGM for approval (Article 56,1);
6. Setting the compensation of the general director and/or collective members of management (Article 65, 10);
7. Providing a recommendation on compensation of the members of the inspection commission (Article 65, 11);
8. Determining compensation of auditors (Article 65, 11);
9. Approving the results of additional share issues (Article 12, 1);
10. Making a decision to repurchase shares issued by the company in instances not related to an intentional decrease of the charter capital (Article 65, 9; Article 72, 2; Article 48, 1.19);
11. Establishing subsidiaries and representative offices, approving resolutions on their establishment (Article 65, 15);
12. Making decisions on the JSC's participation in other organizations (Article 65, 16);
13. Deciding on which transactions to undertake (Article 65, 18; Article 83, 1 and 2);
14. Identifying the market value of property - subject of a major transaction (Article 79, 2);

JSC "Bratsky Aluminum Plant" CASE STUDY

JSC "Bratsky Aluminum Plant" convenes its annual general meeting of shareholders."¹

"Open-type JSC "Bratsky Aluminum Plant" (BAP)

Address: 665716, Bratsk-16, Irkutsk Region convenes its general annual meeting of shareholders (AGM) which will be held on June 29, 1996 at 13:00, at 28 Lenina Street, Bratsk Cultural Center "Mettalurg."

Agenda:

1. Establish a Commission to Count Votes.
2. Report of the Board of Directors on financial and economic activities of the JSC "BAP" in 1995.
3. Approve annual report, profit and loss account and proposed distribution of profit and loss.
4. Report of the Inspection Commission.
5. Report of the Auditor.
6. Approve Dividends.
7. Approve Revisions to the Charter.
8. Approve Regulation "on the Inspection Commission."
9. Approve Agenda of the AGM.
10. Terminate Powers of the Board of Directors before time.
11. Elect Board of Directors.
12. Elect General Director.
13. Elect Inspection Commission.
14. Restate Nominal Value of the JSC's shares to a Uniform Amount (of 200 rubles).
15. Any Other Business

The list of shareholders who have the right to participate in the AGM was prepared in accordance with the shareholders register as of May 15, 1996. Shareholders will be admitted from 9 to 11 a.m. at the Cultural Center "Mettallurg," 28 Lenina Street, Bratsk upon submission of an invitation or voting card. Information related to preparation and conduct of the general annual meeting will be available at the offices of BAP, Department of Privatization, Room 58, tel: 44-15-08 beginning June 27, 1996.

Chairman of the Board of Directors, Gromov B.S."

¹ According to the newspaper "Economica I Zhizn" (Economy and Life) #21, May 1996

Questions to Participants²

(Working in teams participants will prepare answers to all questions except #9. For question 9 each team will answer a, b or c).

1. Agenda of the AGM: Does the wording of the agenda violate Russian legislation?
2. Procedures for submitting proposals by the Board of Directors, shareholders, etc.
3. How many days in advance is it necessary to announce AGM? What should be included in the announcement of the meeting?
4. Which materials on preparation and conduct of the meeting do shareholders have the right to receive?
5. According to the press, an employee of "Zelyony Mys" company (a shareholder of BAP) was buying voting cards at \$300-400 a piece. In your opinion, which regulation of the JSC Law was violated, and what will be the liability?
6. A shareholder holding more than 20% of the shares and several minority shareholders (approximately 4500 people) do not have access to the balance sheet and minutes of the meetings of the Board of Directors/Executive Body. Which documents does a shareholder have the right to receive?
7. During an extraordinary meeting of shareholders, it was announced that a new Board of Directors will be elected. As a result, a new Board was elected. What consequences (problems) in your opinion might this have?
8. A revised Charter was approved at the AGM. The registration body refuses to register it. What should be done?
9. Please prepare a detailed plan of actions that should be taken by JSC in each of the following situations:
 - a) new share issue and placement of the issued shares among the shareholders;
 - b) a closed joint stock company is planning to increase its charter capital up to 10 million dollars by increasing the nominal value of the share;
 - c) an issue of bonds which will be placed through subscription.

² The aim of the questions to participants is to discuss practical aspects of corporate governance and disclosure and have nothing to do with the events that took place in this JSC. The name of the JSC was not changed on purpose to prove the participants that the issues discussed at the seminar are not theoretical and similar events might take place in real life.

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TsUM Trading House¹
New Share Issue

- Who? Managers of joint stock companies who want to raise capital.
- What? Raising capital through new share issues.
- When? Approximately 6 months prior to the planned placement.
- Where? Within the capital markets in Russia and abroad.
- Why? Raise money for modernisation and expansion on favorable terms.
- How? - Prepare the company for share issue and successful placement
- Prepare and register the issue and all the required documents
- Price the issue and place the shares

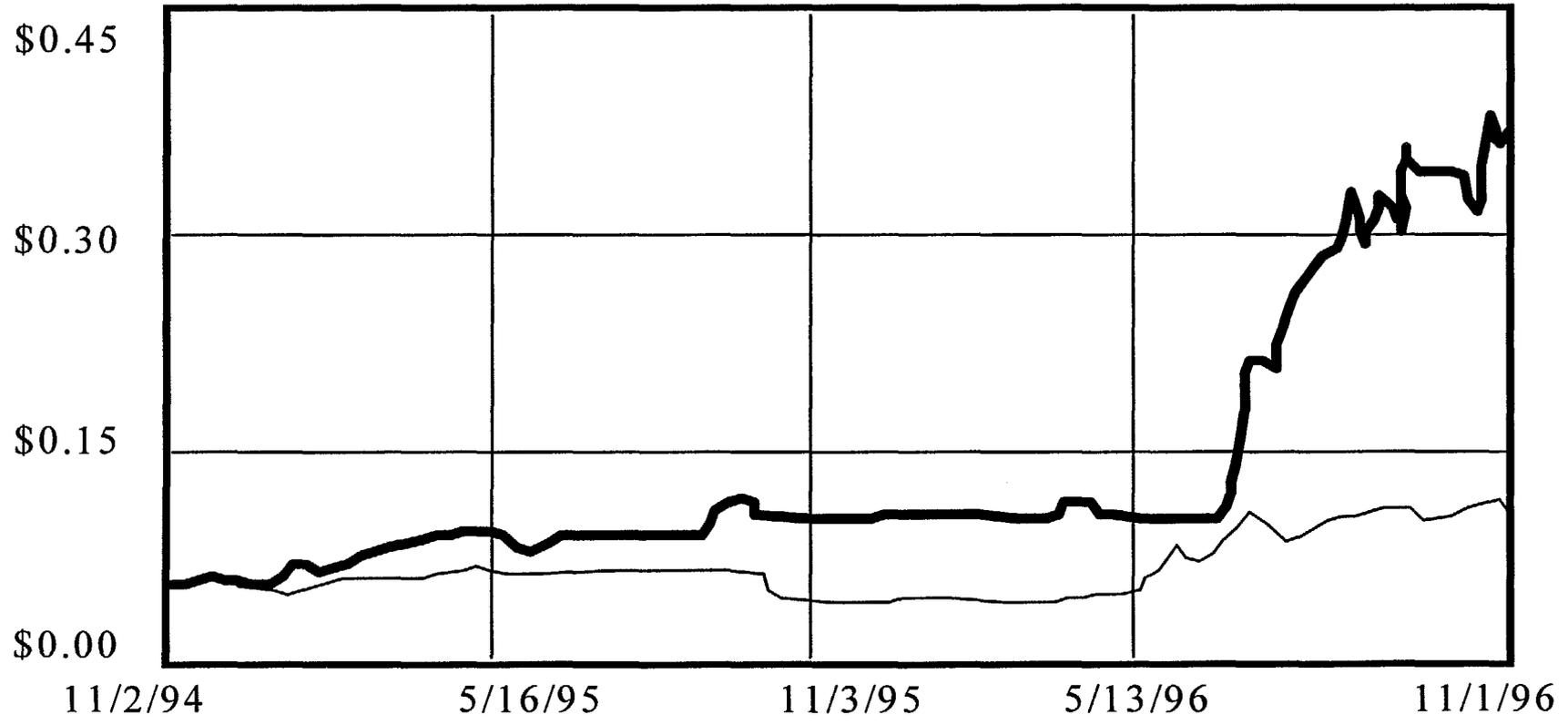
¹ Please refer to the Equity Market Notes, Appendix 1. These notes were produced by CFED as an integral part of this manual and accompanying workshop. Participants should refer to these notes when reviewing the accompanying profiles and case studies.

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TsUM Background

- A restructuring and modernisation of TsUM is required in order to expand the trading area, increase the turnover and profit.
- The cost of the project is \$24 million.
- The forecast revenues of the company are from \$3.5 to \$4 million in 1996 and from \$6.1 to \$6.9 million in 1997.
- TsUM raised \$10.8 million by the third share issue.

Price V. Industry Index (US\$)



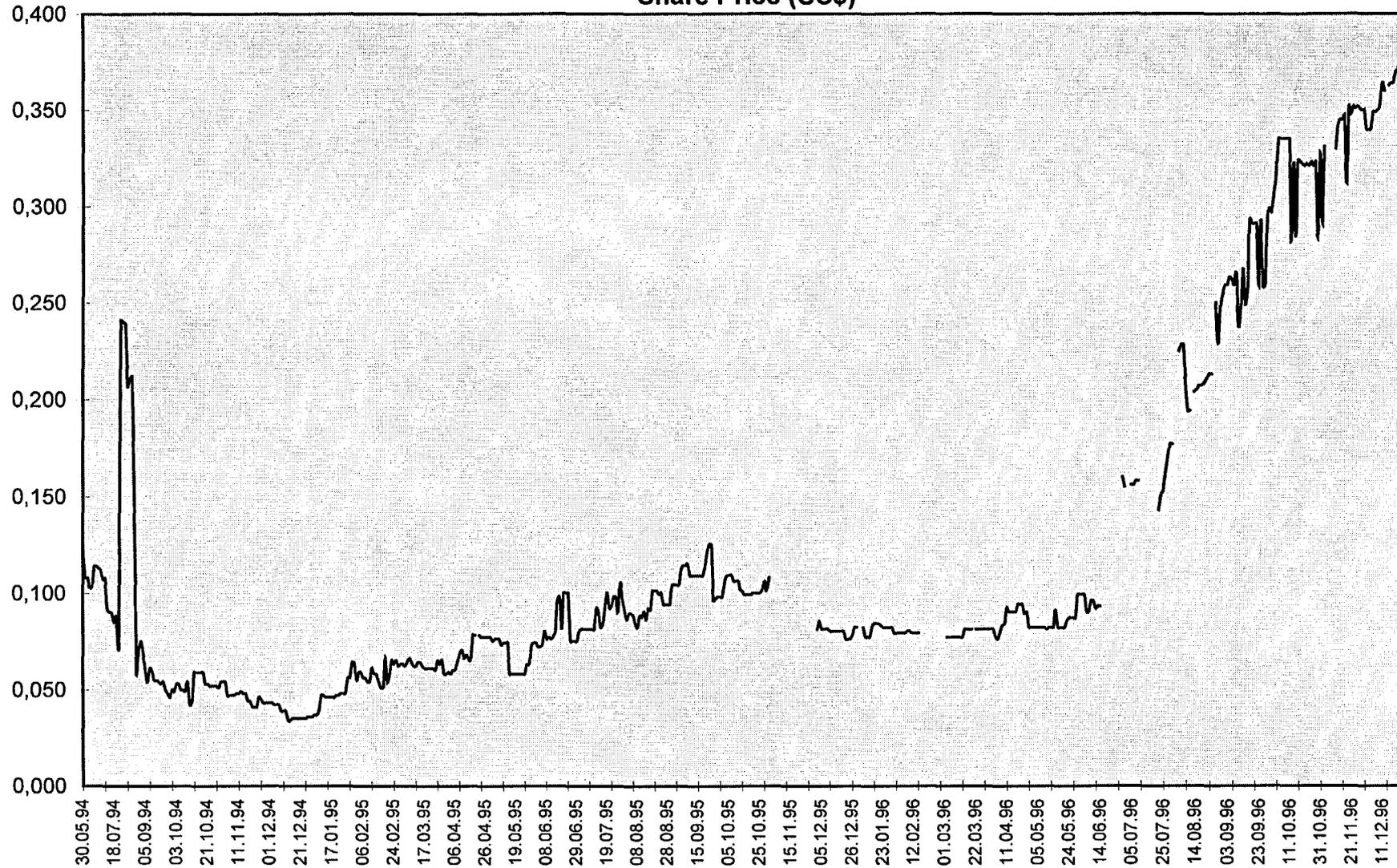
** Representation based on Skate Press Source

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Share Price
History

TSUM Company Profile TSUM

Share Price (US\$)



ff

TsUM
Key Financial Characteristics

Income Highlights (\$ thous)	1994	1995
Total revenue	6,998	11,749
Net income	2,169	2,961
Net profit margin	31.0%	25.2%
Balance Sheet Highlights (\$ thous)		
Current assets	4,955	7,517
Accounts receivable	267	982
Non-current assets	10,693	7,252
Total Assets	15,649	14,769
Current liabilities	3,103	5,753
Accounts payable	2,678	5,123
Non-current liabilities	1,264	1,143
Total liabilities	4,368	6,896
Shareholders' equity	11,281	7,872
Current assets/Current liabilities	1.60	1.31
Tot. liabilities/Shareholders' equity	0.39	0.88

Source: Offering Memorandum

Who?

Managers Who Want to Raise Capital through Share Issues

Criteria:

- Dynamic and qualified managers open to new investors
- Good financial condition and prospects for the future
- Sufficient size

What?

Example of How to Place a New Share Issue

- TsUM's share issue is the first new issue by a Russian company, sold in the Russian market, which successfully placed all its shares.
- TsUM is not a large, oil and gas utility or telecommunications company (the usual market favorites).
- Financial characteristics are satisfactory but not "Blue Chip."
- Most of the shares were acquired by foreign investors. Out of 24 institutional investors, 14 were foreign. Approximately 500 individual investors also bought TsUM's shares.

**When?
Where?**

- TsUM's financial advisor, OLMA company, started negotiations with potential investors in May of 1996
- The deal was completed in December of 1996
- The transaction was placed in the Russia based market, however TsUM is planning a Level I ADR program in order to attract a broader range of investors.

**Why?
Raise money for modernisation and expansion on favorable terms**

- To sell shares at the highest price
- To balance different sources of funding in the company

How?

Step 1.

- Prepare the company for improved share market performance (well in advance of actual share issue).

Choose a financial advisor

Improve disclosure processes (for example):

- publications in press
- videotape on TV
- press-conferences on important events in the company

Auditing

The purpose of Step 1 is to develop a higher share price at the time of the future issue, as well as a ready market of core investors for the new issue.

Step 2.

- Prepare and register the issue and all required documents
- Develop pricing strategy

Step 3.

- Take steps on actual placement of the issue in the market

Note:

The following "How" tables are general in application, and not specifically related to TsUM. The tables take into account the Federal Commission for the Securities Market Regulation 19. (The registration of the TsUM issue preceded Regulation 19.)

How?²

Step 1: Preparing the company for improved share market performance (well in advance of actual share issue).

WHAT	WHY	BY WHOM	HOW LONG	HOW MUCH
Information Memorandum In English and Russian describing: <ul style="list-style-type: none"> ■ The company, and its ■ Activities ■ Equipment ■ Investment and business plans ■ Strategy ■ Management 	Basic document required by any institutional investor	Independent financial advisor, but signed and checked by the company, and prepared on the basis of materials provided by the company	1 to 2 months	\$10,000 - \$25,000
Newsletter Quarterly newsletter in English and Russian, sent to existing and prospective investors containing: <ul style="list-style-type: none"> ■ Latest company information ■ Update of financial events ■ Upcoming Events 	Necessary to keep institutional investors informed and to avoid misunderstandings	The company	Every three months	Production and distribution costs
Videotape Describing the company	Not necessary, but useful and impressive during conferences	Specialised production company	1-2 weeks	Approximately \$ 5,000
IAS Accounting	Not essential, but gives comfort to investors and is evidence of company openness to them.	Preferably, a well-known international audit firm	6 months	\$100,000 - \$200,000
Registrar/Trading Improve share registrar and be included in a well known trading system (for example, RTS)	It is necessary to provide an easier access to the company's shares for investors. This will also have an impact on the share price	The company and financial advisor	several months prior to the beginning of sales	depends on a contract with a registrar

² The following "How" tables are general in application, and not specifically related to TsUM. The tables take into account the Federal Commission for the Securities Market Regulation 19. (The registration of the TsUM issue preceded Regulation 19.)

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How?
Step 2 : Preparation and Registration of Required Documents
Pricing

WHAT	WHY	BY WHOM	HOW LONG	HOW MUCH
<p>Registration:</p> <ul style="list-style-type: none"> • File application (Regulation 19, Annex 1) Prepare and register corporate decision on issue (Reg. 19, Annex 2) Register issue (obtain registration notification) • Prepare (if necessary) and register issue prospectus (format and disclosure requirements as per Reg. 19, Annexes 3, 4 and 5) • Disclose the information in the prospectus • Registration of the Report on the Results of the Securities Issue (Annex 6) • Disclose the information in the Report 	<p>Compliance with Federal Commission for the Securities Market's Regulation 19</p> <p>Meet investors' requirements for proper compliance and full disclosure</p>	<p>Financial advisor/ lead manager and the company</p>	<p>Three - six months</p>	<p>Registration Fees:</p> <p>Financial advisor's fees vary and may be included in the placement fee.</p>
<p>Amend charter, register the amended</p>	<p>Charter should reflect changes in the size of Charter Capital</p>	<p>AGM/Board of Directors as per the proposal to increase the charter capital through a share issue</p>		
<p>Prepare printed materials:</p> <ul style="list-style-type: none"> • Issue prospectus • Selling Memorandum (no longer essential because of the new disclosure requirements for the prospectus, as required in Regulation 19) • Copy of Charter 	<p>Inform investors (and comply with Regulation 19)</p>	<p>Financial advisor/ lead manager, company and printer</p>	<p>Three - six months</p> <p>Selling memorandum will be finalised just before the issue, since it will contain pricing information.</p>	<p>Financial advisor's fees vary and may be included in the placement fee.</p> <p>Depends on contract with the printing company.</p>
<p>Pricing:</p> <p>Price the issue (using a combination of techniques, including: comparison with similar companies, adjusted book value and discounted cash flow).</p>	<p>Determine the price that will raise maximum capital, while being a success in the market.</p>	<p>Financial advisor/ lead manager and the company.</p>	<p>Prior to the placement</p>	<p>Part of advisor's role as lead manager.</p>

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How?
Step 3 : Placement of Shares

WHAT	WHY	BY WHOM	HOW LONG	HOW MUCH
Sell shares	Purpose of placement	Lead manager and agents	Depends on the success of placement	Varies, approximately 5% of funds raised
Coordinate and register payments	Control the selling/payment process	Lead manager	During the period of placement	Part of the lead manager's compensation
Control the issue account	Control and certify transfer of property rights to the shares that are being sold	Registrar	During the period of placement	According to the contract with Registrar
Place Tombstone ³ advertisement in major newspapers and specialised publications.	Provides publicity and useful information to issuers, market participants and investors	Financial advisor/lead manager	Following the offering	According to contract with publications

³ You can find a a sample tombstone of TsUM at the end of this text. For a discussion of these terms, see Appendix 8, Press Coverage of Corporate Governance in Russia, article by Victor Karetnikov, "New Share Issues - American Style," *Dyelovoi Express*. February 19, 1997. Moscow.

TSUM
Discussion Topics

It is 1997, but the situation is absolutely as it was in the middle of May 1996.

Your team will play the role of the Board of Directors of TsUM. A meeting of the Board of Directors has been called to elect a new Chairman, and then finalize a plan for financing the company's capital expenditure requirements - \$24,000,000 over the period 1997-1998, as reported by the Construction Company hired for reconstruction of the building. The board has already decided to raise half the required amount through a new equity issue.

Please:

- Determine the necessary steps to realize the method of raising capital that you have selected, a new equity issue (corporate governance steps for proper approval and implementation of your recommendations, as well as procedural steps for proper government registration and disclosure).
- Be prepared to justify procedural steps taken or recommended by reference to current legislation or regulations.
- Prepare an agenda for the Annual General Meeting (AGM), if necessary.
- Determine points for cooperative work with your financial advisor (market-maker).

Please make reasonable assumptions about any company information or other material information not provided.

TsUM¹

Russian JSC Profile²

Introduction:

Industry: retail trade

Charter capital: about 90 billion rubles

Number of employees: 2492

Description:

Area: 160 thousand square meters

Main type of business of the issuer: trade

The main building of TsUM is located in the center of Moscow - between the Bolshoi and Maly theaters, in the busiest part of the historical center. It is situated on the crossroads of the Petrovka street (now it has its old name again "Karetny Ryad"), Kuznetsky Most street and Neglinka street, within several minutes' walk from the metro stations "Okhotny Ryad," "Kuznetsky Most," "Lubyanka" and "Teatralnaya" with total capacity of 3 and a half million people a day.

In spite of the fact that TsUM is located in the middle of the commercial center of Moscow, it does not have competitors among stores of the same class, since GUM, for instance, is far from TsUM according to European standards and it also requires restructuring and also, what is more important, is more expensive. Another store "Detsky Mir" is not a competitor because of its specialization and because its building is the oldest of all and needs restructuring badly. A commercial center "Manezhnaya Ploshad" that is being built nearby would have extremely expensive shops for very rich people. Still another neighboring store "Petrovsky Passage" is also very expensive for well off people.

TsUM once chose to orient towards middle class customers. As a result, of the TsUM's policy of average prices the trading margin in 1994 -1996 was 18-20%, which was considered to be minimum. For example, GUM had a trading margin of 25.2% in 1995.

History of TsUM

TsUM history dates back to over 100 years ago. The store "Mur and Meryleis" was opened in Moscow in 1885 by a well-known wholesale company with the same name founded by two Scots, Archibald Meryleis and Andrew Moor. The first store of ladies' hats was located at the corner of Kuznetsky Most and Petrovka (in the "house of Khomyakov"). This store is still a part of TsUM. In the same year the company

¹ This text was produced by CFED as of December 1996, using the AK&M data base, materials provided by the companies Skate Press and Olma.

² Please refer to the Equity Market Notes, Appendix 1. These Equity Market Notes were produced by CFED as an integral part of this manual and accompanying workshop. Participants should refer to these notes when reviewing the accompanying profiles and case studies.

bought a building for the store on Teatralnaya Ploshad in the location of the present TsUM. The decision was made to open a big department store similar to Whiteley in London or Bon Marche in Paris.

Already in 1889 there were 25 departments in the store. This was the first large department store in Russia and remained so until the Revolution. In 1892 there was a fire in the store, but its consequences were quickly eliminated.

After the devastating fire in 1900 the store burnt down completely. It was decided to construct a new building at the same place. The design of a new seven-story building was developed by a famous architect R. Klein. For the first time in Russia a new construction technology with reinforced concrete was used and because the walls were thinner trading area could be increased significantly. A new building attracted everybody's attention and was considered to be a masterpiece of architecture.

A new store was opened on Christmas in 1908 and it caused a lot of interest because of its modern equipment (high speed passenger lifts were used here for the first time in Russia), European convenience, and exquisite design. In 1907 the department store became a joint stock company (using the present terminology - "closed type JSC"). 3,000 shares were issued and distributed among the members of Moor's and Merylies' families. The last decision on increasing the charter capital was made on October 25th 1917 (7th of November), however for well known reasons this decision was not fulfilled.

In 1908-1917 the turnover was quickly growing and the scope of the company's business was increasing. In 1913 there were 80 departments in the store as in the biggest stores in London. The level of the turnover and equipment of Moor and Merlies store could be easily compared with those of Harrods. The net profit was 1 million rubles in 1913 and in 1915 it was over 1.5 million rubles (30 billion rubles in today's prices, i.e. twice as much as in 1995).

In autumn 1918 the store was plundered; in November it was nationalized. Building #2 made of glass and metal was constructed in the seventies and now belongs to the JSC.

Privatization

Second type of privatization.

In December of 1995 Moscow government adopted a decree on changes in the plan of TSUM's privatization. These changes included among other things use of modern technologies for restructuring of the trading facilities and restructuring itself without closing down the store. According to this decree the share of the Moscow government in the JSC TsUM was to be increased to 24.5%. This increase was done by transferring of the #2 TsUM building (the area: 17.66 thousand sq. meters) from the city to the company. The Moscow government instructed the Board of State Control over Preservation and Use of Historical and Cultural Monuments to sign with the JSC a lease agreement for 49 years, to lease for the main building #1 of the department store to the JSC. The terms of the lease stipulated that, within five years

after the date of signing this lease agreement, the JSC would be excused up to 70% of the rent if that amount were allocated to restructuring and modernization of the building. Moscow government also decreed to exclude several affiliated branches previously included in the charter capital of TsUM from the privatization plan.

Financial Characteristics of TsUM Activities

	1993 millions rubles	1994 millions rubles	1995 millions rubles
Sales	6,304	24,843	53,455

TsUM was able to finish 1995 with a profit of 13.5 billion rubles; the turnover in 1995 was 70% over the 1994 turnover (in USD).

Disclosure

In 1995 upon recommendation of its financial advisor, OLMA, TsUM launched a campaign on improving disclosure. Financial information became more accessible for shareholders. All most important questions are discussed at the meetings of the Board of Directors, which are held once a month and during the period of preparing for the general meeting - once a week.

In order to inform potential investors the JSC published the following booklets:

- The Charter and Issue Prospectus
- Offer for sale of 30,000,000 shares

These documents provide full information about the company, its structure, management, financial condition, and performance and can not but make investors trust the company and motivate them to buy its shares.

The JSC published a large ad on public sales of its shares in the newspaper "Financial News". This also played a positive role in successful placement of the shares.

Communication with Shareholders

Managers of the JSC together with OLMA try to keep up the price of shares in the secondary market. It's worth mentioning that the administration of the JSC unlike many other Russian JSCs is not a holder of large packages.

Because of the policy of openness and disclosure pursued by the management it is supported by 90% of votes of shareholders attended the general meeting.

Thus, at the meeting in June 11, 1996 all decisions were approved by 99% of votes.

Meetings of Shareholders

On December 28, 1995 an extraordinary meeting of shareholders was held. The following decisions were made: to take into consideration the information on accomplishing the decisions made by the general annual meeting of shareholders, to approve main guidelines for the future development, to analyze the information on the audit of the financial and economic performance, to appoint Mr. A.S. Voskoboinikov to the position of the General Director, to increase the number of members of the Inspection Commission to 5, to approve a new edition of the Charter of the JSC TsUM.

On June 11, 1996, a general meeting was held to discuss the results of 1995. The following decisions were made: to increase the Charter capital from 119.315 million rubles to 59 billion 657 million 500 thousand rubles and to increase the nominal value of a share up to 1000 rubles because of the reevaluation of the fixed assets of the JSC, to pay dividends in the amount of 20 rubles per one ordinary share with the nominal value of 2 rubles.

The increase of the Charter capital was done in accordance with the Letter of the Ministry of Finance of the RF # 14 "On issues related to evaluation of the assets of privatized enterprises, and on the Order of changing charter capitals because of the reevaluation of the fixed assets of the JSCs as of 01.01.94". This also proves that TsUM was trying to protect interests of its shareholders before placing the shares of the new issue into the market.

Information on Share Issues

TsUM's shares first appeared at the stock market on August 13th 1994 when the first voucher auction was held. But the first quotations of TsUM's shares were registered already on August 25, 1993 according to AK&M agency. In January 1996 TsUM's shares were included in the RTS listing. This led to the increase of the volume of trading and raise of quotations. However, the decisive effect on quotations' raise was made by the news that financial results of TsUM's activities were disclosed at the general annual meeting and it was announced that modernization of TsUM would be started soon. The decision was made to increase the nominal value of a share to 1,000 rubles. At present TsUM's shares are among the most liquid Russian shares after the "Blue Chips".

On July 30, 1996 Department of Finance of Moscow registered the increase of the charter capital of TsUM from 119.3 million rubles to 59.7 billion rubles because of the change in the nominal value of a share from 2 to 1,000 rubles (total quantity of TsUM's shares was not changed); totally 59,657,500 shares with the nominal value of 1,000 were issued. The decision on increasing of the charter capital because of the revaluation of the fixed assets was made by the general annual meeting of shareholders on June 11, 1996. According to the issue prospectus shares of the new issue will be distributed among shareholders in accordance with their stakes in the charter capital and shares of the old issue were to be liquidated.

On September 6, 1996 the Department of Finance of Moscow registered the third issue of TsUM's ordinary shares in the total amount of 30 000 000 with the nominal value of 1 000 rubles. The capital raised after the issue will be used on TsUM's restructuring which shall be over by 850th anniversary of Moscow.

As a result of the issue the charter capital of TsUM was increased by one third and now is almost 90 billion rubles. According to OLMA General Director, Mr. Oleg Yachnik, at the moment about 30% of the charter capital belongs to foreign investors. So there is a chance that they could have bought most of the shares issued in October.

By the end of 1996 TsUM sold all the 30 million ordinary shares of the third issue. Placement of shares started on October 1. OLMA investment company was the lead manager and financial advisor. The placement agent was a bank "Societe Generale Vostok".

Fourteen financial institutions from Belgium, Great Britain, Hong-Kong, USA, France, Switzerland, and Sweden became TSUM's shareholders. Only two or three funds have packages of over 5% of the charter capital. Millenium Fund is one of those more or less big buyers.

TsUM's shares were also purchased by 10 Russian companies, including Agroprombank, Unibestbank, and a specialized investment fund "Energy". Individuals hold only 1% in the charter capital. About 500 individual investors took part in the latest placement. However, the majority was not TsUM's shareholders before.

The placement price was 2 000 rubles, i.e. twice as much as the nominal value. So the JSC received 60 billion rubles.

By January 1st 1996 the P/E ratio was 1.68 which proved that TsUM's shares were underestimated in the secondary market and also that they have a potential for growth. By August 1996 the P/E ratio was already 5.5 which is almost the same as GUM's P/E ratio. Most western companies of the similar class have P/E ratios of 15-20, so TsUM's shares have a potential for growth and this can be also proved by the low P/S ratio, which is three times less than GUM's and 6 times less than that of western department stores.

Dividend History

Year	Dividends (rubles and % of the nominal value)
1993	4 (200%)
1994	20 (1000%)
1995	20 (1000%)

Registrars

The registrar of JSC TsUM is an open type JSC "Mosckovsky Fondovy Center" (Moscow Stock Center).

Large-scale Projects and Modernization Program

According to the Decree of the Government of Moscow TsUM was put onto the priority list of constructions that should be restructured and modernized by the 850th anniversary of the city. Not long ago an agreement was signed according to which OLMa investment company became a financial advisor of TsUM.

During the last few years, TsUM's building was several times restructured, repaired and reorganized. Unfortunately, further development of TsUM into a modern class western type department store is being hindered by several factors. Total area of the building is 30 800 square meters. Trading area is about 9 300 thousand square meters, i.e. not more than 1/3 of the entire area. It is located in the first and second buildings and because of architectural peculiarities most of the space is not utilized for trading, but is used for staircases, corridors and passages. The first building is connected to the second one only on one floor - so that customers usually come to only one building. As of July 1st 1996 the trading area of JSC TsUM occupies 38% of the total area, i.e. 3 532 square meters. It is not possible to create a modern department store with large variety of goods on such area. It's necessary to consider also that maintaining the store in working condition requires investment of 10% of the net profit.

A large quantity of independent companies- tenants led to the situation when the same goods can be found at different departments in random combinations.

After a number of restructurings and numerous changes to the store there are more than ten entrances now. All of them are narrow and very inconvenient. And at the same time there is not a single central entrance where a customer could look at the map of the store and for location of different departments.

It is obvious the existing requirements can not be met by small repairs or reorganization or by changing the location of few departments. The experience shows that such approach leads to waste of money and complete loss of the image. In order to turn TsUM into a modern department store where customers could spend minimum time on buying all the necessary goods it will be necessary to have a fundamental restructuring.

At the end of 1995 - beginning of 1996 TsUM held an open international tender for drafting a project of restructuring and its implementation. Several Russian and western companies participated in the tender.

The winner of the competition was a German company ReDesign Einrichtung GmbH, which offered the most attractive contract terms. The choice of this company

was approved by Department of Trade and Moscow Government who appointed ReDesign Einrichtung GmbH the chief contractor for TsUM's restructuring.

ReDesign Einrichtung GmbH is one of the leading and most famous design and constructing companies in Germany and all over Europe, specializing in redesigning and equipping big department stores. The company participated in restructuring of such stores as Herties, Karstadt, Oberpaur, KDW (Germany) and other largest specialty stores, like Neckermann, Ricard, Inter.

The draft of restructuring provides for expanding the space on the first floor by building up the area under awnings, covering the passage between Neglinka and Petrovka streets and joining the first and second buildings into one complex. Offices will be moved out from the third and fourth floors and the space will be taken by trading departments. Some of the offices will be also moved out of the fifth floor. They will be replaced with trading halls. An exhibition hall will be opened on the fifth floor. These and a few other improvements supposedly will make it possible to increase the "production" capacity of TsUM.

Total amount of restructuring according to the preliminary draft is about 20 million dollars.

ReDesign Einrichtung GmbH agreed to do the work without stopping the trading process and that will allow to have minimum profit loss. The project completion date is 1st of July 1996. As a result of restructuring that should be over by September 1997 the trading area of TsUM will be increased by 63%.

It is assumed that after restructuring the department store will have relatively low prices compared to "Petrovsky Passage", for example, or "Roditi" or "Arbatsky Dom" and will be affordable for middle class customers. It will be possible to buy all kinds of consumer goods at the store saving a lot of time and money. There are no stores of this kind in the center of Moscow nor in Russia, in general.

On January 29, 1997 an opening ceremony of the fifth floor was held. The first stage of restructuring cost TsUM 5 million dollars. 3 million out of 5 was TsUM's money, the rest was loans, including funds from companies-lessees which trade in TsUM's premises.

Additionally, about 2,5 thousand square meters more of trading area are being created. This area will be taken by different trading departments, such as audio-video goods, consumer goods, home appliances, toys, souvenirs, office supplies.

At the moment the fourth floor is being restructured and it is supposed to be operational in March of 1997. After restructuring there will be departments of ware, carpets, fabrics, yarn and home appliances.

The restructuring of TsUM will be completed by the 850th anniversary of Moscow.

Issue of I Level ADR

The JSC is planning an ADR Program. The investment advisor of TsUM, OLMA, is currently preparing all the documents required for ADR program. These documents will be sent to SEC already in March. But as of now a western consultant who will be taking care of ADR placement and a depository bank have not been selected yet.

Audit

The auditor of TsUM is "Alex-Audit".

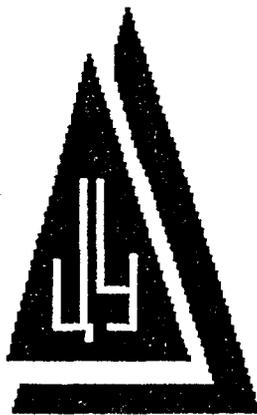
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**Joint Stock Company
CUM Trading House**

Share Offering

**30 000 000
common stocks
of the third issue**





"Торговый Дом ЦУМ"

Открытое Акционерное Общество
"Торговый Дом ЦУМ"

Зарегистрировано Московской Регистрационной Палатой 17 декабря 1992г.,
регистрационный номер 20221

Предложение о продаже

30 000 000

(тридцать миллионов) обыкновенных именных акций
номинальной стоимостью 1000 рублей
по цене 2000 рублей за каждую акцию

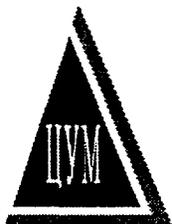
- Проспект эмиссии зарегистрирован
Министерством финансов Российской Федерации
06 сентября 1996 года за № МФ 73-1-01391

*Ведущий менеджер -
Акционерное Общество Открытого Типа
Инвестиционная Фирма ОЛМА
Агент по размещению*

December 1996

All of these securities having been sold, this announcement appears as a matter of record only

New Issue



30,000,000 Shares

TsUM Trading House

Common Stock

Lead Manager

OLMA Investment Company

Placing Agents



INVESTMENT COMPANY



BANQUE SOCIETE GENERALE VOSTOK

Khlebny Dom New Share Issue¹

Who?	Managers of medium sized companies who want to raise capital through new share issues
What?	Example of good governance and disclosure in the context of raising capital
When?	Minimum six months from now
Where?	Within the JSC and in the market
Why?	Raise capital for modernisation and expansion of business activities
How?	Demonstrate commitment to good corporate governance, openness, disclosure and respect for shareholders' rights

¹ Please refer to the Equity Market Notes, Appendix 1. These notes were produced by CFED as an integral part of this manual and accompanying workshop. Participants should refer to these notes when reviewing the accompanying profiles and case studies.

Khlebny Dom New Share Issue -- Plan (Second part of 1995)

Landmark Issue sets New Disclosure Standards for St. Petersburg

On August 31, 1995, Khlebny Dom, the largest bakery in St. Petersburg, announced the launch of its public share issue for cash -- offering 13,812,192 ordinary shares to investors at a price of R1,125 per share (13,818,192 shares X R1,125 = R15,545,466 thousand).

The Information Memorandum contained a level of detail about Khlebny Dom unprecedented in a public share issue by a St. Petersburg company. The issue pioneered the concept of transparency in financial and corporate disclosure, giving the Russian public the fullest possible opportunity to make a properly considered decision on investing in a newly-floated enterprise.

Investment in Modernisation and New Product Development

The proceeds of the sale were intended for use largely to replace existing ovens, improve product quality, increase the bakery's already extensive product range and gear up further its marketing operation.

Offer Structured for Maximum Shareholder Appeal

"We want Khlebny Dom to have a wide shareholder base, one which is fully informed about the activities of the company, its financial position and future prospects. We want shareholders to know as precisely as possible what they are investing in and without making false promises," -- Chairman of Lenstromateriali, brokerage house leading the issue

Source: Khlebny Dom press release, August 31, 1995

Goal

"One of the goals of the Khlebny Dom offering is to demonstrate to well run companies in Russia that they can raise capital by opening their books to the public. I hope it will show the way to other companies" -- British Know How Fund

Source: Moscow Times, September 1, 1995

Russian, Institutional Market

In practice, the main buyers will be institutional investors, rather than retail investors. The shares will be offered in St. Petersburg and other cities. The shares will be targeted solely at Russian investors.

Source: Moscow Times, August 30, 1995

Khlebny Dom
New Share Issue – Result

The company has recently met a significant increase in local demand for its products through the installation of new capacity.

The company first caught the attention of the international investment community in September 1995, when it successfully placed 23% of its equity -- or 13,818,192 shares -- with various institutional investors. The issue was taken up as follows:

- 72% Domestic banks (including Promstroybank, St. Petersburg Bank, Bank-Credit St. Petersburg and Bank Petrovsky)
- 15% Investment funds
- 9% Retail investors
- 4% Brokers

Source: Skate Press, The Skate Blue Chips, November 1, 1996

Khlebny Dom
Key Financial Characteristics

Income Highlights (R mlns)	1993	1994	3 months 1995
Total revenue	7,463	35,830	14,659
Net income	886	6,239	1,799
Net profit margin	11.87%	17.41%	12.27%
Balance Sheet Highlights (R mlns)			
Current assets	1,294	6,416	9,448
Accounts receivable	269	806	2,058
Non-current assets	191	2,604	6,190
Total Assets	1,485	9,020	15,638
Current liabilities	856	1,804	3,454
Accounts payable	726	1,320	3,085
Non-current liabilities	0	846	871
Total liabilities	856	2,650	4,325
Shareholders' equity	629	6,370	11,313
Current assets/Current liabilities	1.5	3.6	2.7
Tot. liabilities/Shareholders' equity	1.4	.4	.4
P/E ratio	not traded	not traded	not traded

Source: Skate Press

How?

Demonstrate Commitment to good corporate governance, openness, disclosure and shareholders' rights

**Information Memorandum
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**Information Memorandum
Comments and Excerpts**

Outstanding effort at disclosure and issuer transparency

Clear exposition of governance and management structure – anticipating the new Joint-Stock Company Law

- General Meeting of Shareholders as the highest governing body
- Election and role of the Board of Directors
- Appointment of General Director
- Role of Management Committee
- Provisions in charter to resolve conflicts of interest

Undertakings of the Board of Directors

“The Board of Directors intends to manage the affairs of the Company in accordance with standards of good faith and competence. To the extent that these standards are not [yet] incorporated in the Company’s Charter or required as a matter of law, the Board of Directors has given the undertakings set out [in the subsequent section].”

Shareholders’ rights (one of the Undertakings of the Board of Directors)

“The Company will treat all shareholders equally and shall not place the interests of any one shareholder or group of shareholders above those of others. In managing the Company the directors will take into account the interests of minority shareholders...”

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Klebny Dom Discussion Topics

In 1995, Klebny Dom raised Roubles 15,545,466 thousand by placing 23% of its equity through a public offering, which, ultimately, was purchased almost entirely by institutional investors. There are 60,000,000 shares outstanding, most of which are owned by management and traded only very rarely. Klebny Dom is reported to be considering issuing and placing 14 million new shares – which may have the effect of diluting management's control, if they are placed with outside investors. (Trades in early 1997 point to a market price of about \$.20 a share; accordingly, sale of 14,000,000 shares would raise approximately \$2,800,000, or Roubles 16,000,000 thousand.)

Your team is the board of a similar company in need of approximately the same amount of capital.

Please consider:

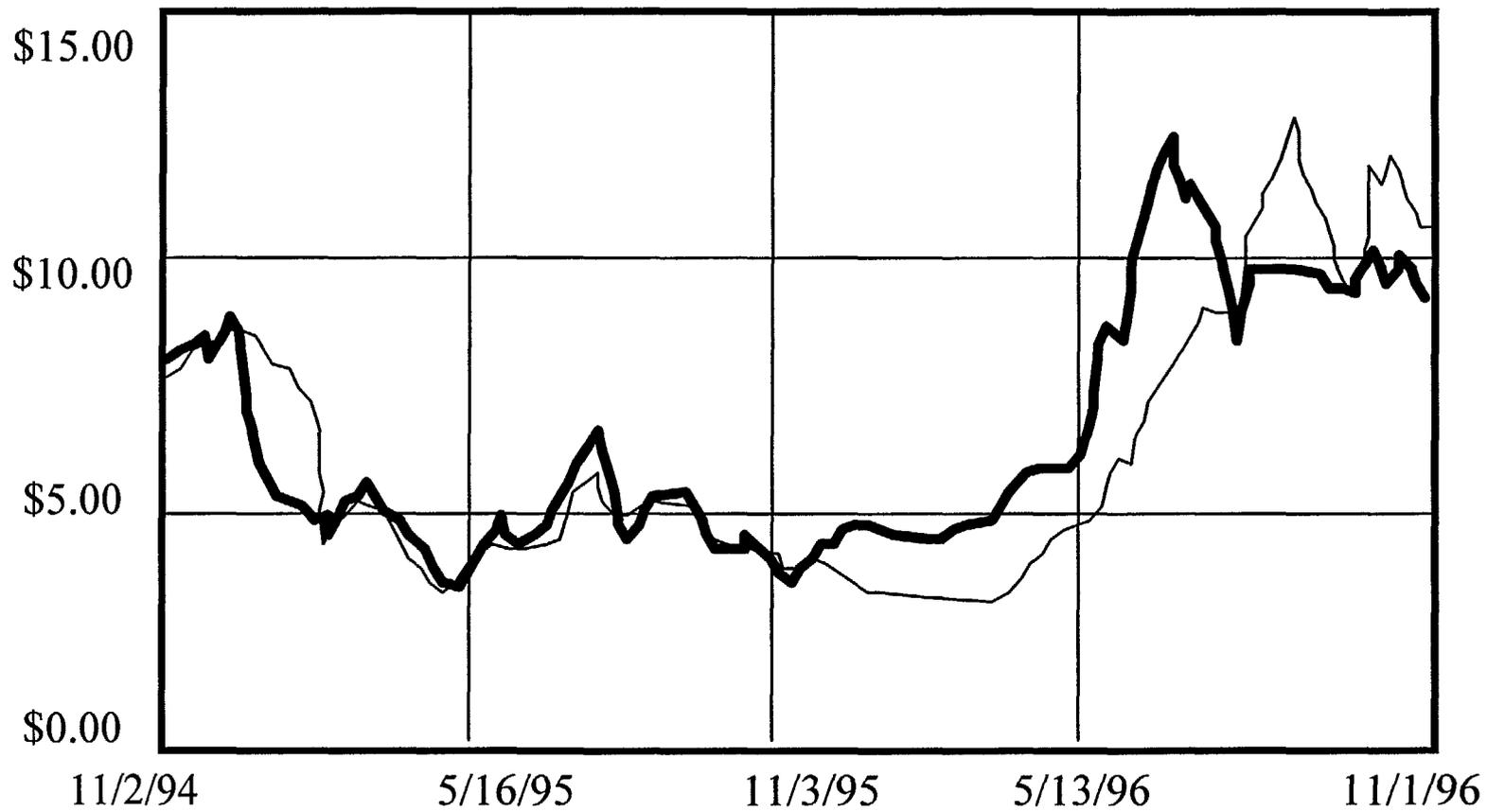
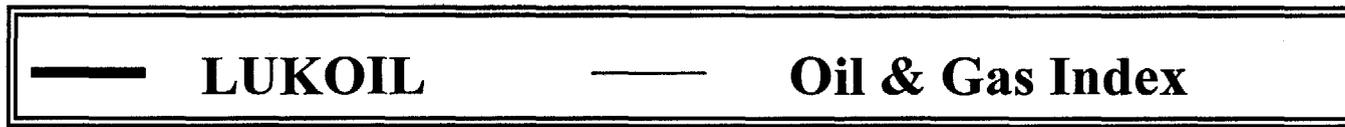
- Advantages or disadvantages of a “private equity/venture capital” transaction vs. a public share issue
- The governance implications and likely demands of the private investor, given his requirement for a clear cut “exit strategy”

LUKoil¹

- Who? Managers interested in reviewing the broad range of Russian and international financing opportunities accessible to a major, successful Russian company
- What? Advantages of a reputation for good governance, openness and respect for shareholder rights
- When? On-going
- Where? Within the JSC, in Russia and major capital markets abroad
- Why?
- Promotes superior capital markets performance and access to more markets
 - Facilitates current and future funding programs
 - Improves attractiveness to potential direct investors and joint-venture partners
- How?
- Make a commitment to good corporate governance
 - Make a commitment to issuer transparency
 - Create a reputation for openness
 - Disseminate information to shareholders, the press, securities industry and investment community

¹ Please refer to the Equity Market Notes, Appendix 1. These notes were prepared by CFED as an integral part of this manual and workshop. Participants should refer to these notes when reviewing the accompanying profiles and case studies.

Price V. Industry Index (US\$)

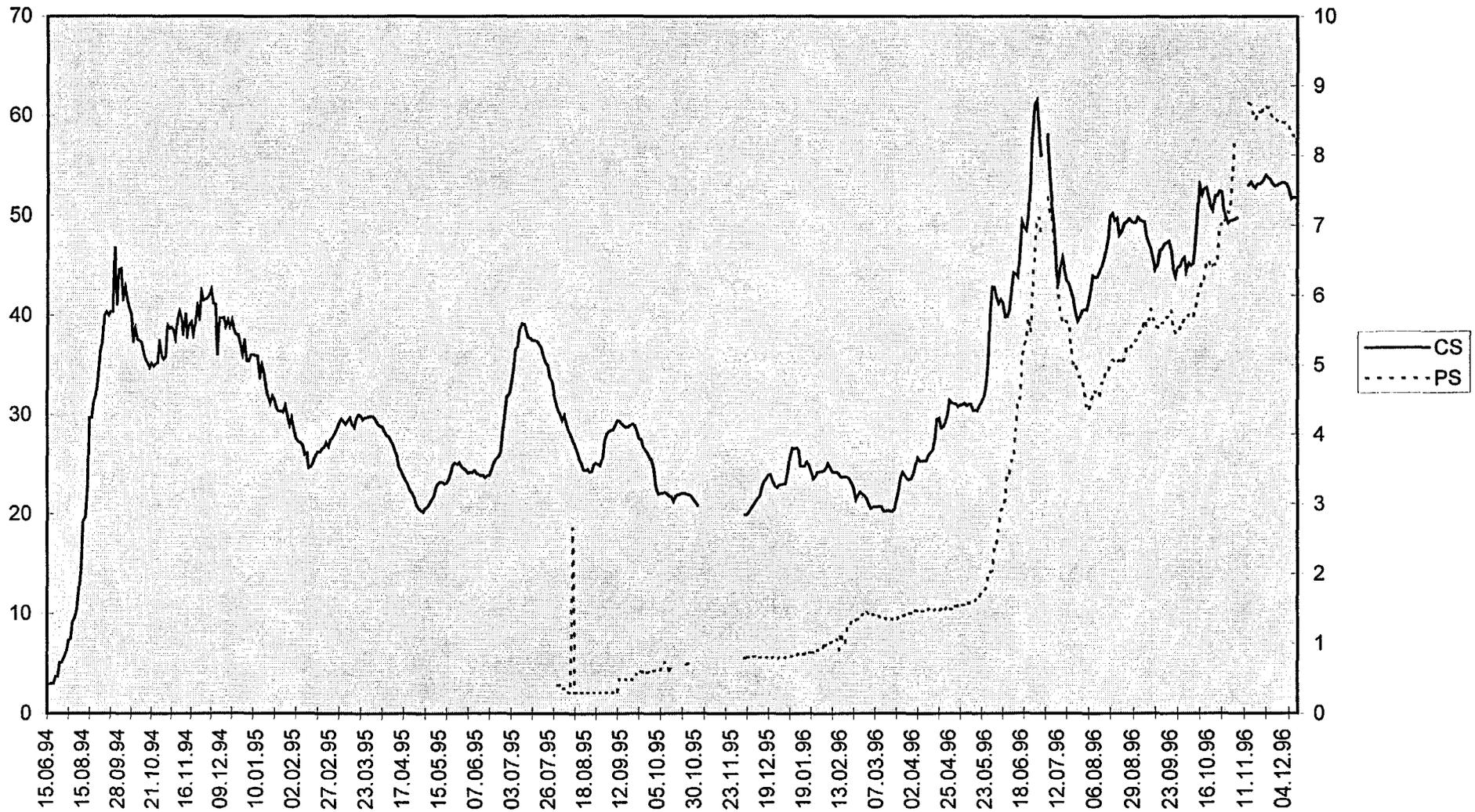


** Representation based on Skate Press Source

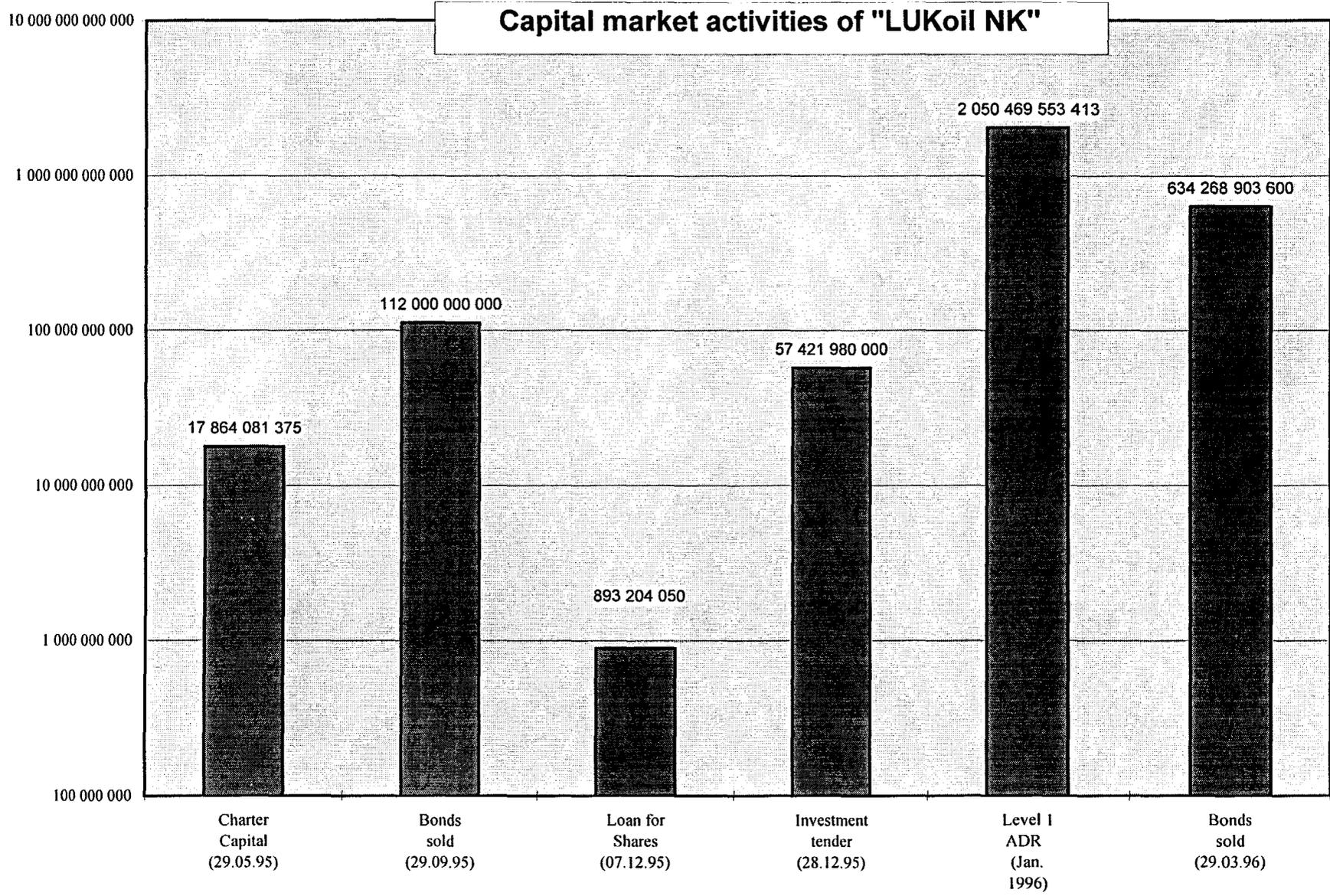
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Share Price
History

LUKOIL Company Profile



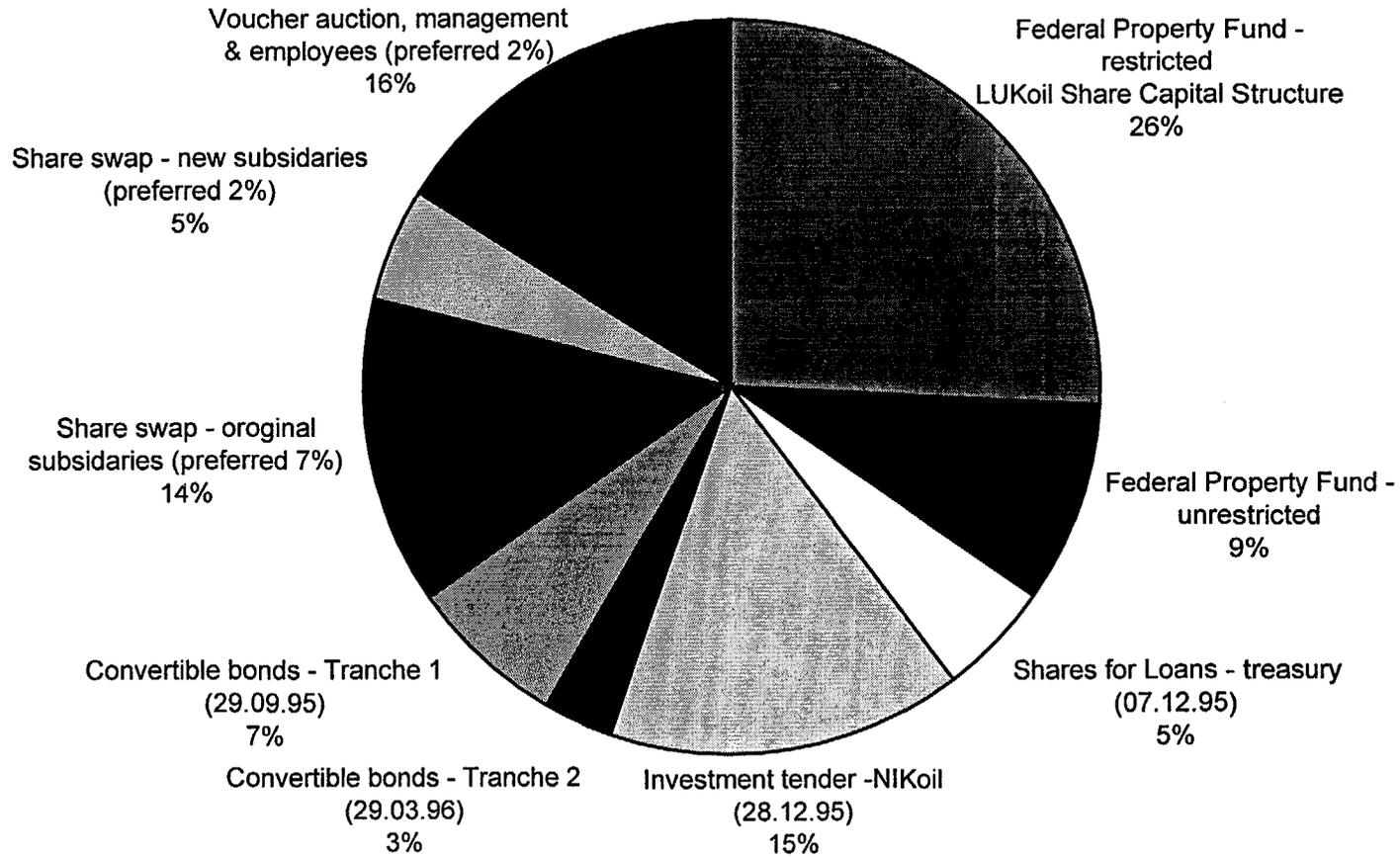
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LUKoil Company Profile

LUKoil Share Capital structure



LUKoil
Key Financial Characteristics

Income Highlights (R mlns)	1994	1995	6 months 1996
Total revenue	4,488,000	20,891,000	23,841,000
Net income	683,000	2,404,000	1,774,000
Net profit margin	15.22%	11.51%	7.5%
Balance Sheet Highlights (R mlns)			
Current assets	3,759,000	11,373,000	17,275,000
Accounts receivable	2,751,000	4,008,000	13,783,000
Non-current assets	8,113,000	32,722,000	47,361,000
Total Assets	11,872,000	44,095,000	64,636,000
Current liabilities	3,923,000	10,256,000	14,339,000
Accounts payable	3,480,000	8,883,000	13,373,000
Non-current liabilities	38,000	457,000	847,000
Total liabilities	3,961,000	10,713,000	15,186,000
Shareholders' equity	7,911,000	33,382,000	50,450,000
Current assets/Current liabilities	.96	1.11	1.20
Tot. liabilities/Shareholders' equity	.50	.32	.30
P/E ratio	20.41X	5.82X	18.89X

Source: Skate Press

LUKoil Discussion Topics

In 1995, Lukoil registered an issue of convertible bonds with the Ministry of Finance of the Russian Federation.

Your team is the board of a large JSC, like Lukoil. You have decided to place a new issue of convertible bonds in the amount of \$25,000,000. Each bond will be convertible into 100 ordinary shares of the JSC at the option of the bond's owner.

Please work with your team to evaluate:

- Which management body of your company has jurisdiction over issuing convertible bonds.
- The reasons – supported by references to specific sections of the Joint-Stock Company Law – for your determination.
- What is management's attitude to debt vs. equity.
- Why investors would choose bonds over equity.

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LUKoil¹

Russian JSC Profile²

Introduction:

Charter capital: 17864 million rubles

Number of employees: 82 900

An oil company, LUKoil at the moment is the largest integrated Russian oil company and a recognized leader of the stock market. Main types of business: survey, oil production, transportation, refining of oil and gas.

Background

1991-1992 - establishment of an oil concern as a result of merging of oil refineries and oil production plants and also regional trading, commercial and service branches.

a) April, 1993 - establishment of Open JSC "NK LUKoil" in accordance with the presidential decree on privatization of enterprises. The company got controlling interest in 3 oil production plants, 2 oil refineries, 7 regional sales companies and 2 service and maintenance companies.

b) Organizational Structure of LUKoil

The company controls 3 large oil refineries, 2 large oil production plants, 7 large regional wholesale and retail oil companies, and 40 trading and service companies in 30 regions of Russia and 16 countries.

Besides, LUKoil has controlling interests in more than 440 sales and service enterprises and financial companies, many of which might become subsidiaries or branches of the company in the near future. Before 1994 all LUKoil's subsidiaries were independent profit centers. But then starting in summer, 1994 in order to rationalize the procedures of sales and payments (reflecting the full vertical integration of the operation) the status of a profit center was taken away from these companies.

Service branches and other subsidiaries being independent legal entities are responsible for their own financial accounting and submit monthly reports and other required documentation to the Company on a quarterly basis.

¹ This text was produced by CFED as of December 1996, using the AK&M data base, materials provided by the companies Skate Press and prepared by the company itself.

²Please refer to the Equity Market Notes, Appendix 1. These Equity Market Notes were produced by CFED as an integral part of this manual and accompanying workshop. Participants should refer to these notes when reviewing the accompanying profiles and case studies.

c) Privatization

In April 1994 LUKoil completed privatization of its subsidiaries.

Privatization of LUKoil itself was done in stages.

- stage of voucher privatization
- stage of auctions
- stage of placement of LUKoil shares in the international markets

d) Relations with central, regional and local authorities.

In accordance with the existing legislation on privatization, central authorities have the right to keep 45% of the company's shares as federal property. Based on that there are representatives of three federal bodies on the company's Board of Directors.

e) Agreements with the Government, including those related to privatization

The first type of agreements is related to government financing of supplies of oil and oil products for state needs. The second type of agreements is related to financing through external loans from international banking organizations, private companies and banks. In accordance with such agreements the company has benefits on additional export quotas in order to be able to make payments on external loans. The company does not have debts related to privatization; the money that the company received after selling shares to the federal bodies was invested in development of production, improving social security and the system of environmental protection.

Openness

LUKoil is one of the Russian "blue chips" companies. Its shares are in demand in the stock market. The success of the company in Russian and international stock markets depends first of all on the good corporate governance and high level of disclosure.

Information on the current activities of the company and its future projects is published in the press; general managers of the company make public presentations and speeches - all of this cultivates trust and improves attractiveness of the company to potential investors as well as promotes good capital market performance. LUKoil is one of the companies with a management style very close to western companies. A strategic analysis of the company was made by McKinsey and Co. LUKoil also contracted for audit KPMG, a well known auditing and consulting company, one of the so-called "Big Six" auditing companies. A company, Miller & Lents, made an independent audit of the west-Siberian reserves of LUKoil. Finally, LUKoil became the first Russian company to start a Level I ADR program.

Evidence of the company's commitment to good corporate governance and respect of shareholders' rights is its regular process of disclosing information on all

aspects of the company's activities, including financial results, new business development and investment projects.

Relations with Shareholders

Regularly published reports on the company's activities as well as full compliance with the existing Law predetermine a high level of trust on the part of investors to the corporate securities of the JSC LUKoil.

It is very important for shareholders that there is no legal basis determining the procedure for a vertically integrated company to acquire 100% of the shares in its subsidiaries through exchange of shares. However, oil companies have the right to do so in accordance with the Presidential Decree from 1995.

High Degree of Integrity with Former Subsidiaries

Like many other large oil companies LUKoil is a large industrial-financial complex, which combines a whole network of enterprises with different types of activities in various regions of Russia and abroad. The company holds 46% of the shares in each of its 10 subsidiaries. Conversion of the shares of the subsidiaries into LUKoil's shares is practically complete.

At the moment there are about 100 enterprises of different legal and organizational structure where LUKoil has its stake; in 50 of them this stake is over 50%, in other LUKoil's capital is from 4 to 50%. The basis for the operation of the regional subsidiaries is LUKoil's concept of their development as a unified financial and economic mechanism.

Two main documents constitute the regulatory framework for the subsidiary joint stock companies:

- regulation on relations between the enterprises included in the unified financial and economic system of JSC LUKoil
- temporary regulation on the order of considering and approving investment projects and visibility studies for regional structures' development.

In order to control and coordinate the activities of the subsidiaries, LUKoil's management made a decision on creating a JSC "LUKoil-Holding-Service".

Information on Share Issues

On July 2, 1993 an issue of ordinary shares with a nominal value of 1,000 rubles for the total amount of 8 184 213 000 rubles was registered (Registration # МФ 73-1п-0231).

Issued:	(1,000) x 8 184 213 shares
---------	----------------------------

The charter capital is 8 184 213 000 rubles.

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On February 14, 1994 an increase of the charter capital for 3 699 990 000 rubles was registered.

	Ordinary shares (nominal value)	preferred shares (nominal value)
Issued	(1,000) - 3 320 463	(1,000) - 379 257
Totally issued	(1,000) - 11 504 676	(1,000) - 379 527

The charter capital is 11 884 203 000 rubles.

On March 14, 1994 - April 11, 1994 - based on the results of the specialized voucher auction there was a split in the share nominal value. The ratio of the split was 1:8. The nominal value after the auction was 125 rubles. Ministry of Finance recorded that appropriate changes were made to the previously registered issue prospectus.

On May 25, 1995 the Ministry of Finance registered a share conversion issue, to exchange for the shares of the subsidiary, in accordance with the Presidential decree # 327 from 11.04.95. The par value of the shares was also changed to 25 rubles.

The total amount of the issue was 5 979 878 375 rubles.

	Ordinary shares (nominal value)	preferred shares (of the A type) (nominal value)
Issued	(25) - 189 364 351	(25) - 49 830 784

On August 4, 1995 the conversion of the shares of the subsidiaries into the shares of JSC LUKoil started.

	Ordinary shares (nominal value)	preferred shares (of the A type) (nominal value)
Issued	(25) - 649 551 391	(25) - 65 011 864

Representing 90.902% and 9.098% of the charter capital respectively.

The charter capital is 17 billion 864 million 081 thousand 375 rubles.

Dividend History

1994 ordinary shares with a nominal value of 125 rubles - 500 rubles per year
Type A preferred shares with a nominal value of 125 rubles - 500 a year

1995 ordinary shares with a nominal value of 25 rubles - 800% per year
Type A preferred shares with a nominal value of 25 rubles - 2000% per year

Registrars

“Oil Investment Company NIKOIL”	- shares
“ING Bank”	- RDC
“Bank of New York”	- ADR

Bonds

On July 13, 1995 the Department of Securities and Capital Market of the Ministry of Finance of the Russian Federation registered an issue of convertible bonds for the sum of 2 trillion 300 billion rubles in the amount of 460 000 bonds with the nominal value of 5 000 000. The registration # MF № 73-2-0006.

On September 29, 1995 results of the competition to place the first tranche of the bonds was announced. The winners were “CS First Boston” and “Mejdunarodniy Promishlenniy Bank”. In the process of placement an American oil company, “Atlantic Richfield Company”, acquired 241 080 bonds. 78 920 bonds were placed among investors from Russia, USA, Great Britain, France, Italy, Switzerland, the Netherlands.

March 29, 1996 - winners of the commercial competition on placing the remaining 140 000 convertible LUKoil’s bonds were “CS First Boston”, and Bank “Imperial”; the total amount of investments was 634 268 903 600 (second tranche).

Big Projects and Modernization Program

Main types of activities of the regional JSCs are: exploring and survey of oil and gas fields, drilling, oil refining and selling of oil products, manufacturing of oil machinery, industrial and housing construction, agricultural production. Today about 16.5 thousand highly qualified employees work in these spheres.

In May 1995 a new specialized drilling company “Oil-Drilling” was founded. Main objectives of this new joint stock company with modern equipment and 10 thousand qualified employees were building operational and research oil wells, installation of drilling rigs and maintenance of the drilling equipment. The company’s employees made a good showing in the process of oil rigs’ construction under different climate, geographical and geological conditions.

Besides, the subsidiary in Western Siberia it is planned to establish similar companies in Perm, Volgograd and Astrakhan regions.

LUKoil also develops the so-called non-traditional types of activities - transportation of oil, oil products and other cargo. At the beginning of 1994 a transportation company “LUKoil-Trans” was created. It has subsidiaries in Perm, Volgograd and Stavropol for transportation of oil products by railway and trucks. The company has 2200 railway tanks and over 500 truck tanks with the volume of up to 15 cubic meters. JSC LUKoil is developing new forms of transportation and delivery services. In 1995 more than 30% of LUKoil shipments were transported by this company. Last year JSC “LUKoil-Trans”

transported for the first time a cargo-tugboat "Neftegas-62" ("Oils") from St.Petersburg to Azerbaidzhan.

Since the end of last year LUKoil has a terminal for temporary storing and customs clearance of different shipments for west-Siberian mining enterprises from Europe and Baltics. The capacity of this terminal is 25 thousand tones per year.

The cargo is handled very efficiently and within very short terms. The terminal is equipped with modern equipment and also has convenient and secure rooms for clients.

LUKoil is completing construction of a plant for manufacturing and refining engine oil in Tumen Region. The capacity of this plant will be 16 thousand tons per year. Best western technologies of oil production will be used at this plant. The production shall comply with the standards of the All-Russian Scientific and Research Institute of Oil Products and API.

Since the volume of production will not be large, machine oils will be sold in the local market, mostly in Tumen region passing by commercial organizations and suppliers of oil products. Market research showed high competitiveness of these oils in the oil market of Western Siberia. It is planned to increase the capacity of the plant to 24 thousand a year with three shift operation. Payback of the project is 3.5 years.

In accordance with an agreement with republic of Tatarstan, LUKoil started construction of a factory for oil packaging on the basis of the existing facility. The capacity of this factory is supposed to be 54 thousand cubic meters. The factory will be equipped with machinery from a Portuguese company, "Shell Portugal". Oil will be packed in 4-5 liter plastic bottles and 200 liter metal barrels to be sold at service stations and stores of the republic.

In order to avoid purchasing expensive oil extracting equipment and pipes with antitrust covering, LUKoil makes large investments into the development of its regional subsidiaries which specialize in manufacturing different products of machine engineering (JSC "OZONIG - LUKoil" and JSC "Ural-LukTrubMash"). These enterprises were established on the basis of the existing machine engineering plants in the town of Oktyabrsky (Republic Bashkyrtostan) and in Chelyabinsk. The main purpose of these companies is to manufacture various products for mining enterprises, subsidiaries of LUKoil. In 1995 upon the requests of these subsidiaries JSC "OZONIG - LUKoil" manufactured 10 items of production for oil mining for the total amount of 25 billion rubles. Chelyabinsk factory manufactured and repaired 169 sets of pumps and over 50 tons of pipes with antitrust covering. The company's investment program provides for the further development of the machine engineering plants during 1996 which shall be completed in 1997.

One of the priority guidelines of the company's activity is constructing oil pipelines and a network of gas stations in various regions of Russia. This program has already been started. About 100 gas stations have been put into operation in new

regions, several of them on the terms of lease. In the near future it is planned to start up 70 gas stations and 8 oil bases.

The basis for this cooperation in the sphere of creating a network of gas stations in Russia is agreements with administrations of autonomous republics as well as oblast and krai administrations.

Aside from the above-mentioned types of activities, LUKoil subsidiaries provide also consulting services and work with financial investments, provide information, technical and material support, security services; charter sea and river cargo boats, and lease planes.

Alongside with production development the Board of Directors of the company and its management are taking an active part in different charitable programs (assistance to various institutions of culture, assistance to the former Afghanistan soldiers, to veterans, and invalids).

The growing network of regional subsidiaries is not fashion ("Let's do everything the way they do it in the west"), but necessity. In the situation of instability and economic crisis it is always better to rely upon one's own production forces and capacities.

Joint Ventures with Western Partners, including "Atlantic Richfield"

LUKoil founded two big and a few small joint ventures for oil production. The main partner Of LUKoil at the moment is AGIP. In addition to a joint venture in Kogalym and a joint venture in Caspian Sea region, LUKoil founded another joint venture with AGIP which is working on the research of oil fields in Tunisia and Egypt.

A company ARCO might become LUKoil's partner in a joint venture "ARCO and LUKoil". The agreement was signed on 19.09.96. It is assumed that 54% in this new JV will belong to LUKoil and 46% - to ARCO. ARCO will be responsible for raising 3 billion rubles for various JV projects. ARCO is a so-called ideal partner for LUKoil, since it has a lot of experience in oil production in the Arctic. (over 60% of oil produced in Alaska), and is a strategic investor in LUKoil.

Issue of Level I ADR

In January 1996 Russian stock market made another step forward - an oil company LUKoil became the first Russian company to issue a Level I ADR. Thus, all interested investors from the USA got access to shares of "NK LUKoil".

During the process of working on the ADR program financial and legal consultants of the Company, such as Nikoil and Akin Gump as well as Bank of New York, which is the depository bank of the program, played a very important role. Registrar company "Nikoil" did a great job of analyzing services provided by the Bank

of New York, and researching methods of preparing documentation required for the issue of the ADR.

General Director of the registration company "NIKoil" Mr. Sergei Levitin commented on the process of purchasing ADRs and noted that investors can transfer shares that they already have into ADRs. They can also buy shares in the Russian stock market and use them to create ADRs. As for the changes in the register of shareholders, the procedure would be the same in both cases. The ratio between shares of "NK LUKoil" and ADRs is as follows: 4 shares equal 1 ADR.

Three companies participate in the process of issuing ADRs: a registrar, a depository and a custodian.

For LUKoil ADR program the registrar was registration company "NIKoil", depository - Bank of New York and custodian - ING Bank Eurasia.

As it turned out the issue of ADR resulted in the increased interest of the participants of the stock market and improved the price of LUKoil shares. Western brokers started to quote LUKoil ADR even before they appeared in the market.

Vice-president of the company said that "now LUKoil shares will be bought by investors who could not do it before for many procedural reasons. Issue of the Level I ADR - is the second step of the company on the way towards international financial markets: in September we managed to raise \$321 million in the international market and in the USA through placing convertible bonds among institutional investors. Our goal is to be on a par with well known western companies whose shares are quoted in the international stock exchanges."

According to the Senior Vice-president of the Bank of New York, who is the Head of depository receipts department, issue of ADR by LUKoil is a very important event for investors planning to buy shares of Russian companies. Institutional and individual investors in the US and other countries will be able to buy shares of the leading Russian oil company using depository receipts which are easily bought and sold in the US market. "This is a very significant step, which allows to facilitate the procedure of investing into Russian shares", he said.

Audit

"KPMG"

Loan Auction

On 7.12.95 5% of the charter capital was put up for a loan auction. The commission decided that the winner was a consortium "LUKoil-bank "Imperial" which offered a loan of \$35 010 000 to the budget. The winner is to pay the debt of the LUKoil's subsidiaries for the federal budget in the amount of 500 billion rubles.

Investment Tender

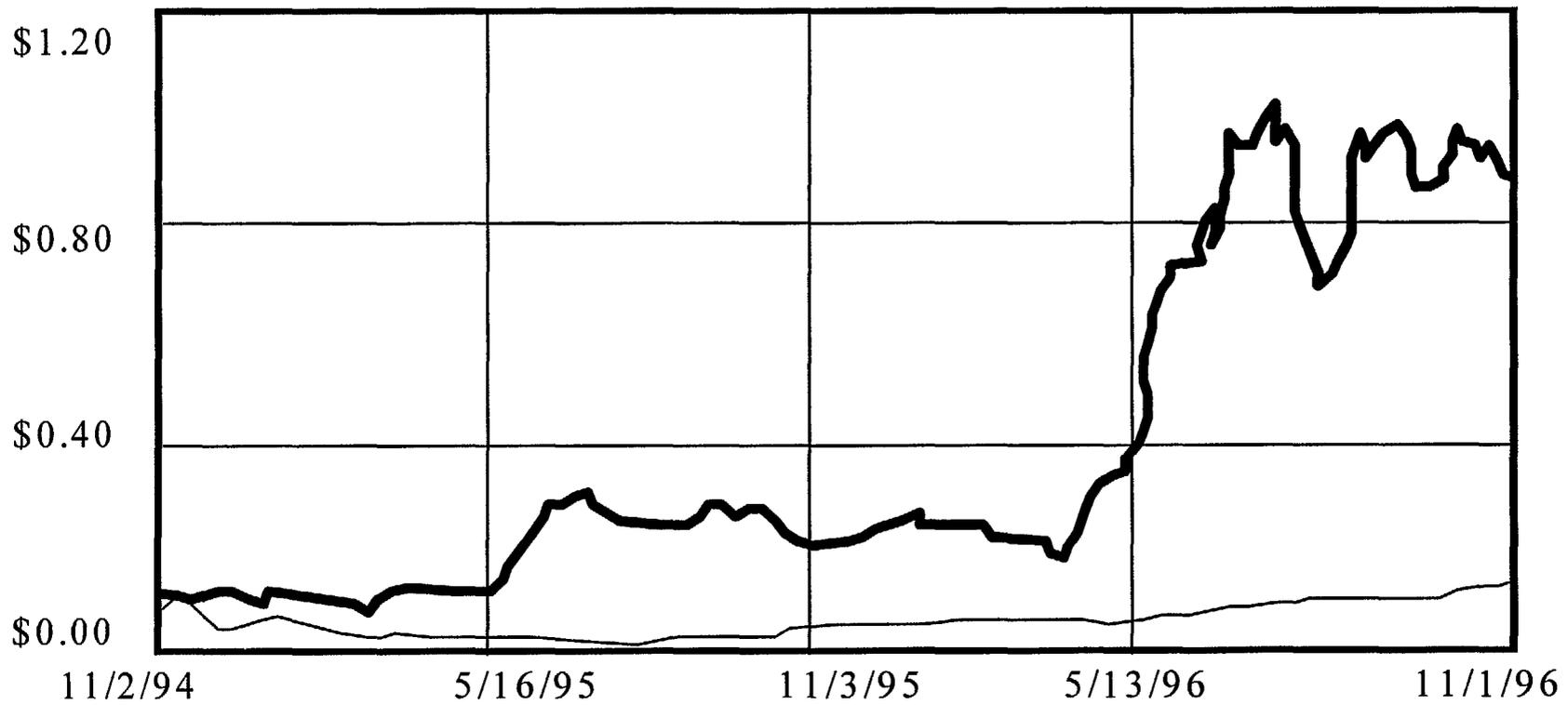
On 28.12. 95 the winner of an investment competition (16% of the charter capital) was NIK "Nikoil", Moscow; total amount of investments was 800 billion rubles for the period of two years.

ADR Level III

LUKoil is planning to place up to 15% of the shares planned for selling to foreign investors on the London and/or New York stock exchange.

"We want that our shares can be bought not only by institutional investors but also individual western investors...That is why we are considering a possibility of placing shares not only in according to 144A rule, but also through stock exchange listing", said Mr. Peter Neev, the Head of the public relations department of the company. According to Mr. Neev the company is working on getting permission for issuing sponsored ADRs Level III which can be placed on the stock exchange. "While before we were interested mainly in getting on the New York stock exchange, now we are considering the London stock exchange as well, and are in the process of negotiating a listing it. We hope that by the time we'll get the permission we will be already registered at the NYSE ... and that will give us an opportunity to place the shares among as many investors as possible", Peter Neev noted.

Price V. Industry Index (US\$)

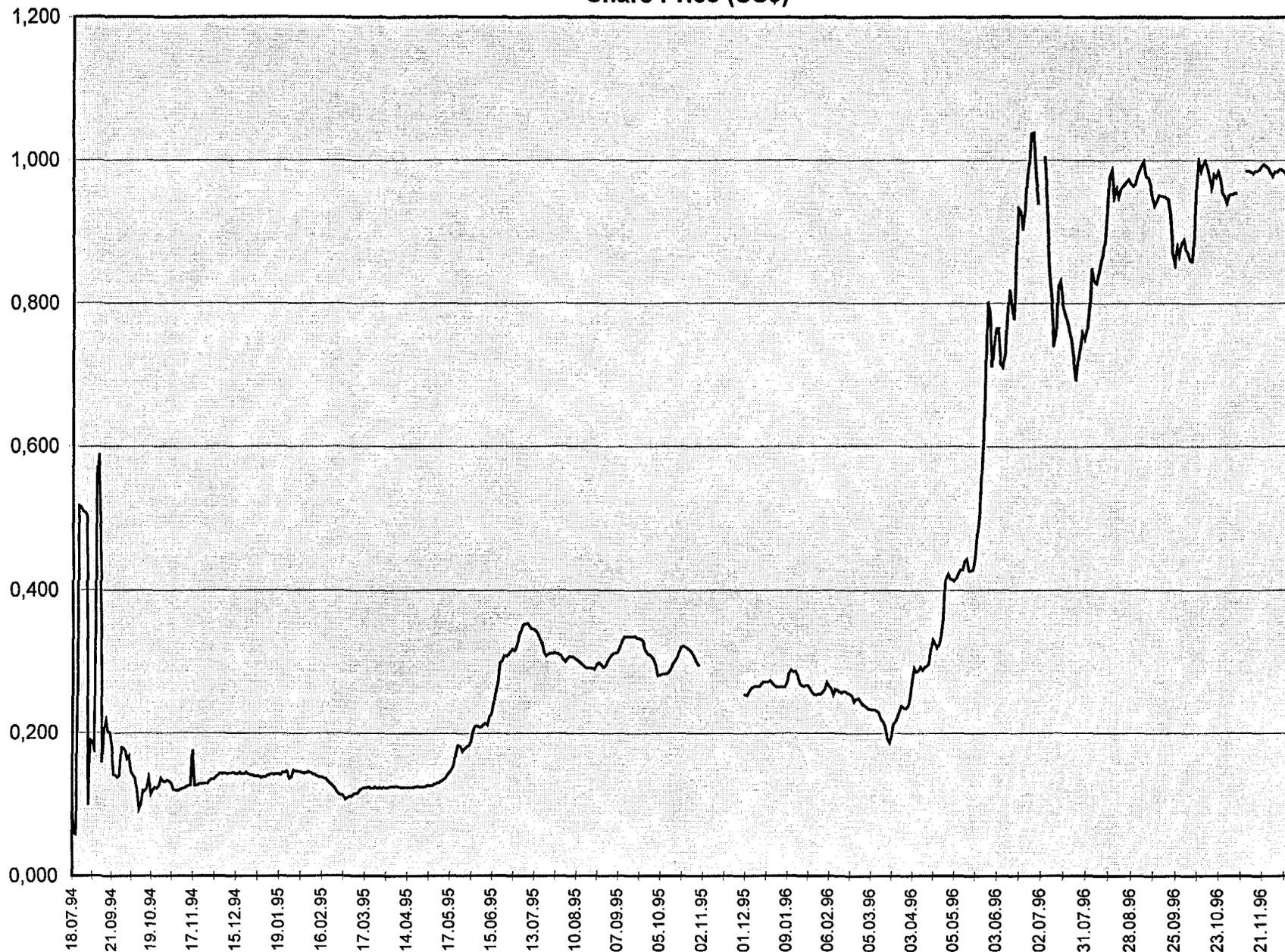


** Representation based on Skate Press Source

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MOSENERGO Company Profile

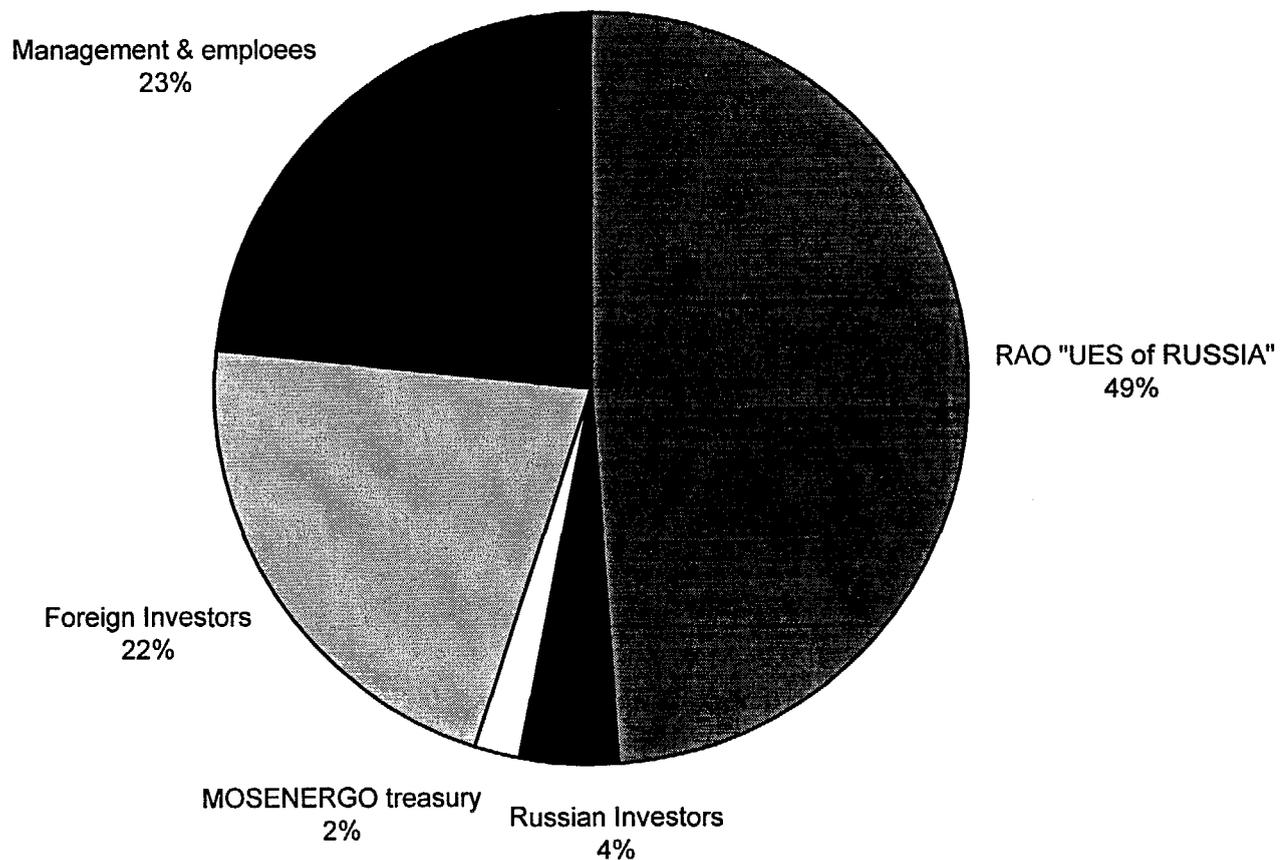
Share Price (US\$)



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MOSENERGO Company Profile

MOSENERGO Ownership Structure 1.01.96



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Mosenergo¹ **Discussion Topics**

In 1995, Mosenergo became the first Russian company to establish an ADR program. Mosenergo's initial program was a \$22.5 million 144A ADR. In September of 1996, Mosenergo confirmed its plans to establish a Level I ADR program.

Your team is the board of a large JSC, like Mosenergo. You have decided to establish an ADR program, and have met to discuss whether to establish a Level I, Level II, Level III or a 144A program. Your discussion is at the point of determining how to secure proper JSC authorisation for the ADR.

Please work with your team to evaluate:

- Which management bodies of your company have jurisdiction over the decision to establish the different types of ADR programs
- The reasons why there might be a difference

Level I ADR

A Level I ADR program is a mechanism to facilitate trading of already issued shares in the U. S. over-the-counter share market. A Level I ADR is not a mechanism for issuing new shares.

Level II ADR

A Level II ADR program is a mechanism to facilitate trading of already issued shares, through a listing on a U. S. stock exchange or the NASDAQ market. A Level II ADR is not a mechanism for issuing new shares.

Level III ADR

A Level III ADR program is designed to raise capital in the U. S. market through a public issue of new shares, to be listed on a stock exchange or NASDAQ.

144 A Program

A 144A ADR program is designed to raise capital through private placement of new shares with large institutional investors in the U. S.

¹ Please refer to the Equity Market Notes, Appendix 1. These notes were prepared by CFED as an integral part of this manual and workshop. Participants should refer to these notes when reviewing the accompanying profiles and case studies.

“Mosenergo”¹

Russian JSC Profile²

Introduction

Charter capital: 2 560 000 million rubles

Number of employees: 49120 as of 01.01.96

The company has 56 regional subsidiaries.

The main types of activity are: production, transmission and distribution of heat and electricity, repairs and maintenance of energy equipment. JSC Mosenergo - a big Russian energy company, second largest company that produces energy after Russian JSC “Unified Energy System of Russia”. The capacity as of 01.04. 96 including power stations rented from Russian JSC “Unified Energy System of Russia” is 14478 mega watts. From the beginning of 1996 power stations of the company produced 52.2 billion kwatt/hour of energy which was 1.3% more than during 9 months of the previous year. The volume of sales was 42.9 billion kWh which was 1.2% more than in 1995.

Compared to the period of 9 months of the previous year the volume of energy wholesale increased by 4.7% and was 8.8 billion kWh

During 9 months of this year the energy system produced and sold 56.7 million kcal. of heat energy which is 9.8% more than during the period of 9 months of the previous year.

During 9 months of 1996 the revenue of Mosenergo was 10152.6 billion rubles (6754.3 billion rubles for 9 months of 1995): 7213 billion rubles - for electrical energy and 2230 billion rubles for heat energy.

The amount of revenues before paying taxes was 2766.6 billion rubles (it was 2200.1 billion rubles the previous year) including excess profit that the company managed to make by increasing the volume of energy sales and decreasing the cost of production. The net profit after paying taxes was 1962.1 billion rubles (15550 billion rubles during 9 months of 1995).

It is said in the company’s press-release that “Mosenergo” does not have any outstanding liabilities to the state or to its employees.

¹ This text was produced by CFED as of December 1996, using the AK&M data base, materials provided by the companies Skate Press and prepared by the company itself.

² Please refer to the Equity Market Notes, Appendix 1. These Equity Market Notes were produced by CFED as an integral part of this manual and accompanying workshop. Participants should refer to these notes when reviewing the accompanying profiles and case studies.

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Disclosure

“Mosenergo” was the first Russian company (the first Russian “Blue Chips” company) which passed an international audit in accordance with GAAP. Such audit of the financial status is necessary if the company is going to deal with foreign investors and especially if it is going to issue shares and place them in the international markets. According to the General Director, Mr. Nestor Serebryanikov, the main purpose of such audit was increasing attractiveness of the company to both Russian and foreign investors. Despite an overall economic recession in Russia appearance of the leading and most successful Russian companies (Gazprom and VimpelCom (Beeline) in the international markets as well as issue of eurobonds were accompanied by very high almost exciting demand among investors.

Relations with Shareholders

High Level of Integrity with Subsidiaries

Information on Securities Issues:

Totally issued: 2 560 000 000 ordinary shares with the nominal value of 1000 rubles.

Nominal holders are: Bank of New York, “CS First Boston” , open type JSC “Troika Dialog”, JSC “Depository Clearing Company”, “Chase Manhattan Bank.”

Dividend History

Date: 1993 - ordinary shares (nominal value of 1000 rubles) - 2000 rubles
1994 - ordinary shares (nominal value of 1000 rubles) - 20 rubles
1995 - ordinary shares (nominal value of 1000 rubles) - 50 rubles

Registrars

JSC of a closed type “Register-Service”.

Bonds

“Mosenergo” is planning to issue eurobonds for the total amount of 100-150 million dollars during the first three months of 1997. The money received after placements of these bonds will go for the construction of the second unit of the Northern Heat Power Station in Moscow, Hydroaccumilating Power Station in Zagorsk and Gas Turbine Station in the town of Electrostal. The investment consultant of the issue is “Salomon Brothers” company. The term for paying off the bonds will be approximately 5 years.

Large-scale Projects and Modernization Program

“Mosenergo” program for major construction provides for the following expenditures (mln. USD) for the period of up to 2000:

	1994	1995	1996	1997	1998	1999	2000
Power stations	177	197	184	302	288	354	178
Pipelines	128	65	91	73	74	74	75
Transmission lines	47	45	62	62	62	66	61
Underground cables	4	5	7	26	26	26	26
Maintenance	20	116	83	29	25	69	20
Research and Developments	8	5	26	24	20	20	20
Total:	384	432	457	516	497	605	382

Source: Salomon Brothers, European Emerging Markets Research (Russia-Utilities), January 1996

Issue of I Level ADR

“Mosenergo” received an exemption 12g3-2(b) from the US Securities and Exchange Commission. This document exempts the company from the necessity to submit very detailed financial and accounting information required for issuing ADR. At the moment the documents are being prepared for signing a depository agreement with the Bank of New York. As soon as the documents are ready “Mosenergo” will issue I Level ADR

Audit

“MB-Center”

In 1996 Arthur Andersen audited the company.

Loan Auctions

Investment Competitions

New Mergers

144A ADR

At the moment “Mosenergo’s” 144A ADRs are quoted at Berlin and Frankfurt stock exchanges. When these securities appeared at the stock exchange the demand was three times higher than the offer. Initially it was planned to place 50 million ADRs. But the requests (applications) were submitted for 170 million ADRs. Considering the investors’ interest the management of the company made a decision to increase the offer 1,5 times. Thus, 75 million was placed for the total amount of 22,5 million dollars. All these shares were bought by the JSC in the secondary market. The financial consultant and advisor of the company is “Salomon Brothers”. The depository is Bank of New York.

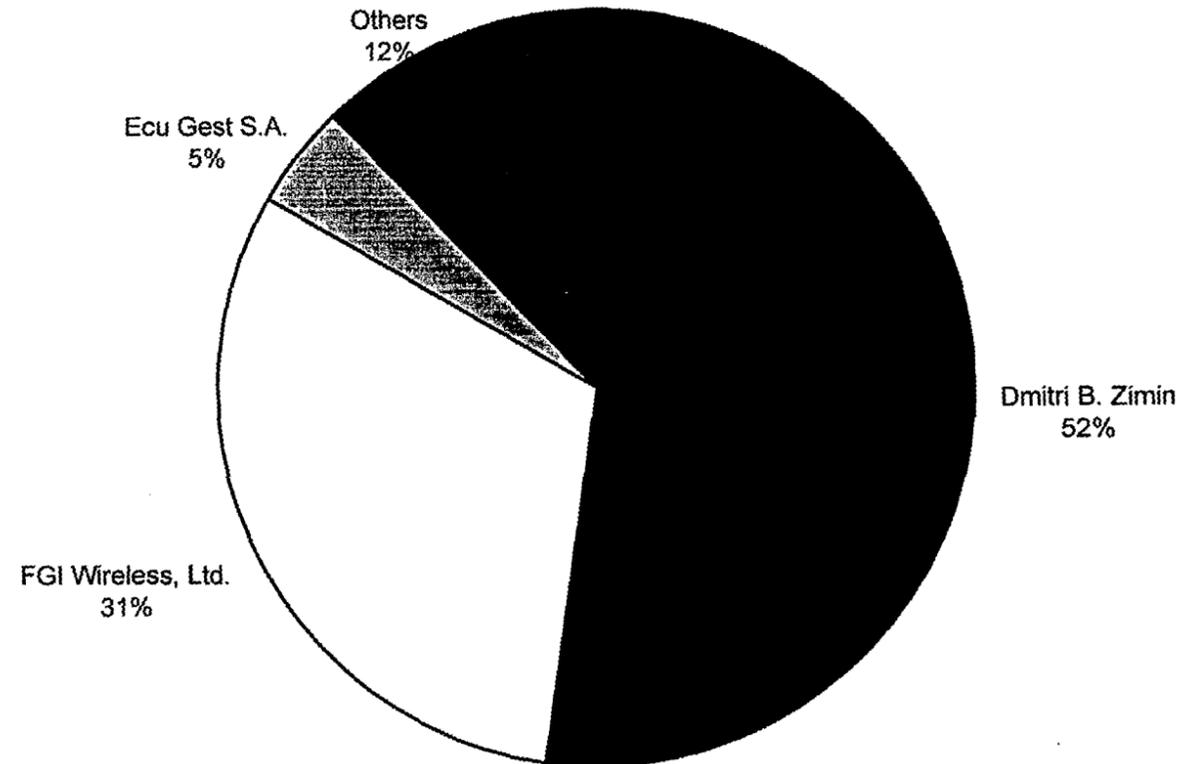
VimpelCom¹

- Who? Managers interested in reviewing the success of the first Russian company to raise capital in the US public market (the first Russian Level III ADR) and obtain a listing on the New York Stock Exchange (NYSE).
- What? Company which satisfied disclosure criteria of the United States Securities and Exchange Commission (SEC) and met the exacting standards of the NYSE – the most stringent in the USA.
- When? Well in advance of approaching the equity market and consistently thereafter
- Where? Within the JSC, in Russia and major capital markets abroad
- Why?
- Enables a young company to gain access to the Blue Chip market
 - NYSE listing is a “stamp of approval,” attracting a broader base of investors
 - Facilitates current and future funding programs
 - Improves attractiveness to potential direct investors and joint-venture partners
- How?
- Make a commitment to good corporate governance
 - Make a commitment to issuer transparency
 - Create a reputation for openness
 - Disseminate information to shareholders, the press, securities industry and investment community
 - Comply with full SEC disclosure (for example, USGAAP statements) and NYSE listing requirements

¹ Please refer to the Equity Market Notes, Appendix 1. These notes were produced by CFED as an integral part of this manual and accompanying workshop. Participants should refer to these notes when reviewing the accompanying profiles and case studies.

VIMPELCOM Company Profile

**Vimpelcom Beneficial Ownership
Prior to offering**



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VimpelCom
Key Financial Characteristics

Income Highlights (US\$ 000's)	1994	1995	6 months 1996
Total revenue	27,974	100,917	84,386
Net income	9,521	27,621	18,761
Net profit margin	34.0%	27.37%	22.23%
Balance Sheet Highlights (US\$000's)			
Current assets	21,890	43,038	64,649
Accounts receivable	4,742	10,219	15,707
Non-current assets	12,426	79,560	106,412
Total Assets	34,316	122,598	171,061
Current liabilities	14,168	48,422	82,973
Accounts payable	828	3,586	14,338
Non-current liabilities	5,212	30,779	39,030
Total liabilities	19,380	79,201	122,003
Shareholders' equity	14,936	43,397	49,058
Current assets/Current liabilities	1.55	.89	.78
Tot. liabilities/Shareholders' equity	1.30	1.83	2.49
P/E ratio	not traded	not traded	not traded

Source: Company Prospectus

VimpelCom Discussion Topics

Your team will play the role of the Board of Directors of VimpelCom. A meeting of the Board of Directors has been called to elect a new Chairman, and then develop a plan for financing the company's capital expenditure requirements for its cellular network (for purchasing new equipment and development of a new DCS-1800 standart).

Please:

- Discuss the advantages and disadvantages of issuing different levels of ADR (especially Level III) for raising capital;
- Referring to VimpelCom's prospectus, identify what information a company needs in order to have a Level III ADR program.

Please make reasonable assumptions about any company information or other material information not provided.

Factors affecting the Board's deliberations include:

Funds Requirements

In excess of \$100,000,000.

Competition and Need for Modernisation

The Company has a good market niche with at least three competitors working in other frequencies diapasons.

The company demonstrated the increased of sales and profits in 1996.

Financial Condition

The company's financial condition is excellent. The majority of funding for capital expenditures and investments has come from internal cash flow and purchasing the communication equipment on extended terms.

Share Situation

Converted to open type company in 1993. Without any free float.

Shareholder Concerns

Some shareholders are concerned about selling shares on the Russian market.

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VimpelCom¹

Russian JSC Profile²

Introduction:

Paid charter capital: 128,533,000

Number of employees: more than 700

The company "Vimpel Communications" was established in September, 1992 as a closed joint stock company. It was founded by a group of Russian institutions, among which there were Radio-technical Institute named after Mintz, Scientific and Research Institute "Giprosvyaz", Scientific and Production Complex "Vimpel" and All-Russian State TV and Radio Company. In 1993 this joint stock company was transferred into an open JSC. Vimpelcom's biggest foreign shareholder is an American company FGI Wireless. At the moment "Vimpelcom" is a group of companies, including JSC "Macrocom" (Moscow operator of cellular communications "Bee-Line", AMPS-800 standard), design bureau "Impulse" (operator of the digital network DCS-1800). The majority of the users of the cellular communications (more than half) are clients of "Vimpelcom". At the moment the number of Vimplecom clients is about 48 000, and by the end of the year the company thinks to increase it up to 60 000 people. In order to expand its network the company is pursuing a very active investment policy: in 1996 "Vimpelcom" raised two credits - from a Swedish company "Ericsson" (one - for 28 million dollars, the amount of the second one has not been disclosed) and also a credit from a German company Alcatel (about 40 million dollars), which will go for construction of DSC-1800 network. In return Alcatel got 12% of "Vimpelcom" shares.

Interesting that none of the original "Vimpelcom" founders saved their packages.

Openness

An example of openness, still unusual for many Russian companies, is a report prepared by the company RC Securities, Inc. (member of Renaissance Capital Group) which was necessary to start III Level ADR program.

¹ This text was produced by CFED as of December 1996, using the AK&M data base, materials provided by Skate Press and prepared by the company.

² This text was produced by CFED as an integral part of this manual and accompanying workshop. Participants should refer to the Equity Market Notes, Appendix 1 when reviewing the accompanying profiles and case studies.

Among a very detailed review of the telecommunications market and services in cellular communications and equipment provided by the company, the report includes the following:

- detailed financial information about the company for several years
- risk factors for investors
- description of company's activity
- legal framework for telecommunications services
- description of company's management
- structure of stock capital and major transactions on buying and selling shares of other companies
- description of the capital and detailed description of the legal framework for all the procedures related to the JSC activity
- taxation
- underwriters
- references to the US legislation which regulates issue of ADR
- financial accounts of "Vimpelcom", affiliated companies and their brief review.

High Degree of Integrity with Affiliated Companies

In October 1996 "Vimpelcom" acquired 88% of the design Bureau "Impulse". This company was controlled by Mr. Zimin and it has a license for using DCS-1800 standard.

This transaction was financed by Moscow Bank of Reconstruction and Development, which allocated 18 million dollars for it.

"Macrocom" company is a closed JSC, founded in September 1994 by "Vimpelcom, company "Mocom" and "Electrosvyaz". Initially, "Vimpelcom" held 50% of "Macrocom's shares; and "Mocom" and "Electrosvyaz" - 40% and 10% correspondingly. The acquisition was done through an additional share issue by "Macrocom" and further transfer the shares to "Mocom". Then "Vimpelcom" bought these shares at 36 000 dollars which equaled the nominal value of the shares, and thus bringing its share in "Macrocom" to 95%.

Information on Charter Capital and Share Issue

The Charter capital consists of:

19,280,000 ordinary shares with the nominal value of 5 rubles
6,426,600 preferred shares with the nominal value of 5 rubles

The ADR offering was backed by 2,598,600 new Vimpelcom shares offered by the company and a secondary offering of 1,455,642 shares offered by a shareholder, FGI Wireless (together, 4,054,242 shares, represented by 5,405,656 ADRs).

Issued and placed before the new issue were 16 681 400 ordinary shares and 4 170 000 preferred shares.

The above charter capital includes 2 256 600 preferred shares "Vimpelcom" planned to issue right after ADRs in order to secure Mr. Zimin's control over the company.

Registrars

Large-scale Projects and Modernization Program

In order to create a system of cellular communications in Moscow "Vimpelcom" announced a public tender for supplying telecommunications equipment. The winner of this tender was a French company "Alcatel-Alsthom" with the headquarters in Paris. The value of the order was 135 million dollars. The future telephone network will cover 380 thousand users in Moscow and Moscow suburbs. New equipment will comply with DCS-1800 standards. The buyer is the design Bureau "Impulse", Vimpelcom's branch.

III Level ADR Issue

The financial consultants and underwriters of "Vimpelcom" were "Renaissance Capital" and "Donaldson, Lufkin & Jenrette."

The total amount of issued ADRs was 5.4 million. Of this quantity 3 464 800 was sold by "Vimpelcom" and 1 940 856 - by shareholders. One depository receipt equals $\frac{3}{4}$ of one share. There were requests for ADRs for the amount of 1.15 billion dollars. However, according to the SEC rules, the company did not have the right to place ADRs for the amount of more than \$100 million rubles. The average price of the placement was 20.5 dollars. The buyers of the ADRs according to "Renaissance Capital" were big investment funds from Europe and America, specializing in investments in telecommunications. "Vimpelcom" is going to spend the money raised on expanding Bee-Line network and introducing new cellular communication standard DCS-1800.

Audit

Ernst & Young, since 1995.

Comment

Revenues in 1995:	105.5 million dollars
Profit for 1995:	27.6 million dollars
Revenues for 6 months of 1996:	84.3 million dollars
Profit for 6 months of 1996:	18.8 million dollars

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VimpelCom

Contents of Information Memorandum for buyers of ADRs

Enforceability of Civil Liabilities

General Part

- Description of the group of companies controlled by "Vimpelcom"
- Review of Russian Telecommunications Industry
- Competition
- Business Strategy
- Offerings
- Financial Data

Risk Factors

- Risks relating to the Russian Federation
- Risks relating to the Group
- Other risks

Dilution

Capitalization

Use of Proceeds

Dividend Policy

Selected Financial Data

Management's Discussion and Analysis of Financial Condition and Results of Operation

- Overview
- Results of Vimpelcom Operations
- Six Months Ended June 30, 1996 Compared to Six Months Ended June 30, 1995
- Year Ended December 31, 1995 Compared to Year Ended December 31, 1994
- Liquidity and Capital Resources
- Basis of Presentation of Financial Results
- Inflation

Business

- History
- Current Operations
- Cellular/PCS Technology
- The Russian Telecommunications Sector
- Strategy
- Marketing and Sales
- Products and Services
- Network Technology and Operations

Regulation of Telecommunications in the Russian Federation

- Regulatory Authorities
- Licensing to Provide Services
- Radio Frequency Allocation
- Equipment Certification
- Competition and Pricing

Management

Major Transactions on Purchasing and Selling Shares and Securities of Other Companies

- Purchase of KBI shares (Design Bureau "Impulse")
- Macrocom Purchase
- Sale of Bonds

Shareholders

Shares Eligible for Future Sale

Description of Capital Stock

- Joint Stock Company
- Common Stock
- Preferred Stock
- Shareholder Meeting
- Dividend and Dividend Rights
- Share Capital Increase
- Share Capital Decrease; Share Buy-Backs
- Preemptive Rights
- Liabilities of Shareholders
- Board of Directors
- Liquidation
- Reserve Funds
- Share Registration, Transfers

Description of American Depository Receipts and Procedures of Their Issue

Taxation

- Russia
- USA

Underwriting

Legal Matters

Experts

Additional Information

Report of Independent Auditors

Detailed Financial Information and Accounts of "VimpelCom," "Impulse" and "Macrocom"

PROSPECTUS
November 15, 1996

5,405,656 American Depositary Shares
Representing 4,054,242 Shares of Common Stock
Open Joint Stock Company Vimpel-Communications



Each American Depositary Share ("ADS") being offered hereby will represent three-quarters of one share of common stock (the "Common Stock") of Open Joint Stock Company Vimpel-Communications ("VimpelCom"). The ADSs will be evidenced by American Depositary Receipts ("ADRs"). See "Description of American Depositary Receipts."

Of the 5,405,656 ADSs offered hereby, 3,464,800 ADSs are being offered by VimpelCom, and 1,940,856 ADSs are being offered by FGI Wireless, Ltd., an Illinois corporation (the "Selling Shareholder"). Of the 5,405,656 ADSs offered hereby, 3,919,100 ADSs are being offered for sale in the United States and Canada by the U.S. Underwriters (the "U.S. Offering") and 1,486,556 ADSs are being offered for sale outside the United States and Canada in a concurrent offering by the International Managers (the "International Offering" and, together with the U.S. Offering, the "Offerings"), subject to transfer between the U.S. Underwriters and the International Managers. See "Underwriting."

Prior to the Offerings, there has been no public market for the Common Stock or ADSs in the Russian Federation, the United States or elsewhere. See "Underwriting."

The ADSs have been approved for listing on the New York Stock Exchange under the symbol "VIP," subject to official notice of issuance.

See "Risk Factors" beginning on page 14 for a discussion of the risks that should be considered by prospective investors.

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION NOR HAS THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

	Price to the Public	Underwriting Discounts and Commissions(1)	Proceeds to VimpelCom(2)	Proceeds to the Selling Shareholder(2)(3)
Per ADS	US\$20.50	US\$1.44	US\$19.06	US\$19.06
Total(3)	US\$110,815,948	US\$7,784,145	US\$66,039,088	US\$36,992,715

(1) VimpelCom, the Selling Shareholder and Ecu Gest S.A., a shareholder of VimpelCom ("Ecu Gest"), have agreed to indemnify the several Underwriters named herein against certain liabilities, including liabilities under the Securities Act of 1933, as amended. See "Underwriting."

(2) Before deducting offering expenses estimated at US\$2.5 million payable by VimpelCom.

(3) The Selling Shareholder and Ecu Gest have granted to the U.S. Underwriters a 30-day option to purchase up to an aggregate of 810,848 additional ADSs at the Price to the Public less Underwriting Discounts and Commissions, solely to cover over-allotments, if any. If such option is exercised in full, the total Price to the Public, Underwriting Discounts and Commissions, and Proceeds to the Selling Shareholder (and Ecu Gest) will be US\$127,438,332, US\$8,951,766 and US\$52,447,478, respectively. See "Underwriting."

The ADSs offered hereby are being offered by the several Underwriters, subject to prior sale, when, as and if delivered to and accepted by them and subject to various prior conditions, including their right to reject orders in whole or in part. It is expected that delivery of the ADRs evidencing ADSs will be made in New York, New York on or about November 20, 1996.

Renaissance Capital Group and Donaldson, Lufkin & Jenrette Securities Corporation are the Global Coordinators of the Offerings.

Donaldson, Lufkin & Jenrette
Securities Corporation

RC Securities, Inc.
(Member Renaissance Capital Group)

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No person has been authorized to give any information or to make any representation not contained in this Prospectus in connection with the offering made hereby, and, if given or made, such information or representation must not be relied upon as having been authorized by VimpelCom, the Selling Shareholder, the Underwriters or any other person. Neither the delivery of this Prospectus nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Group since the date hereof or that the information contained herein is correct as of any time subsequent to the date hereof. This Prospectus does not constitute an offer to sell or a solicitation of an offer to buy any of the securities offered hereby by anyone in any jurisdiction in which such offer or solicitation is not authorized or in which the person making such offer or solicitation is not qualified to do so or to any person to whom it is unlawful to make such offer or solicitation.

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Until December 10, 1996 (25 days after the date of this Prospectus), all dealers effecting transactions in the ADSs, whether or not participating in this distribution, may be required to deliver a Prospectus. This requirement is in addition to the obligation of dealers to deliver a Prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

5,405,656
American Depositary Shares
Representing
4,054,242 Common Shares

Open Joint Stock Company
Vimpel-Communications

PROSPECTUS

Donaldson, Lufkin & Jenrette
Securities Corporation

RC Securities, Inc.
(Member Renaissance Capital Group)

November 15, 1996

Evidence from DEVELOPED CAPITAL MARKETS and ECONOMIES IN TRANSITION demonstrates a RELATIONSHIP BETWEEN GOOD GOVERNANCE AND MARKET VALUATION

Germany - DISCLOSURE

In 1993, Daimler-Benz AG became the first German joint stock company (JSC) to list its shares on the New York Stock Exchange (NYSE). For several years, a group of large German JSCs had presented a united front to the United States Securities and Exchange Commission (SEC) and the NYSE, hoping to list their shares on the NYSE without restating their financial accounts in accordance with United States Generally Accepted Accounting Principles (US GAAP) as required by the SEC. After Daimler-Benz posted disastrous results in 1992, it thought a NYSE listing would provide some good news and future access to what it called "the world's largest and most dynamic stock market." It broke ranks with its German cohorts, and in early 1993 sought a NYSE listing alone. The agreement among the company, the SEC and the NYSE required that Daimler-Benz present financial data in accordance with German and US requirements. Its restated accounts included DM4 billion (US\$2.42 billion) of hidden reserves as "extraordinary earnings." This move was seen as a major precedent; due to competition for capital resources, some companies are clearly ready to make corporate governance concessions in order to gain access to foreign capital.

United Kingdom - DISCLOSURE

Report of the Committee on The Financial Aspects of Corporate Governance (1 December 1992), Article 4.48 "The lifeblood of markets is information and barriers to the flow of relevant information represent imperfections in the market. The need to sift and correct the information put out by companies adds cost and uncertainty to the market's pricing function. The more the activities of companies are transparent, the more accurately will their securities be valued."

United States of America - SHAREHOLDERS' RIGHTS

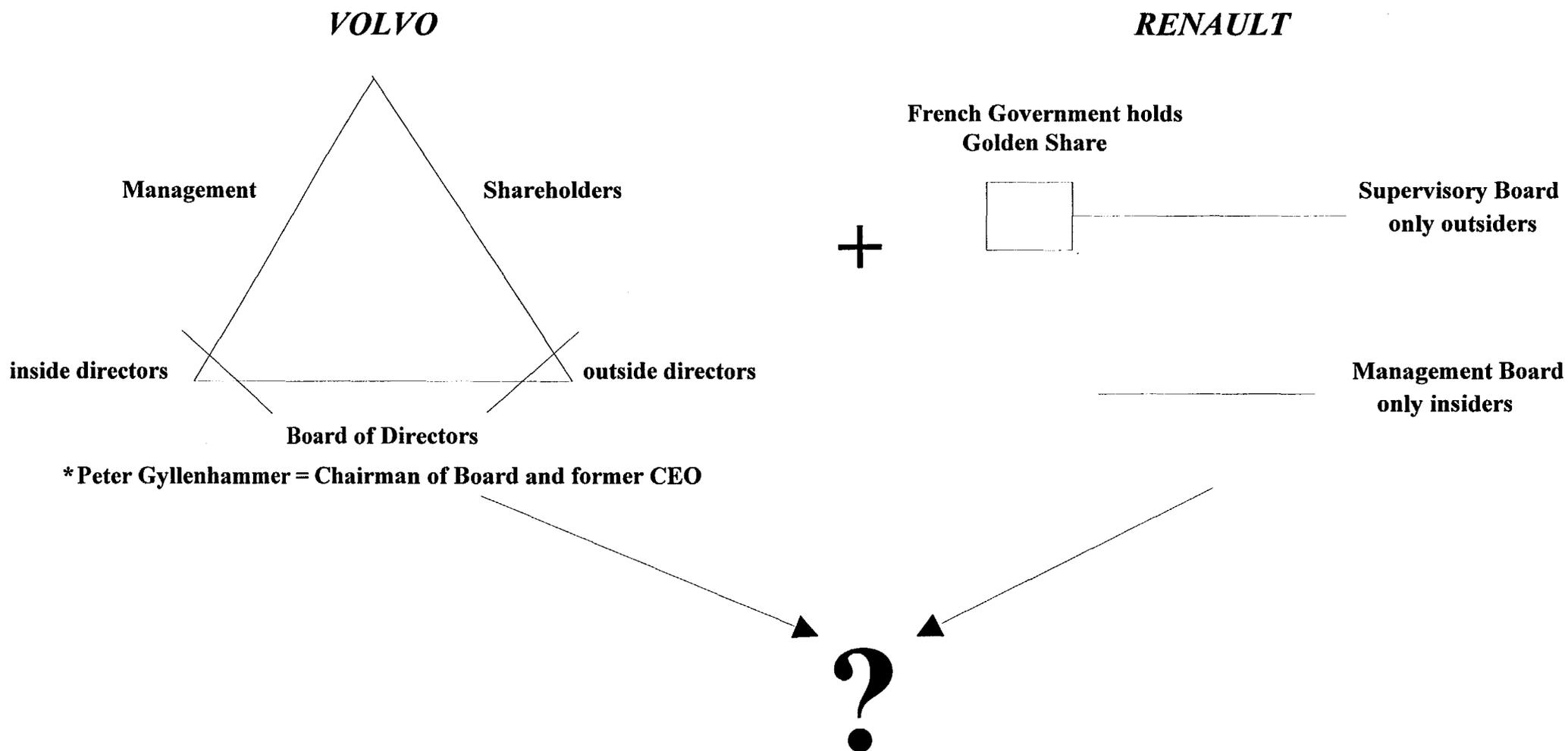
A 1992 study of shareholder activism by the management consulting firm Wilshire Associates demonstrated the profitability of such efforts. A \$500,000 shareholder initiatives program undertaken by the California state employees' pension fund CalPERS resulted in \$137 million extraordinary returns (above the Standard & Poors Index).

A 1993 book by corporate competitiveness guru and former US Treasury Department Corporate Finance Director Michael Jacobs entitled "Break The Wall Street Rule: Outperform the Stock Market by Investing as an Owner" argues that exercising ownership rights (information rights and voting rights) over the long term can be more profitable than buying and selling shares on a short term basis.

Sweden - MANAGEMENT-SHAREHOLDER RELATIONS

In late 1993, Swedish and foreign shareholders scuttled the proposed merger of Swedish vehicle manufacturer Volvo and French state-owned vehicle manufacturer Renault. Shareholder opposition focused on the loss of minority shareholder' rights and the uncertain corporate governance structure of the merged company. Volvo's CEO, who had pushed for the merger, resigned in response to shareholder refusal to approve the merger.

PROPOSED MERGER OF VOLVO AND RENAULT



- ~ Complex ownership structure of holding company (majority owned by Renault) and Renault-Volvo Automotive operating company (majority owned by French government [46.36%] and RVC [35%]).
- ~ Loss of minority shareholders' rights to holding company and French government.
- ~ No privatization schedule for privatization of Renault.

ISI

Shareholder Veto Of Proposed Merger Of Volvo And Renault - Timetable

1990

The Swedish vehicle manufacturer Volvo and the majority state-owned French vehicle manufacturer Renault establish a "strategic alliance" by purchasing shares in each others' truck and automobile divisions.

September 23, 1993

Volvo announces proposal to merge with Renault.

Volvo issues "Information to Volvo Shareholders" explaining the proposal and convening an Extraordinary General Meeting of Shareholders on November 9 to vote on the merger.

October 5, 1993

Aktiespararna, the Swedish Shareholders' Association (SSA), issues a statement supporting continuing collaboration between Volvo and Renault, but concluding that a commercial valuation of the proposed merger was difficult to assess, because Volvo had presented neither profit-based nor valuation-based information. SSA also notes that the "Information to Volvo Shareholders" failed to prove that a merger was the best and most appropriate option for the two companies to pursue. It questions the advantage of a merger over an ongoing strengthening of the strategic alliance between the two companies.

The SSA notes several problematic aspects of the proposed merger, especially the following:

- The ownership structure of the merged company was complex, making it difficult for Volvo shareholders to understand their new ownership position;
- Renault was a state-owned company with plans but no specific timetable for privatization;
- The French government, as owner of Renault, would be entitled to hold a "golden share," granting it the right to approve or veto any takeover or sale/purchase of a large block of shares.
- The French government would retain this "golden share" even after the privatization of Renault.

October - early November 1993

SSA places an advertisement in the October 1993 issue of its monthly magazine calling on its members to vote against the proposed merger. The votes collected represent 2.7 percent of the share capital and 2.3 percent of the votes of Volvo AB. (Like most Swedish joint stock companies, Volvo has a dual-class capital structure consisting of two classes of shares with different voting rights.)

The board of directors of the Fourth Pension Fund, Volvo's second-largest shareholder (owning 7.5% of voting shares), splits 8-6 in favor of approving the merger. The Fourth Fund is an equity investment fund managed by Swedish trade unions; blue collar unions support the merger, while white collar unions oppose it. Gunnar Hohansson, a former Volvo executive, opposes the deal, arguing that Volvo should remain a vehicle manufacturer and not merge with the conglomerate Renault. Due to

continued discussion of this issue, however, the board convenes a second meeting, where it decides to vote against the merger.

November 4, 1993

The SSA issues a statement urging Volvo's board of directors to withdraw the proposal. The statement argues that Volvo's articles of association would have to be amended before the proposed merger could be consummated.

November 6, 1993

Volvo issues a prospectus with additional information on the proposed merger. Some shareholders do not receive the information until they have given their voting instructions to the SSA or to depositary banks. Other shareholders do not receive the information until after November 9, the scheduled date of the Extraordinary General Meeting of Shareholders.

In response to significant shareholder opposition to the merger, Volvo postpones the Extraordinary General Meeting of Shareholders until December 7, 1993.

mid-November 1993

Despite attempts by Volvo management to control the situation, shareholder and employee opposition to the merger grows. The SSA continues its demands for more precise information on the structure of the merged company.

Foreign institutional investors analyze the effect of the merger on the corporate governance structures of Volvo, Renault and the merged company.

Volvo postpones Extraordinary General Meeting of Shareholders for a second time. Meeting rescheduled for January 19, 1994.

December 1, 1993

Soren Gyll, Chief Executive Officer of Volvo, informs Pehr G. Gyllenhammar, Chairman of Volvo's Board of Directors, that management does not support the merger. Gyllenhammar informs Renault that Volvo is abandoning the deal.

As a consequence of the failed merger proposal, Gyllenhammar resigns.

January 19, 1994

Despite abandonment of the merger, the scheduled Extraordinary General Meeting of Shareholders is held to elect a new board of directors following Gyllenhammar's resignation.

Of the former board members, only Soren Gyll, Chief Executive Officer, is reelected.

Spring 1994

Domestic and foreign investors meet with Volvo to recommend that the company improve its disclosure policy.

Disclosure is an important issue at annual general meetings of all of Sweden's largest joint stock companies.

Discussion Topics

1. Which mistakes did Volvo's management and board of directors make in their dealings with each other and with shareholders?
2. Which problems did shareholders identify in the merger proposal, and why?
3. This case study identifies which corporate governance issues?
4. Compare the corporate governance practices of Volvo and Renault.

Slovakia

In 1996, the Slovak Business & Banking Advisory Center conducted a survey of 25 Joint Stock Companies (JSCs) pursuing "comprehensive restructuring plans." Over the course of the survey, 7 JSCs reported "strong change"; 12 reported "slow change"; 4 reported "stalled change" and 2 reported "no change" towards completing the plan. Specific survey findings suggest a strong correlation between governance and restructuring.

<u>FACTOR</u>	<u>IMPACT</u>	<u># OF JOINT STOCK COMPANIES</u>
# of Business Units of JSC	No impact on change	
Condition of Market	No impact on change	
Condition of Buyer Industry	No impact on change	
Initial Financial Condition of JSC	Negative impact on change	6 JSCs in financial crisis - 3 achieved "slow change" - 3 achieved "no change"
Share Ownership Pattern	No majority state owned companies included Management-owned companies did best Investor-owned companies did worse	
Role of Supervisory Board	Strong positive correlation with change	7 "strong change" JSCs - board played supportive role (2) - board played leading role (4) 6 "no change" JSCs - board played negative role (4) - board played limited role (2)
Role of Management	Strongest positive correlation with change	7 "strong change" JSCs - management played leading role 21 Of 25 companies - leading (7) or supportive role (14)
Involvement of Bank	Passive or negative in 19 of 25 cases	Bank used "carrot approach" in 1 case

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Russia
MARKET REGULATION

When an Austrian investment fund plans to invest in a market outside the European Union, the Austrian Ministry of Finance evaluates whether the market is “recognized, regulated and open to the public, and well-functioning.” If the Ministry determines that a market meets these criteria, a fund may invest in listed JSCs there without restriction; if a market does not meet these criteria, a fund may not invest more than 10% of its assets in JSCs in that market. The Austrian Ministry of Finance has approved markets in Czech Republic, Hungary, Poland and Slovakia, but not Russia, thereby limiting the investment that Austrian funds may make in Russian JSCs. (See Appendix 7: “Austrian Fund Managers Await Ministry Recognition of Russia.” *Russia Portfolio*. August 7, 1995.)

CUSTODY / SECURITIES REGULATION / SHARE REGISTRATION

In the spring of 1996, ICR Survey Research Group conducted a “Survey of Western Portfolio Investors in Russia” for the Federal Commission for the Securities Market. Managers of emerging market funds answered questions concerning the attractiveness of the Russian market, its risks, deficiencies, each fund’s investment strategy and investment methodology. Respondents noted the inadequate custody system (44%), a lack of securities regulations (31%) and inadequate clearing and settlement system (26%) as the main infrastructure deficiencies of the Russian securities market.

SHAREHOLDERS’ RIGHTS

From the company’s initial privatization until 1994, Komineft’s share price rose fivefold to just under \$25 per share. Then, two unrelated incidents frightened investors: an oil pipeline leak and reports that the company had distributed secretly a new share issue to selected investors. Demand for Komineft’s shares plummeted and they currently trade at below \$2, demonstrating investors’ unease about both the company’s physical state and governance regime. (See Appendix 7: “Russian Market’s Fortunes Revealed in ADRs.” *The Financial Times*. December 3, 1996.)

SHAREHOLDERS’ RIGHTS

ING Barings posited that Surgutneftegaz shares would continue to trade at a discount to other shares of Russian oil companies due to investors concerns over the company’s governance practices. Although ING Barings rates Surgutneftegaz as “fundamentally the most attractive producer” of Russia’s three major oil companies (LUKoil, Yugansk and Surgutneftegaz), it “would only recommend Surgutneftegaz to investors actively seeking risk, as concerns must persist as to management’s observation of minority shareholders’ rights. (See Appendix 7: “Surgut Share Issue Violations Cited.” *The Moscow Times*. December 11, 1996.)

Red October
Medium-term Results - Effective Corporate Governance and Disclosure¹

- Who? Managers of joint stock companies who want to improve their share prices and attract investors
- What? Results of effective corporate governance and disclosure => high level of attractiveness of the shares in the market
- When? Immediately and on an ongoing basis
- Where? Within the JSC, in Russia and major capital markets abroad
- Why? Provide for maximum increase of the share price, facilitate funding programs at present and in the future
- How?
- Establish effective corporate governance
 - Make a commitment to issuer transparency
 - Create reputation of a highly reliable company with a good system of information disclosure and try to gain investors' trust
 - Disseminate information about the company to investors

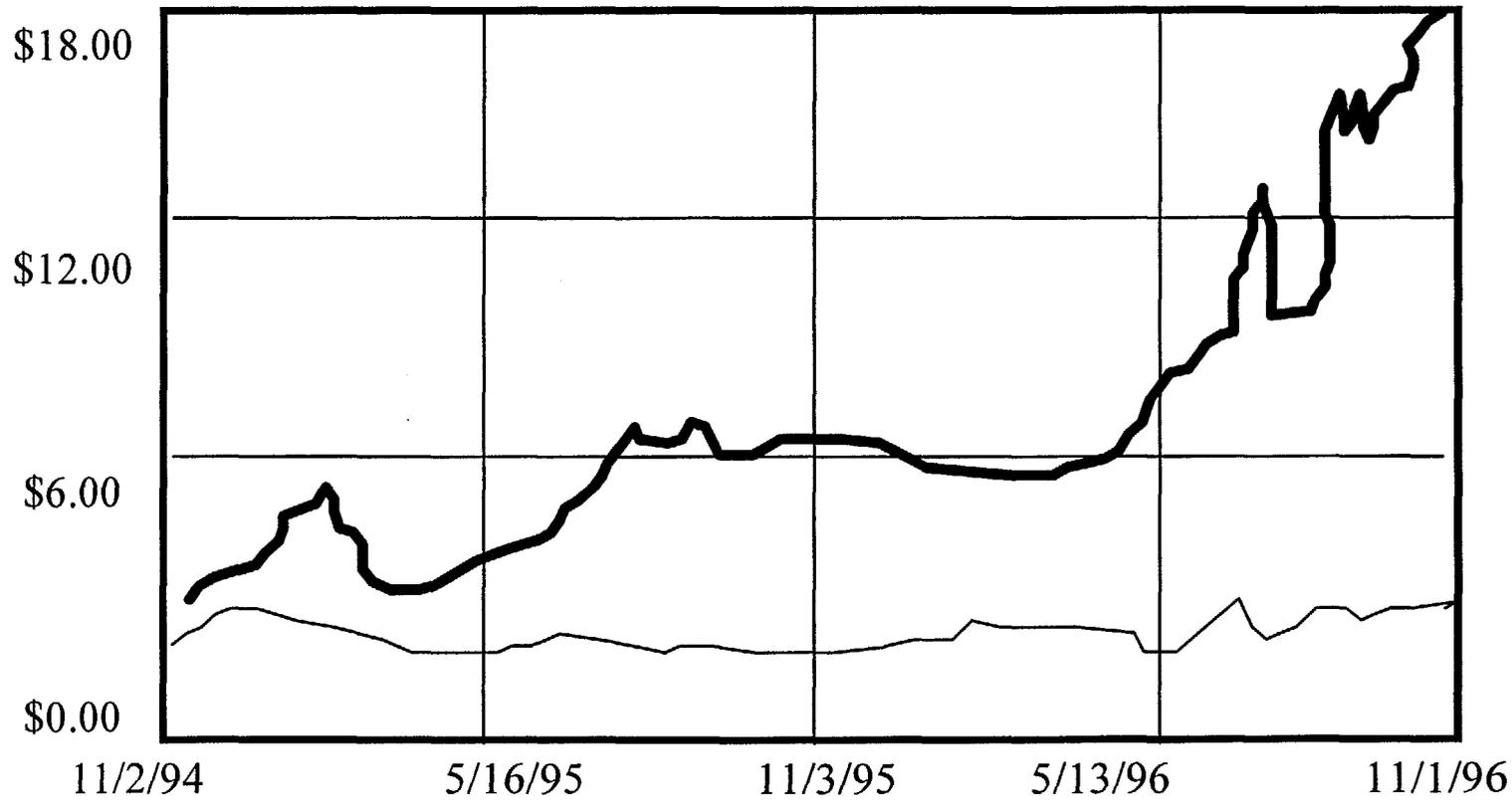
¹Please refer to the Equity Market Notes, Appendix 1. These notes were produced by CFED as an integral part of this manual and accompanying workshop. Participants should refer to these notes when reviewing the accompanying profiles and case studies.

Red October
Favourable Results of Effective Corporate Governance and Disclosure

	January 1995	February, 1997
Share price	\$3.4	\$25.00
Market capitalisation	\$28 mln.	\$209 mln.

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Price V. Industry Index (US\$)



** Representation based on Skate Press Source

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**Red October
Key Financial Characteristics**

Income Highlights (R mlns)	1994	1995	9 months 1996
Total revenue	228,137	596,081	492,888
Net income	48,519	136,457	65,861
Net profit margin	21,31%	22,89%	13,36%
Balance Sheet Highlights (R mlns)			
Current assets	83,092	158,938	234,813
Accounts receivable	4,678	34,774	75,534
Non-current assets	27,926	114,657	241,350
Total Assets	111,018	273,593	476,163
Current liabilities	24,496	41,741	72,084
Accounts payable	17,683	37,638	40,774
Non-current liabilities	3,645	1,035	0
Total liabilities	28,141	42,776	72,064
Shareholders' equity	82,878	230,817	404,078
Current assets/Current liabilities	3.4	3.8	3.3
Tot. liabilities/Shareholders' equity	0.34	0.19	0.18
P/E ratio	2.20	1.39	7.12

Source: Skate Press

Who?

Managers of joint stock companies who want to improve their share prices and attract investors

Criteria:

- be ready to work with Russian and foreign investors
- cooperate and be open with brokers, dealers, media, and other companies which comprise the securities industry and its infrastructure
- be ready to disclose the information not only in accordance with the regulations of the Federal Law on Joint Stock Companies but also with the requirements of investors; the more information is disclosed the more attractive a JSC is for investors
- work with independent registrars
- comply with the law

What?

Effective Corporate Governance and Disclosure => Higher Level of Attractiveness of the Shares for Investors

Making shares of the company attractive for investors through effective corporate governance and disclosure. Disclosure includes the following:

- detailed information about production activity
- information about available equipment
- financial accounting
- strategic plan for development
- business plan
- investment plan
- pricing policy
- constantly informing shareholders, press, the securities market community on all important events in the JSC

The management of the company shall be ready to work with investors and know and respect their shareholders' rights

How?

Establish effective corporate governance,

which means creating a system for effective interaction between three parties of a JSC (shareholders, management and Board of Directors) and ways for representing their interests. This includes the following main concepts:

- Rights and responsibilities of the parties and their interaction within a JSC
- General legal framework for JSC's activities
- Common practice in a given jurisdiction

Make a commitment to issuer transparency,

includes transparency for new issues, the procedures for which are established in the FCSM's Regulation #19 and its annexes.

Create a reputation of high reliability and openness and gaining investors' trust,

which means the necessity to provide investors upon the first request all the required information (in accordance with the Law and common practice) and desire to get high evaluation of transparency and reliability of such information

Disseminate information about the company to investors,

which means using all opportunities to disseminate information about the company through mass media, specialised publications and brokerages, and others working in the securities market.

Red October Discussion Topics

At the April 12, 1997 AGM, the shareholders voted to increase the dividend on ordinary shares from 1,800 roubles to 1,900 roubles and authorize the issue of approximately 1.5 million preferred shares at the nominal value of 1,000 roubles per share. Following the meeting, the press reported further details of the company's plans for raising funds to meet its previously announced \$100,000,000 capital expenditure requirements over the period 1997 - 2000:

- The preferred shares – expected to be issued the first half of 1997 – are to be priced at 75% - 80% of the market price of ordinary shares at the time of issue;
- The company plans a \$20,000,000 Eurobond issue the fourth quarter of 1997;
- The company has arranged a \$15,000,000 credit facility from the European Bank for Reconstruction and Development, to be finalised in the near future.

Please:

- Discuss the results of the Autumn 1994 flotation, and the reasons that all the shares were not placed. Your discussion should include conclusions drawn and lessons learned from the first issue, which will be useful in planning a new issue;
- Review the proposed sources of funding to meet the company's capital expenditure requirements over the period 1997 - 2000. In the interests of achieving a "balanced" approach and meeting the company's full requirements, please consider additional types of funding (for example, internally generated funds and issuing additional common shares). Your review should consider the advantages, disadvantages and corporate governance implications related to each source of funds;
- Determine which party (Annual General Meeting, Board of Directors, or Management) has the authority to approve each funding source.

Please make reasonable assumptions about any company information or other material not provided.

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Background information for your review includes:

Competition and Need for Modernisation

Margins and profit decreased in 1996 (albeit after a strong 1995), principally because of competition. Competition from foreign owned confectionery plants in Russia is expected to become more intense. The competition fought the company for market share, and limited the company's ability to raise prices. The problem was exacerbated by shutdowns of certain production lines as equipment underwent repairs. For the business to grow, the company will need to achieve higher capacity utilisation through modernisation, add regional subsidiaries and develop its distribution network.

Earnings

If the above conditions are met, industry analysts expect earnings to recover, approaching 1995 levels by the year 2000.

Financial Condition

The company's financial condition is strong. In the past, the majority of funding for capital expenditures and investments has come from internal cash flow, but during 1996 the company increased short term loan balances to provide additional funds. Due to a policy to raise equity rather than debt, the company is medium-long term "debt free," and the improving interest rate environment opens the possibility that the company will raise medium-long term debt.

Previous New Share Issue Experience

The company has been a pioneer in new share issues and commitment to disclosure, but new share placements have not been easy. In late 1994, the company sold 1.9 million of a planned 3.5 million share issue. Retail investor interest did not materialise as expected and international investor interest at the time of the issue was impeded by, among other media reports, a Financial Times article in London urging caution when dealing with investments in Russia. The company also made an offering of 2 million shares in the first half of 1996. The issue was not an "easy sell." The City of Moscow ultimately bought 1.65 million shares in exchange for fixed assets and other investors took up the remaining .35 million. The offering price was \$8.75 per share, higher than the market price over the period (the market price was approximately \$5.25 at the beginning of 1996).

1995

Current Share Situation

The company's shares are traded on the Russian Trading System (RTS) and are included in the RTS 24 group of best performing shares. ING Barings estimates that 30% of the company's shares are held by foreign portfolio investors; the company is involved in ING Barings' Russian Depository Receipt Program. In April 1997, the company's shares were trading for \$20.00, vs. book value (or net assets) per share of less than \$10.00. There were 8,355,775 shares issued and outstanding. When asked why the company is one of the top performers in the Russian share market (along, primarily, with energy and telecommunications companies), one investment analyst replied "Mainly because they have a reputation for openness, and are known to be the best Russian company in their field."

Shareholder Concerns

Some shareholders are concerned about dilution; some about taking on excessive debt. Maintaining competitiveness and profitability are general concerns.

Red October¹

CASE STUDY²

The main stage of privatization in Russia has been completed quickly and more or less easily. But as it turned out later companies and their employees had to face difficulties after the official privatization. Independence of privatized enterprises from the state had not only positive sides but also negative. Among the main problems is lack of any hope for getting government investments. However, production development is not possible without raising new capital and that makes joint stock companies and their managers try and search different possibilities to attract investments.

Basically, for open type joint stock companies there have been only two main sources of investments: bank loans and new share issues on the equity market. Since interest charges on bank loans have been very high, for many Russian JSCs a new share issue has been the only way to attract capital for development. A JSC needs to not only effectively issue shares, but also place them. The amount of incoming investment funds depends, among other factors, upon the market price of the shares. There are several determinants of share value. One of the main determining factors is an effective system of corporate governance.

Basic Information About the Company

Confectionery "Red October" was founded in 1867. In 1992 state enterprise Moscow Confectionery Factory "Red October" was registered as an open type joint stock company. At the end of 1994 JSC Red October had almost 10 thousand shareholders. There were about 35 managers who had been working for the company for approximately 16 years. They supervised 3,000 employees.

Red October was registered as an open type joint stock company with a charter capital of 224 million rubles: 159,041 ordinary shares and 64,960 preferred shares (owned by Moscow Property Fund). The nominal value of a share was 1,000 rubles. In August 1993 Moscow Property Fund transferred these preferred shares over to Red October which then converted them back into ordinary shares. The stock was then split into 100 ruble shares (2.24 million shares). In December, 1993 the shareholders voted to increase the charter capital to 2.24 billion rubles by increasing the nominal value of the shares to 1,000 rubles. They explained their decision by the high level of inflation existing at the time.

¹ This case was prepared by CFED in December, 1996, using the information provided by Price Waterhouse and Skate Press. We have not done an independent evaluation of this information but we believe that it is reliable.

² This case study was produced by CFED as an integral part of the manual and accompanying workshop. Participants should also refer to Appendix 1 "Equity Market Notes" when reviewing the company profiles and case studies.

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As a result of privatization 51% of the shares were acquired by the company's management and employees, 20% - by subcontractors and suppliers, with the balance held by diverse shareholders who participated in the cash and voucher auctions.

In 1993 "Red October" manufactured over 59 tons of products. 60% of the products were sold in the Moscow region, 28% in other regions of Russia and 12% were exported (mainly to Afghanistan and Mongolia). Main types of production are hard candies (36%) and caramels (37%). The remaining 27% comprise chocolates, cocoa powder and other confectionery products. At present the company manufactures over 200 products with brand names such as "Mishka" and "Rakovaya Sheika".

Development Strategy

The Board of Directors and the managers of the JSC believed that the strategy of the company should be to keep leading positions in the confectionery industry of Russia in terms of quality, volumes of production and sales. Popularity among Russian customers and high demand for the production made it possible for the JSC to keep high prices. Steps of the Russian government aimed at protection of the Russian market against western confectionery products had a positive effect on Red October activities. Several multi-national confectionery factories had been trying to gain direct access to the Russian market. As a result, the management thought that in the future the Russian confectionery industry would have to live through the period of consolidation as powerful multinational firms merged with or acquired the less efficient domestic companies.

In March 1994 the general annual meeting of shareholders was presented with the following guidelines for strategic development of the company: strengthen its role in the regions; complete construction of a new confectionery factory in Kolomna, for which the company hoped to find a joint-venture partner; prepare itself for the possible consolidation in the confectionery industry by establishing a financial holding group in order to be able to buy shares of other Russian confectioneries; increase the volume of production of the most popular brand "Mishka" - to meet this requirement it will be necessary to purchase new technological equipment in Europe; diversify production by starting up manufacturing of a new brand - fried peanuts in small packages; despite the profitability of the local market - to increase export in order to attract hard currency. The productivity aims for all technological lines shall be increasing efficiency and meeting market requirements.

The ambitious development strategy of the company required significant financial resources. Shareholders attending the meeting realized that. They agreed upon another increase in the charter capital. Red October needed 4.5 million dollars for a new technological line to manufacture the most popular brand "Mishka". Besides, it was necessary to raise millions of dollars to replenish working capital, to repair and improve the existing 43 production lines and also to take into account the company's stake in the planned Kolomna factory.

The shareholders made a decision to increase the charter capital by 7.76 billion rubles to add up to 10 billion rubles. In order to do so it was necessary to issue 7.76

million shares with the nominal value of 1,000 rubles. The shareholders voted also for paying 2.24 million shares as dividends. Thus, it was necessary to issue and sell 5.52 million shares. The company's "old" partner - investment and financial company Grant, helped in meeting these requirements. However, during the period from May to July 1994, only 15,000 shares were sold. Giving the possibility of finding a more effective means of obtaining the capital increase, management began exploring other options.

Attempts to Meet the Set Requirements

The JSC management rejected the idea of bank loans right away because of the high interest rates. For the same reasons it rejected the idea of issuing bonds and selling them both in the local market and abroad. Management also considered private placement, but eliminated the idea because regulations at the time prohibited private placements for issues in excess of 50 million rubles.

In October 1994 a British merchant bank, Samuel Montagu, supported by the British Know How Fund, offered Red October and Grant assistance in selling the shares. The managers of Red October seized this opportunity, since they understood that if they worked with a reputable bank such as Samuel Montagu and the consortium of financial institutions affiliated with it, they would be able to not only just sell the shares but sell them at a comparatively high price. They decided that two million shares out of the 5.5 million authorized, un-issued shares should be aimed at a strategic investor and 3.5 million - at Russian and western portfolio investors, both institutional and individual. Such combination had two targets: first, it was supposed to provide the company with cash and broaden the range of potential investors and second, it was supposed to give a Russian or western investor, who has long-term plans for the Russian confectionery industry, an opportunity to purchase a significant package of Red October shares.

Sale of Shares

While developing a strategy for selling shares, specialists of the investment company Grant, as well as representatives of Samuel Montagu, came to the conclusion that out of 3.5 million shares offered for sales to portfolio investors, one million would be sold to Russian individual investors, 1.5 million to Russian institutional investors and one million to western investors. Russian cities where shares would be sold were Moscow, St. Petersburg, and Ekaterinburg. The period for selling the shares was set for two weeks. The short term was explained by the desire of the management to avoid the inflation effects on the share price and also to avoid possible macroeconomic and other risks. In order to successfully sell Red October shares the company Grant appointed several employees to take care of the sales and created a "sales group". The agent of the company in western capital markets was the brokerage firm "James Capel", which was affiliated with Samuel Montagu.

A lot of attention was paid to preparing an Offering Memorandum for the issue. Grant and Samuel Montagu endeavored to provide potential investors with as

much information about the financial condition of the company as possible in order to gain the their trust.

One of the difficulties that the organizers of the share sales had to face was setting the initial share price. American consulting company Price Waterhouse had suggested a value of \$5/share in January 1993, using the method of discounted cash flows (this valuation was not related to the issue); the bank Samuel Montagu evaluated the net assets of the company and suggested a price of 10 dollars for a share; and the company James Capel compared Red October with similar companies in Eastern Europe and suggested that shares be sold at \$6.50/share.

Grant representatives suggested a price of \$ 6.00 (20,000 rubles) and noted that this price was much higher than the price for Red October's shares in the Russian market, which was 10,000 rubles.

Mass media of Russia and Great Britain covered the sales of Red October shares. However, by December 1994 the main aims of Grant and Samuel Montagu were not reached. Of 3.5 million shares offered to portfolio investors, 1.9 million were sold.

Bank MENATEP's Offer to Buy Shares of Red October

On July 11th, 1995 an investment company Alliance-MENATEP placed an ad in the newspapers "*Commersant*" and "*The Moscow Times*" offering to buy 51% of Red October shares from shareholders at \$7.50 per share. This offer was valid through July 25. Alliance-MENATEP made this offer on behalf of JSC "Koloss", the biggest Moscow food processing company. Alliance-MENATEP was a financial consultant of "Koloss". Bank MENATEP was a shareholder of JSC "Koloss" and owned most of its shares. The advertisement said that "Koloss" did not have any plans to make changes to the composition of Red October management. This offer was a typical example of a public tender for share sales.

What is a public tender for purchasing shares? The meaning of this notion is clear: a buyer announces about his/her intention to acquire a controlling interest of shares in a certain company, offers a price for the purchase and then asks shareholders to submit applications for selling their shares at this price within the set period of time. The buyer collects the applications and if he has enough to buy the necessary number of shares he purchases the shares and pays for them. If this number is not enough the buyer has the right to decline his intention to buy shares of this company or to extend the period of his offer. Besides, shareholders have the right to call their shares back during the above-mentioned period of time and submit them again within the time prior to the expiration of that period. For the sake of objective evaluation and security of the documents a third party, depository, which counts the applications and keeps them, is involved.

The price offered by Alliance-MENATEP for an ordinary share was \$7.50. On July 3, 1995 Red October shares traded at \$5.38 which increased to \$6.70 after the

advertisement in the newspapers. 51% out of 6.3 million existing shares would cost the formal buyer, JSC "Koloss", \$24.3 million. It's worth mentioning that if the net profit of the "Red October" in 1994 was 13,7 million dollars (48 519 million rubles), in 1995 it was 29, 4 million dollars (136 457 million rubles).

The advertisement announcing the public tender surprised both the management of Red October and Grant. The Board of Directors of Red October declared in its appeal to the shareholders: "The offer was neither approved by nor coordinated with the company's management. Nevertheless, at the moment the management is considering the offer from the point of view of its attractiveness for both the company and shareholders."

Later Red October and Grant developed "protective" program. By the end of the tender, Alliance-MENATEP did not extend its period even though it did not collect the necessary number of shares. As a result JSC "Koloss" managed to acquire 0.1% of the shares; 2% belong to MENATEP subsidiaries.

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**JSC Heavy Industry
Openness and Rights of Minority Shareholders¹**

- Who? Managers faced with control issues – or other concerns related to relationships with shareholders
- What? Choice between tactical expedient and decision framed by good corporate governance and disclosure –
Choose good corporate governance and disclosure
- When? Always
- Where? Within the JSC, its subsidiaries and governing bodies
- Why? - Avoid reversals due to non-compliance
- Facilitate raising capital: investors reward good governance and disclosure
- How? - Openness – commitment to disclose
- Respect rights of minority shareholders
- Compliance with legal requirements

¹ Please refer to the Equity Market Notes, Appendix 1. These notes were produced by CFED as an integral part of this manual and accompanying workshop. Participants should refer to these notes when reviewing the accompanying profiles and case studies.

12/1

Who?
Managers faced with control issues or related concerns
Example – JSC Heavy Industry

Background

In an effort to consolidate activities, JSC Heavy Industry (Heavy) proposes a complicated stock swap. Heavy perceives minority shareholders to be hostile to its interests, and is apprehensive because one of the options in the swap is for shareholders in Heavy's other subsidiaries to exchange their shares for shares in Heavy's major subsidiary (Major).

Problem

Heavy fears losing control of Major.

Action

Heavy counters risk of losing control by arranging a secret share issue for Major (Heavy controls Major's board). New Major shares are priced at their nominal value (way below market value). Heavy purchases the entire issue, firming up its control.

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What?
Choice between tactical expedient and decision framed by good corporate governance and disclosure
Example – JSC Heavy Industry

Heavy's board of directors chose the tactical expedient – the wrong choice.

Even assuming Major's shareholders had delegated the decision about the share issue to the board, and shareholders did not enjoy pre-emptive rights (not stipulated in Major's charter or waived by Major's shareholders), Heavy and Major made a poor choice:

- The JSC Law clearly states that new issues should be priced at “market value”
- Their decision demonstrates disregard for the rights of minority shareholders
- Their decision dilutes the value of the interests of minority shareholders

Why?

Choose good corporate governance and disclosure

Avoid reversals due to non-compliance

Monitoring and enforcement procedures will grow teeth. The best way to avoid a costly reversal -- for example with respect to the below market pricing of the Major issue -- is to do the right thing in the first place.

Facilitates raising capital: investors reward good governance and disclosure

As a general rule, investors will pay higher prices for good governance and disclosure, *conversely*

Poor governance and lack of disclosure =>

Uncertainty =>

Perceived risk =>

Risk adjusted pricing =>

Lower pricing (or no sale at all)

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How?

Openness

Disclosure should go beyond compliance with formal requirements. It is important to keep shareholders and the investment community informed about plans for new share issues and other significant events.

Respect rights of minority shareholders

Avoid non-shareholder friendly policies such as poor disclosure (for example, inconsistent or irregular communications), refusal of preemptive rights (causing dilution) and non-compliance with legal requirements regarding governing bodies (for example, rights of access).

Compliance

Follow the intent as well as the letter of the law. Do not look for loopholes which may exist because of the newness of laws and procedures.

JSC Heavy Industry Discussion Topics

Your team will develop one of the following three positions:

- YES: JSC Heavy's actions were justified by events and were legal (with justification for the legality);
- NO: JSC Heavy's actions were not legal; and even if justified by some "loophole," violate the spirit and intent of the law and will have an adverse impact on the company's access to international markets (including its planned ADR);
- ALTERNATIVE: How JSC Heavy should have defined and handled the situation.

Please refer to the accompanying relevant portions of the JSC Law for reference, and make any necessary assumptions about the company's charter and prior decisions of the general meeting of shareholders.

JSC Heavy Industry¹

CASE STUDY²

The board of directors of JSC Heavy Industry ("JSC Heavy") met urgently to discuss how to assert and maintain better control over its subsidiaries. JSC Heavy's major subsidiaries were themselves joint-stock companies, with a diverse group of other shareholders beside JSC Heavy. Some of the minority shareholders in JSC Heavy companies were JSC Heavy's competitors. JSC Heavy's overall strategy for obtaining better operational as well as legal control was consolidation, to be implemented through a stock conversion plan - which had been approved by an extraordinary shareholder meeting several months earlier.

The conversions would take place one subsidiary at a time. The essence of the Stock Swap was to offer minority shareholders in each subsidiary a choice of three options:

- Conversion of the subsidiary's shares into a specified number of JSC Heavy's shares;
- Conversion of the subsidiary's shares into a specified number of the shares of JSC Heavy's major subsidiary ("Major");
- A cash buyout of subsidiary's shares, at pre-determined, announced price.

Overall, the swap plan had been proceeding well, with a few bumps in the road.

Problem Situation

The problem arose in a subsidiary ("Recalcitrant") in which JSC Heavy did not have an absolute majority of the shares and in which local business interests had strong operational relationships as well as significant minority shareholdings. The local investors in Recalcitrant also expressed dissatisfaction with the share conversion ratios offered by JSC Heavy, particularly the conversion ratio with respect to Major's shares. Based on the perceived to be unsatisfactory share conversion ratios offered, Recalcitrant's minority shareholders decided to take control of Recalcitrant and go it alone. As a result, a number of these Recalcitrant minority shareholders called an extraordinary shareholder meeting, and -- not allowing JSC Heavy's representative to vote, based on allegedly improper documentation -- excluded JSC Heavy from Recalcitrant's founders (amending the charter to do so), removed JSC Heavy's representatives from Recalcitrant's board and approved a new issue of Recalcitrant common stock to be distributed only among Recalcitrant shareholders in their region.

After the "closed subscription," JSC Heavy's stake in Recalcitrant was diluted from 40% to 10%.

¹ This fictional case study has been prepared by CFED as a basis for seminar discussion about corporate governance concepts and issues. It does not represent an actual situation.

² Please refer to the Equity Market Notes, Appendix 1. These Equity Market Notes were produced by CFED as an integral part of this manual and accompanying workshop. Participants should refer to these notes when reviewing the accompanying profiles and case studies.

JSC Heavy is taking legal action against Recalcitrant; but JSC Heavy's board saw its problems as not over, since several of its other subsidiaries also have difficult minority shareholders. One approach to the problem would be to improve the conversion ratios to make them more attractive to minority shareholders. This "appeasement," however, raised the possibility of putting more of Major's shares in the hands of people not seen to be particularly friendly to JSC Heavy's management.

JSC Heavy's Concerns and Actions

With JSC Heavy owning only slightly more than 50% of Major's voting shares, and smarting from their experience of dilution from the Recalcitrant "closed subscription," JSC Heavy's board became worried about losing control of Major. This could have happened theoretically if enough subsidiary shareholders converted into Major shares, or if Major preferred shareholders obtained voting rights - if for some reason Major missed a preferred dividend.

Fearing the worst, the Major board - acting in alliance with JSC Heavy and without consulting shareholders - voted for a new Major share issue, to be offered at significantly less than market price. The entire issue, which was unannounced, was acquired by JSC Heavy, boosting its percentage of voting shares in Major to comfortably over 50% - and significantly diluting the value of the interests of Major's minority shareholders.

Exhibits

Relevant portions of JSC Law.

Article 11. Company's Charter

1. The company's charter shall be considered a founding document of a company.

2. The requirements of the charter shall be binding for all the bodies of the company and its shareholders.

3. The company's charter shall specify
the full and abbreviated name of the company,
its location,
the type of the company (open or closed),
the number, nominal value, class (ordinary, preference) of shares and types of preference shares issued by the company;
rights of shareholders owning shares of each class (type);
amount of the charter capital of the company,
the structure and the jurisdiction of the company management bodies and the procedure for decision-making;
the procedure for the preparation and holding of the general shareholder meeting, including the list of issues on which decisions are to be taken by a qualified majority or unanimous vote;
information on subsidiaries and representative offices of the company;
and other provisions provided for by this Federal Law.

The company's charter may establish limitations with respect to the number of shares belonging to a single shareholder and their total nominal value, and also the maximum number of votes granted to one shareholder.

The company's charter may include other provisions that are not contrary to this Federal Law and other federal laws.

4. Upon the demand of its shareholders, the auditor or any other concerned person the company shall be obligated within a reasonable time to afford shareholders the opportunity to familiarize themselves with the company's charter, including any amendments to it. The company shall give a copy of its effective charter to a shareholder, on his demand. The charge to be taken shall not exceed the cost of having a copy made.

Article 12. Amendments to and Revision of Company's Charter

1. Introducing amendments to the company's charter or approving a revised company's charter shall be executed on the decision of the general meeting of shareholders. Introducing amendments related to the decrease of the charter capital of the company to the company's charter shall be executed on the grounds of the decision to decrease the charter capital adopted by the general meeting of shareholders.

Amendments to the company's charter related to the increase of the charter capital shall be introduced on the grounds of:

the decision to increase the company's charter capital by way of increasing the nominal value of the shares or through placement of additional shares adopted by the general meeting of shareholders or the Board of Directors (Supervisory Board) of the company, if in conformity with the decision of the general meeting of shareholders or the company's charter the latter is entitled to adopting such a decision; and

the decision of the Board of Directors (Supervisory Board) of the company to approve the results of additional shares placement.

The increase of the charter capital by way of placing additional shares shall be registered in the amount of the nominal value of the additionally placed shares. In this case the number of the authorized shares of certain classes and types shall be decreased by the number of additionally placed shares of these classes and types.

2. Amendments shall be made to the charter or the revised charter of the company shall be approved by the decision of the general meeting of shareholders, adopted by a three fourths majority vote of shareholders possessing voting shares, who participate in the general meeting of shareholders, and in instances provided for by subparagraphs 3-5 of paragraph 1 of this Article - on the grounds of the decision by the shareholder general meeting adopted by the majority vote of shareholders participating in the general meeting or on the grounds of the decision by the company's Board of Directors (Supervisory Board) adopted unanimously.

Article 28. Increase of Company's Charter Capital

1. The company's charter capital may be increased through the increase of the nominal value of the shares or through placement of additional shares.

2. The decision on increasing the charter capital through an increase in the nominal value of the shares and on relevant amendments to the company's charter shall be made at the general meeting of shareholders or by the company's Board of Directors (Supervisory Board) in instances when the Board of Directors (Supervisory Board) has a right to adopt such a decision in conformity with the company's charter or in accordance with a decision of the general meeting of shareholders.

3. Additional shares may be placed by the company only within the amount of the authorized shares established by the company's charter.

Should the decision with respect to the increase of the charter capital through the issuance of additional shares be within the jurisdiction of the general meeting of shareholders, the decision on the increase of the charter capital through the placement of additional shares may be taken at the general meeting of shareholders together with the decision on the increase of the number of authorized shares.

The decision on the increase of the charter capital through the placement of additional shares within the amount of authorized shares may be taken by the company Board of Directors (Supervisory Board), should it have the right to take such a decision in conformity with the company's charter or the decision of the general meeting of shareholders.

The decision to increase the charter capital through the issuance of additional shares shall also determine the number of additionally placed ordinary shares and each type of preference shares within the amount of the authorized shares of this class (type), the time limits and terms for their placement, including the price for placing additional shares of the company with the shareholders having the preemptive right to acquire the issued shares in conformity with this Federal Law.

4. The increase of the charter capital through the issuance of additional shares which includes the block of shares providing for 25 percent of votes at the general meeting of shareholders and retained in state or municipal ownership in conformity with the legal acts of the Russian Federation may be executed in the course of the retention period only if the state or municipal share is preserved under such an increase.

Article 32. Rights of Shareholders Owning Preference Shares of Company

1. Shareholders owning preference company's shares shall have no right to vote at a general meeting of shareholders, unless provided otherwise by this Federal Law or the company charter for a certain type of preference shares of the company.

The preference shares of the same type shall grant the shareholders owning these shares an equal amount of rights and shall be of the same nominal value.

2. The company's charter shall determine the amount of the dividend and (or) the value paid when the company is liquidated (liquidation value) for the preference shares of each type. The amount of the dividend and the liquidation value shall be determined as a fixed monetary sum or as a percentage of the nominal value of the preference shares. The amount of the dividend and the liquidation value of the preference shares shall be determined also pursuant to the charter of the company if such establishes a procedure for determining them. The shareholders owning preference shares of an unspecified dividend amount shall have the right to receive dividends on an equal basis with the shareholders of ordinary shares.

Should the company's charter provide for the preference shares of two or more types, the charter of the company shall also establish the priority for payment of dividends and the liquidation value of each type of preference shares.

The company's charter may establish that the dividend on preference shares of a certain type the amount of which is specified in the charter that is not paid or is not fully paid shall be accumulated and paid in the future (cumulative preference shares).

The company's charter may also specify the possibility and the terms for converting preference shares of a certain type into ordinary shares or preference shares of other types.

3. Shareholders owning preference shares shall participate in the general meeting of shareholders with the right to vote on the issue of reorganization and liquidation of the company. Shareholders owning preference shares of a certain type shall acquire a right to vote on the issues related to the introduction of amendments into the charter of the company limiting the rights of the shareholders owning such types of preference shares, including issued related to determining or increasing the liquidation value paid on preference shares of the preceding priority, and also granting shareholders owning other types of preference shares privileges as to the priority of payments of dividends and (or) liquidation value of shares.

4. Shareholders owning preference shares of a certain type the amount of dividend on which is determined by the company's charter, with the exception of shareholders owning cumulative preference shares, shall have the right to participate in the general meeting of shareholders and the right to vote on all issues within its jurisdiction starting with the meeting following the annual general meeting of shareholders which did not accept a decision on payment of dividends or adopted a decision on partial payment of dividends on preference shares of this type. The right of shareholders owning preference shares of this type to participate in the general meeting of shareholders shall be terminated from the moment of the first full payment of dividends on these shares.

Shareholders owning cumulative preference shares of a certain type shall have the right to participate in the general meeting of shareholders and the right to vote on all issues within its jurisdiction starting with the meeting following the annual general meeting of shareholders which should have adopted the decision to pay the full amount of dividends accrued on these shares, if such decision was not adopted or if a decision was adopted to pay the dividends in part. The right of shareholders owning cumulative preference shares of a certain type to participate in the general meeting of shareholders shall be terminated from the moment all the dividends accrued on the specified shares are paid in full.

5. The company's charter may provide for the right to vote on the preference shares of a certain type, if the company's charter provides for the possibility to convert shares of this type into ordinary shares. In this instance the owner of such preference share shall have a number of votes not exceeding the number of votes on the ordinary share into which the preference share belonging to him may be converted.

Article 40. Securing Shareholder Rights under Issue of Shares and Securities Convertible into Shares

1. In the event the company places voting shares and securities convertible into voting shares through an open subscription while paying for them in money, the company's charter may provide that the shareholders who own voting shares of the company shall have the preemptive right to acquire these securities in an amount proportionate to the company's voting shares owned by them.

2. The decision to waive the preemptive right to acquire voting shares and securities convertible into voting shares where they are placed through an open subscription and are paid for in money, and also on the terms of the validity of such decision, may be adopted at the general meeting of shareholders, by the majority vote of the shareholders owning voting shares and participating in the general meeting of shareholders.

The decision to waive the preemptive right to acquire voting shares and securities convertible into voting shares shall be valid within the term established by the decision of the general meeting of shareholders, but no longer than a year from the moment of adopting such a decision.

3. The provisions of this Article shall not apply to the owners of preference shares who acquired the right to vote in conformity with paragraphs 3 and 4 of Article 32 of this Federal Law.

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Article 41. Procedure for Exercising Preemptive Right to Acquire Shares and Securities Convertible into Shares

1. Not later than thirty days prior to the first day of the placement of voting shares and securities convertible into voting shares payable for in money, shareholders owning the voting shares of the company shall be notified about the possibility of exercising the rights provided in Article 40 of this Federal law in conformity with the procedure provided for by the Federal Law with respect to the information on holding the general meeting of shareholders.

The notification shall comprise information on the number of the voting shares and securities convertible into voting shares placed, the price for their placement (including the price for their placement with the company's shareholders who exercise a preemptive right of acquisition), the procedure for determining the amount of securities that each shareholder has the right to acquire, the term of validity and the procedure for executing this right by the shareholder.

2. A shareholder shall have the right to exercise his preemptive right either fully or partially by means of sending to the company within the established period a written application for the acquisition of ordinary shares and securities convertible into voting shares, which shall include the name (company name) and address (location) of the shareholder, the number of shares being acquired by him and the document confirming his payment for the securities. Such application shall be sent to the company no later than the day preceding the starting date of placing additional voting shares and securities convertible into voting shares.

Equity Market Notes¹

Ready Market for a Company's Securities

A company should develop and preserve a ready market for its securities. The company and its shares should be sufficiently known and appreciated by the investment community that secondary share offerings, even if substantial, can be readily sold to retail investors or placed with institutional investors. In this way, strategic financial management and capital raising depend on open disclosure practices and developing a reputation for commitment to shareholder interests.

Linkage Between Disclosure, Issuer Transparency and Pricing Stability/Value

A company wishing to develop a market for its shares must be ready to disclose a significant amount of information. More generally, the company must be known to be open to external investors and aware of investor rights.

The concept is straight-forward. If investors are given thorough information on a company and have confidence in the information they are given, they will be more likely fully to value the company based on its fundamental attributes and prospects. Their valuation based on the fundamentals should lead to a more stable stock price. Stock prices which are not based on fundamentals tend to react more to rumors – unfounded or not – and general market swings.

Transparency also promotes a more diversified shareholder base, including long term holders, less likely to sell in the short term as a result of factors not connected to the fundamentals of the company. Finally, transparency is a major criterion of many institutional investors. Opening the possibility of ownership to these investors – frequently long term holders --increases demand for the shares, leading to a potentially higher price.

Share Demand and Supply

In a thinly traded market, there is often a wide spread between the bid (what buyers are willing to pay) and asked (what sellers are willing to sell for) price for shares. If buyers without much zeal are offering R100, sellers – assuming they have confidence in the company and believe it is worth more --will not have a great motivation to sell; and without much enthusiasm may offer their shares for R175, or may not offer them at all. As a result, few if any shares will trade because the gap is too wide. If more demand for the shares is created – especially if potential buyers can be made to compete with each other -- the bid prices will rise. Once the bid prices rise, potential sellers will take notice. Seeing the possibility of a reasonable price, the sellers will be motivated more seriously to consider selling. This increases the supply of shares potentially available. Some holders will lower their asked prices. Spreads will narrow and more trades will take place. For example if bids increase from, say, R100 to R165; some holders of the shares will decide to lower their asked price from R175 and trades will take place.

Liquidity

Liquidity in the equity markets is defined as the ability of a stock to absorb a substantial amount of buying and selling without disturbing the price significantly. This reduction in volatility gives investors confidence in the ownership positions they have

¹ These "Equity Market Notes" were produced by CFED as an integral part of this manual and accompanying workshop. Participants should refer to these notes when reviewing the company profiles and case studies.

taken in a company, since wide market swings can distract attention from solid company fundamentals or favorable prospects. Liquidity is a key criterion for foreign institutional investors, since they always want to be able to "exit" from a position without their own selling transaction causing a price decline – resulting in a loss for them.

Liquidity and Pricing

Liquidity promotes better pricing for a number of related reasons, all connected to increased demand for the shares. There is more demand because there are more investors interested in the stock. Investors are more interested in the stock because of price efficiency (resulting in lower spreads between bid and asked prices), caused by competition among potential buyers. There is also more demand because sophisticated investors are attracted to stocks with less volatility, reducing the risk of loss due to illiquidity.

Better Pricing and Raising Capital, with Less Dilution and Lower Cost

A successful stock with a favorable price history and ready market is clearly a more effective vehicle for raising fresh capital because the new issue will be met with investor enthusiasm and buying interest. Another reason relates to dilution: a company whose shares are selling for R100 will have to sell half as many new shares (and ownership interest) to raise R100mn as a company whose shares are selling for R50. Additionally, the cost of equity capital is less for a company with a higher price, as measured by the price-to-earnings (P/E) ratio. The cost of capital is less because a company does not have to sell as large a percentage of its ownership (and therefore future earnings and dividends) to raise a similar amount of money as it would if it had a lower P/E. (Let us compare a company with a P/E of 5 and a company with a P/E of 10, and switch the ratio around to an earnings-to-price ratio. The company with a P/E of 5 has an earnings-to-price ratio of 20:100 and the company with a P/E of 10 has an earnings-to-price ratio of 10:100. In a new equity raising exercise, the company with a P/E of 5 is selling R20 worth of earnings to raise R100 while the company with a P/E of 10 only has to give up R10 of earnings to raise R100.)

How ADRs can Improve Stock Pricing Stability/Value

ADRs can improve share pricing stability by facilitating access to a broader, larger and more diversified investor base – including the type of sophisticated investors who appreciate companies with open disclosure, sound fundamentals and a liquid share market. The price may be helped because demand will rise as investor interest becomes more widespread.

New Issues – Selected Terminology²

Tombstone

Following equity and debt offerings, as well as certain private financing transactions, a "tombstone" advertisement is placed in major newspapers and specialised publications. The tombstone identifies the issuer, amount and type of transaction, as well as bankers instrumental in the financing (for example, lead manager, underwriter and placing agent). The tombstones are placed by the financial institutions, providing publicity and useful information to issuers, market participants and investors.

² For a discussion of these terms, see Appendix 8, Press Coverage of Corporate Governance in Russia, article by Victor Karetnikov, "New Share Issues - American Style," *Dyelovoi Express*, February 19, 1997. Moscow. Also, see also TsUM company profile, section 6 of this manual, for a sample tombstone.

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Red Herring

A "red herring" in America is a preliminary prospectus, which companies and their bankers circulate to potential investors for information purposes while a new issue transaction is in the process of being registered. Such a preliminary prospectus is called a "red herring," because of the statement in red ink on its front page indicating that the company is not selling securities before registration is effective.

Balanced Funding Approach – Need for Equity Capital

The proportion of short-term debt, long-term debt and equity a company uses to fund its requirements depends on a number of factors, including:

- risk
- financial condition
- cash flow
- purpose
- availability and cost
- philosophy.

Equity is the main building block, the solid foundation of any enterprise's capital structure. Accordingly, a portion of the funding requirements of expansion or other activities should only be financed with debt to the extent that risk is controlled or eliminated. Keeping in mind the limitations summarized below, short term debt can be suitable for short term, often seasonal requirements (the classic example is using short term debt to help acquire an inventory of Christmas trees in November, with the debt paid off through the sale of the trees before Christmas); medium/long term debt is suitable for financing assets whose usefulness lasts more than one year (for example, a truck, with debt paid off by cash flow over the useful life of the truck). Equity is suitable for more permanent asset levels. Equity also acts as a "cushion," to provide a margin of safety in case business results vary from plan – which is almost always the case.

As a business grows, it needs to add fresh equity to maintain a healthy leverage ratio (Total Liabilities/Net Worth). Accordingly, a growing business needs to add to its equity base -- through retained earnings and/or new issues -- if the business is to maintain its ability to borrow (to fund a portion of its requirements).

Risk

The proportion of equity a project or venture requires is a function of risk. If virtually all risks are eliminated, a project has an assured cash flow and needs only a small portion of equity. In most businesses, this is not the case.

Looking back at the Christmas tree example, let us say you paid \$1,000 for a shipment of trees in November. You borrowed \$500 for 60 days and used equity to fund the balance.

After Christmas, you find you have not sold 20% of the trees. However, you still generated sufficient cash to pay off your debt – because you used equity to fund half the cost of the trees. Equity requirements grow: the following year, if you want to buy \$2,000 worth of trees, you will need \$1,000 worth of equity.

The same concept of equity acting as a cushion applies to the truck example. You buy a truck for \$10,000. You borrow \$4,000 for three years and use your equity to fund the rest of the purchase price. Your truck misses out on some important cargo contracts and is out of commission for some time due to breakdowns. However, because you used your equity to finance part of the cost, you are still able to make

payments on the debt. If your business grows and you want to buy two trucks for a total of \$20,000, you will need \$12,000 worth of equity.

Financial Condition

A company's financial condition results from how the company capitalized itself (in other words, if it had enough equity in the first place) and whether or not the company was profitable. Financial condition is often measured in terms of certain financial statement ratios. Two of the most commonly used ratios are the Leverage Ratio and the Current Ratio.

Although there are various ways to calculate leverage, one popular way is Total Liabilities/Net Worth. The lower the ratio the better. The number resulting from this calculation becomes too high when liability growth exceeds the growth of equity. This generally happens when the business is growing without improving its profitability sufficiently, not retaining enough earnings in the business, losing money or not controlling the growth of liabilities. What is considered a satisfactory leverage ratio varies according to industry and market practice. Apart from the need for better management controls (see immediately above), an unsatisfactory leverage ratio means the company needs more equity.

The Current Ratio is a measure of balance sheet liquidity and is calculated as Current Assets/Current Liabilities. The higher the ratio the better. The number resulting from this calculation becomes too low when current liability growth exceeds the growth of current assets. What is considered a satisfactory Current Ratio varies according to industry and market practice. One way to increase the Current Ratio is to reduce the level of current liabilities by replacing them with longer term debt financing or equity. Accordingly, an unsatisfactory Current Ratio means the company needs more longer term capital – most likely equity.

Equity is the main building block. A company whose financial condition indicates a need for more equity will certainly need to increase its equity before it can hope to be successful in obtaining debt financing.

Cash Flow

A company will only be able to borrow what its cash flow projections, allowing for risk, indicate it will be able to repay comfortably. Beyond that, additional funding requirements must be sourced from additional equity.

Purpose

Short-term funding should never be used to finance long-term or permanent requirements. Long-term debt or equity should be used to finance at least a portion of all short-term requirements.

Availability and Cost

Only instruments and maturities reasonably available (or expected to be available) in a specific market should be considered. It does not make sense to plan to borrow a 15 year loan if it is not available in your market.

Reducing the overall cost of funding is also important. Debt is clearly relatively more attractive when interest rates are low. Higher price-to-earnings ratios make equity relatively more attractive by reducing the equity cost of capital. The equity cost of capital is lower because the company does not need to sell as large a portion of its ownership (and earnings and dividends) to raise a specific amount of money.

Philosophy

Some company's believe in leverage and some do not. There are many successful American companies which could borrow substantial funds but do not simply because they do not like debt. The reason they do not like debt is that they do not like risk. Avoidance of debt is also attractive to certain investors. The legendary investor Warren Buffett always looks for companies with little or no debt.

Legal and Regulatory Environment for Russian Joint Stock Companies

General

Federal Law on Joint Stock Companies

Federal Law on the Securities Market

Civil Code of the Russian Federation

Securities

Law of the Russian Federation No. 39 "On the Securities Market" adopted by the State Duma on 20 March 1996 and effective 25 April 1996

Regulation No. 1 (?) of the Federal Commission for the Securities Market

Regulation No. 2 (?) of the Federal Commission for the Securities Market

Regulation No. 3 (1995) of the Federal Commission for the Securities Market

Regulation No. 4 (1996) of the Federal Commission for the Securities Market, "On Methods for Accounting and Reporting by United Investment Funds" (May 5)

Regulation No. 5 (1996) of the Federal Commission for the Securities Market, "On the Circulation of Undocumented Promissary Notes; On Certification of Operators of the System of Circulation of Undocumented Promissary Notes; Standards for the Activities of Participants in the System of Circulation of Undocumented Promissary Notes" (May 5)

Regulation No. 6 (1995) of the Federal Commission for the Securities Market

Regulation No. 7 (1996) of the Federal Commission for the Securities Market, Amendments and Additions to Regulation No. 6, "Interim Procedures for Licensing the Maintenance of Registers of Registered Securities Holders" (May 5)

Accounting

Regulation for Book-keeping and Accounting in the Russian Federation (Approved by the Instruction of Ministry of Finance of the Russian Federation No. 170 of 26 December 1994) as amended on 19 December 1995.

Letter of the Ministry of Finance of the Russian Federation No. 115 of 19 October 1995 on the Instructions for Filling in of the Forms of Annual Financial Statements in 1995. Items 3.1 - 3.14 were replaced by Order No. 31 (see below) effective 1 April 1996.

Chart of Accounts - Order of the Ministry of Finance of the USSR, 1 November 1991, No. 56 as amended on 28 December 1994 and 28 July 1995.

Regulations for Accounting of Assets and Liabilities in Foreign Currency, No. 150, 13 June 1995.

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Order of the Ministry of Finance of the Russian Federation from 27 March 1996, No. 31, "The Model Forms for the Quarterly Book Accounting Reports."

Order of the Ministry of Finance of the Russian Federation from 8 February 1996, No. 10, "The Approval of the Regulations for Accounting."

Order of the Ministry of Finance of the Russian Federation from 13 June 1995, No. 49, "Instructions for the Inventory Making of Property and Financial Obligations."

Decree of the President of the Russian Federation from 8 May 1996, No. 685, "On the Main Principles of Tax Reform in the Russian Federation."

Federal Law 129-FZ of November 21, 1996. "On Accounting."

Shareholders' Rights

Presidential Decree No. 408, "Complex Program on the Protection of Investors' and Shareholders' Rights (March 21, 1996)

Regional-Specific Corporate Governance Issues

The dates of our workshops were:

Nizhny Novgorod	-	February 1997
Kazan	-	March 1997
Irkutsk	-	April 1997
Vladivostok	-	May 1997.

Following each workshop, our regional advisory team and Moscow-based team produced a report on regional-specific corporate governance issues. Each report includes a synopsis of the issues discussed in the workshop, responses to specific concerns raised by participants, and suggestions on how to obtain further information and/or consultation on particular corporate governance problems.

The reports were distributed to all workshop participants as well as Moscow and regional offices of the Federal Commission for the Securities Market and the Chamber of Commerce and Industry of the Russian Federation.

Sample Corporate Governance Documents

Participants will work with a number of documents, distributed to them at the seminar as handouts.

The following documents were prepared by the International Institute for Law-Based Economy Foundation (ILBE) in Moscow:

- Model Charter
- Regulations regarding the Annual General Meeting of Shareholders
- Regulations regarding the Board of Directors
- Regulations regarding the General Director
- Regulations regarding Executive Management
- Regulations regarding the Audit Commission
- Regulations regarding the Inspection Commission
- Regulations regarding the Share Register.

Participants will also receive copies of these documents:

Federal Law on Joint Stock Companies.

Federal Law on the Securities Market.

Regulation 19 of the Federal Commission on the Securities Market, "On Approval of the Standards for Share Issues and Issues Prospectuses During the Creation of Joint Stock Companies and Additional Issues of Shares and Bonds."

Regulation 8 of the Federal Commission on the Securities Market, (Amendments to Regulation 19).

Glossary of Corporate Governance and Corporate Finance Terminology, published by the Moscow Public Committee for Shareholders Rights, 1994.

Three Models of Corporate Governance from Developed Capital Markets

Introduction

The corporate governance structure of joint stock corporations in a given country is determined by several factors: the legal and regulatory framework outlining the rights and responsibilities of all parties involved in corporate governance; the *de facto* realities of the corporate environment in the country; and each corporation's articles of association. While corporate governance provisions may differ from corporation to corporation, many *de facto* and *de jure* factors affect corporations in a similar way. Therefore, it is possible to outline a "model" of corporate governance for a given country.

In each country, the corporate governance structure has certain characteristics or constituent elements, which distinguish it from structures in other countries. To date, researchers have identified three models of corporate governance in developed capital markets. These are the Anglo-US model, the Japanese model, and the German model.

Each model identifies the following constituent elements: key players in the corporate environment; the share ownership pattern in the given country; the composition of the board of directors (or boards, in the German model); the regulatory framework; disclosure requirements for publicly-listed stock corporations; corporate actions requiring shareholder approval; and interaction among key players.

The purpose of this article is to introduce each model, describe the constituent elements of each and demonstrate how each developed in response to country-specific factors and conditions. Readers should understand that it is not possible to simply select a model and apply it to a given country. Instead, the process is **dynamic**: the corporate governance structure in each country develops in response to country-specific factors and conditions.

The Anglo-US model¹

The Anglo-US model is characterized by share ownership of individual, and increasingly institutional, investors not affiliated with the corporation (known as outside shareholders or "**outsiders**"); a well-developed legal framework defining the rights and responsibilities of three key players, namely management, directors and shareholders; and a comparatively uncomplicated procedure for interaction between shareholder and corporation as well as among shareholders during or outside the AGM.

Equity financing is a common method of raising capital for corporations in the United Kingdom (UK) and the US. It is not surprising, therefore, that the US is the largest capital market in the world, and that the London Stock Exchange is the third largest stock exchange in the world (in terms of market capitalization) after the New York Stock Exchange (NYSE) and Tokyo.

There is a causal relationship between the importance of equity financing, the size of the capital market and the development of a corporate governance system. The US is both the world's largest capital market and the home of the world's most-developed system of proxy voting and shareholder activism by institutional investors.

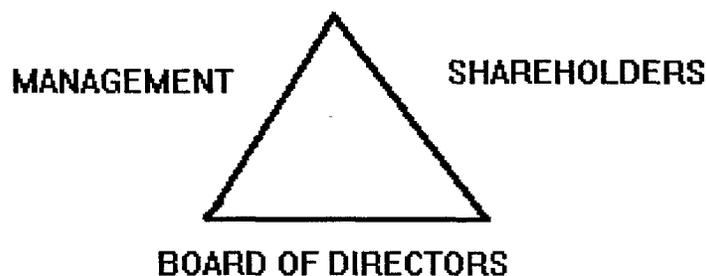
¹ The Anglo-US model governs corporations in the UK, the US, Australia, Canada, New Zealand and several other countries.

Institutional investors also play an important role in both the capital market and corporate governance in the UK.

Key Players in the Anglo-US model

Players in the Anglo-US model include management, directors, shareholders (especially institutional investors), government agencies, stock exchanges, self-regulatory organizations and consulting firms which advise corporations and/or shareholders on corporate governance and proxy voting.

Of these, the three major players are management, directors and shareholders. They form what is commonly referred to as the "corporate governance triangle." The interests and interaction of these players may be diagrammed as follows:



The Anglo-US model, developed within the context of the free market economy, assumes the separation of ownership and control in most publicly-held corporations. This important legal distinction serves a valuable business and social purpose: investors contribute capital and maintain ownership in the enterprise, while generally avoiding legal liability for the acts of the corporation. Investors avoid legal liability by ceding to management control of the corporation, and paying management for acting as their agent by undertaking the affairs of the corporation. The cost of this separation of ownership and control is defined as "agency costs".

The interests of shareholders and management may not always coincide. Laws governing corporations in countries using the Anglo-US model attempt to reconcile this conflict in several ways. Most importantly, they prescribe the election of a board of directors by shareholders and require that boards act as **fiduciaries** for shareholders' interests by overseeing management on behalf of shareholders.

Two diagrams at the end of this article explain the dynamics of the Anglo-US model in theory and in practice.

Share Ownership Pattern in the Anglo-US model

In both the UK and the US, there has been a marked shift of stock ownership during the postwar period from individual shareholders to institutional shareholders. In 1990, institutional investors held approximately 61 percent of the shares of UK corporations, and individuals held approximately 21 percent. (In 1981, individuals held 38 percent.) In 1990, institutions held 53.3 percent of the shares of US corporations.²

² The term "capital market" is broad, encompassing all the markets where stocks (also known as shares), bonds, futures, derivatives and other financial instruments are traded. "Securities market" is more specific, referring to stocks and bonds. "Equity market" is most specific, referring only to stock, also known as equity.

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The increase in ownership by institutions has resulted in their increasing influence. In turn, this has triggered regulatory changes designed to facilitate their interests and interaction in the corporate governance process.

Composition of the Board of Directors in the Anglo-US model

The board of directors of most corporations that follow the Anglo-US model includes both “insiders” and “outsiders”. An “insider” is as a person who is either employed by the corporation (an executive, manager or employee) or who has significant personal or business relationships with corporate management. An “outsider” is a person or institution which has no direct relationship with the corporation or corporate management.

A synonym for insider is **executive director**; a synonym for outsider is **non-executive director** or **independent director**.

Traditionally, the same person has served as both chairman of the board of directors and chief executive officer (CEO) of the corporation. In many instances, this practice led to abuses, including: concentration of power in the hands of one person (for example, a board of directors firmly controlled by one person serving both as chairman of the board of directors and CEO); concentration of power in a small group of persons (for example, a board of directors composed solely of “insiders”; management and/or the board of directors’ attempts to retain power over a long period of time, without regard for the interests of other players (entrenchment); and the board of directors’ flagrant disregard for the interests of outside shareholders.

As recently as 1990, one individual served as both CEO and chairman of the board in over 75 percent of the 500 largest corporations in the US. In contrast to the US, a majority of boards in the UK have a non-executive director. However, many boards of UK companies have a majority of inside directors: in 1992, only 42 percent of all directors were outsiders and nine percent of the largest UK companies had no outside director at all.³

Currently there is, however, a discernible trend towards greater inclusion of “outsiders” in both US and UK corporations.

Beginning in the mid-1980s, several factors contributed to an increased interest in corporate governance in the UK and US. These included: the increase in institutional investment in both countries; greater governmental regulation in the US, including regulation requiring some institutional investors to vote at AGMs; the takeover activity of the mid- to late-1980s; excessive executive compensation at many US companies and a growing sense of loss of competitiveness vis-a-vis German and Japanese competitors.

In response, individual and institutional investors began to inform themselves about trends, conduct research and organize themselves in order to represent their interests as shareholders. Their findings were interesting. For example, research conducted by diverse organizations indicated that **in many cases a relationship exists between lack of effective oversight by the board of directors and poor corporate financial performance**. In addition, corporate governance analysts noted that “outside” directors often suffered an informational disadvantage vis-a-vis “inside” directors and were therefore limited in their ability to provide effective oversight.

³ Data from “Board Directors and Corporate Governance: Trends in the G7 Countries Over the Next Ten Years,” a study prepared for Russell Reynolds Associates, Price Waterhouse, Goldman Sachs International, and Gibson, Dun & Crutcher, by Oxford Analytica Ltd. Oxford, England, September 1992.

Several factors influenced the trend towards an increasing percentage of "outsiders" on boards of directors of UK and US corporations. These include: the pattern of stock ownership, specifically the above-mentioned increase in institutional investment the growing importance of institutional investors and their voting behavior at AGMs; and recommendations of self-regulatory organizations such as the Committee on the Financial Aspects of Corporate Governance in the UK and shareholder organizations in the US.

Board composition and board representation remain important shareholder concerns of shareholders in the UK and US. Perhaps this is because other corporate governance issues, such as disclosure and mechanisms for communication between corporations and shareholders, have largely been resolved.

UK and US boards are generally smaller than boards in Japan and Germany. In 1993, a survey of the boards of the 100 largest US corporations conducted by the executive search firm Spencer Stuart found that boards were shrinking slightly; the average size was 13, compared with 15 in 1988.

Regulatory Framework in the Anglo-US model

In the UK and US, a wide range of laws and regulatory codes define relationships among management, directors and shareholders.

In the US, a federal agency, the Securities and Exchange Commission (SEC), regulates the securities industry, establishes disclosure requirements for corporations and regulates communication between corporations and shareholders as well as among shareholders.

Laws regulating pension funds also have an important impact on corporate governance. In 1988, the agency of the Department of Labor responsible for regulating private pension funds ruled that these funds have a "fiduciary responsibility" to exercise their stock ownership rights. This ruling had a huge impact on the behavior of private pension funds and other institutional investors: since then, institutional investors have taken a keen interest in all aspects of corporate governance, shareholders' rights and voting at AGMs.

Readers should note that because US corporations are registered and "incorporated" in a particular state, the respective state law establishes the basic framework for each US corporation's rights and responsibilities.

In comparison with other capital markets, the US has the most comprehensive disclosure requirements and a complex, well-regulated system for shareholder communication. As noted above, this is directly related to the size and importance of the US securities market, both domestically and internationally.

The regulatory framework of corporate governance in the UK is established in parliamentary acts and rules established by self-regulatory organizations, such as the Securities and Investment Board, which is responsible for oversight of the securities market. Note that it is not a government agency like the US SEC. Although the framework for disclosure and shareholder communication is well-developed, some observers claim that self-regulation in the UK is inadequate, and suggest that a government agency similar to the US SEC would be more effective.

Stock exchanges also play an important role in the Anglo-US model by establishing listing, disclosure and other requirements.

Disclosure Requirements in the Anglo-US model

As noted above, the US has the most comprehensive disclosure requirements of any jurisdiction. While disclosure requirements are high in other jurisdictions where the Anglo-US model is followed, none are as stringent as those in the US.

US corporations are required to disclose a wide range of information. The following information is included either in the annual report or in the agenda of the annual general meeting (formally known as the "proxy statement"): corporate financial data (this is reported on a quarterly basis in the US); a breakdown of the corporation's capital structure; substantial background information on each nominee to the board of directors (including name, occupation, relationship with the company, and ownership of stock in the corporation); the aggregate compensation paid to all executive officers (upper management) as well as individual compensation data for each of the five highest paid executive officers, who are to be named; all shareholders holding more than five percent of the corporation's total share capital; information on proposed mergers and restructurings; proposed amendments to the articles of association; and names of individuals and/or companies proposed as auditors.

Disclosure requirements in the UK and other countries that follow the Anglo-US model are similar. However, they generally require semi-annual reporting and less data in most categories, including financial statistics and the information provided on nominees.

Corporate Actions Requiring Shareholder Approval in the Anglo-US model

The two routine corporate actions requiring shareholder approval under the Anglo-US model are elections of directors and appointment of auditors.

Non-routine corporate actions which also require shareholder approval include: the establishment or amendment of stock option plans (because these plans affect executive and board compensation); mergers and takeovers; restructurings; and amendment of the articles of incorporation.

There is one important distinction between the US and the UK: in the US, shareholders do not have the right to vote on the dividend proposed by the board of directors. In the UK, shareholders do vote on the dividend proposal.

The Anglo-US model also permits shareholders to submit proposals to be included on the agenda of the AGM. The proposals - known as **shareholder proposals** - must relate to a corporation's business activity. Shareholders owning at least ten percent of a corporation's total share capital may also convene an extraordinary general meeting (EGM) of shareholders.

In the US, the SEC has issued a wide range of regulations concerning the format, substance, timing and publication of shareholder proposals. The SEC also regulates communication among shareholders.

Interaction among Players in the Anglo-US model

As noted above, the Anglo-US model establishes a complex, well-regulated system for communication and interaction between shareholders and corporations. A wide range of regulatory and independent organizations play an important role in corporate governance.

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Shareholders may exercise their voting rights without attending the annual general meeting in person. All registered shareholders receive the following by mail: the agenda for the meeting including background information and all proposals ("proxy statement"), the corporation's annual report and a voting card.

Shareholders may vote by proxy, that is, they complete the voting card and return it by mail to the corporation. **By mailing the voting card back to the corporation, the shareholder authorizes the chairman of the board of directors to act as his proxy and cast his votes as indicated on the voting card.**

In the Anglo-US model, a wide range of institutional investors and financial specialists monitor a corporation's performance and corporate governance. These include: a variety of specialized investment funds (for example, index funds or funds that target specific industries); venture-capital funds, or funds that invest in new or "start-up" corporations; rating agencies; auditors; and funds that target investment in bankrupt or problem corporations. **See the diagram "Diversified Monitoring in Anglo-US Corporate Governance" for a pictorial explanation of this phenomenon.** In contrast, one bank serves many of these (and other) functions in the Japanese and German models. As a result, one important element of both of these models is the strong relationship between a corporation and its main bank.

The Japanese model

The Japanese model is characterized by a high level of stock ownership by affiliated banks and companies; a banking system characterized by strong, long-term links between bank and corporation; a legal, public policy and industrial policy framework designed to support and promote "*keiretsu*" (industrial groups linked by trading relationships as well as cross-shareholdings of debt and equity); boards of directors composed almost solely of insiders; and a comparatively low (in some corporations, non-existent) level of input of outside shareholders, caused and exacerbated by complicated procedures for exercising shareholders' votes.

Equity financing is important for Japanese corporations. However, insiders and their affiliates are the major shareholders in most Japanese corporations. Consequently, they play a major role in individual corporations and in the system as a whole. Conversely, the interests of outside shareholders are marginal. The percentage of foreign ownership of Japanese stocks is small, but it may become an important factor in making the model more responsive to outside shareholders.

Key Players in the Japanese model

The Japanese system of corporate governance is many-sided, centering around a main bank and a financial/industrial network or *keiretsu*.

The main bank system and the *keiretsu* are two different, yet overlapping and complementary, elements of the Japanese model.⁴ Almost all Japanese corporations have a close relationship with a main bank. The bank provides its corporate client with loans as well as services related to bond issues, equity issues, settlement accounts, and related consulting services. The main bank is generally a major shareholder in the corporation.

⁴ See Bergloef, Eric, 1993. "Corporate Governance in Transition Economies: The Theory and its Policy Implications." in Masahiko Aoki and Hyung-Ki Kim, editors, *Corporate Governance in Transitional Economies: Insider Control and the Role of Banks*. Washington, D.C.: The World Bank.

In the US, anti-monopoly legislation prohibits one bank from providing this multiplicity of services. Instead, these services are usually handled by different institutions: commercial bank - loans; investment bank - equity issues; specialized consulting firms - proxy voting and other services.

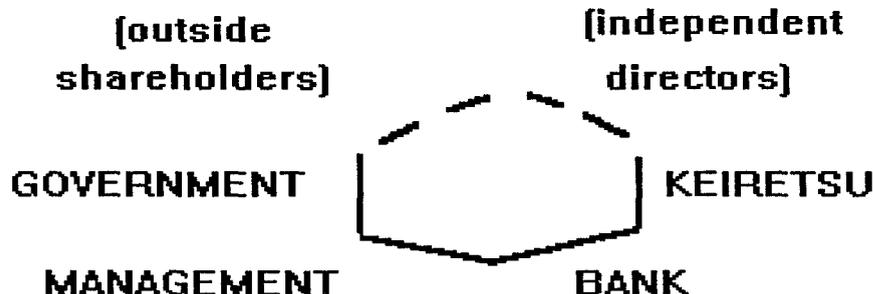
Many Japanese corporations also have strong financial relationships with a network of affiliated companies. These networks, characterized by crossholdings of debt and equity, trading of goods and services, and informal business contacts, are known as *keiretsu*.

Government-directed industrial policy also plays a key role in Japanese governance. Since the 1930s, the Japanese government has pursued an active industrial policy designed to assist Japanese corporations. This policy includes official and unofficial representation on corporate boards, when a corporation faces financial difficulty.

In the Japanese model, the four key players are: main bank (a major inside shareholder), affiliated company or *keiretsu* (a major inside shareholder), management and the government. Note that the interaction among these players serves to link relationships rather than balance powers, as in the case in the Anglo-US model.

In contrast with the Anglo-US model, non-affiliated shareholders have little or no voice in Japanese governance. As a result, there are few truly independent directors, that is, directors representing outside shareholders.

The Japanese model may be diagrammed as an open-ended hexagon:



The base of the figure, with four connecting lines, represents the linked interests of the four key players: government, management, bank and *keiretsu*. The open lines at the top represent the non-linked interests of non-affiliated shareholders and outside directors, because these play an insignificant role.

Share Ownership Pattern in the Japanese model

In Japan, financial institutions and corporations firmly hold ownership of the equity market. Similar to the trend in the UK and US, the shift during the postwar period has been away from individual ownership to institutional and corporate ownership. In 1990, financial institutions (insurance companies and banks) held approximately 43 percent of the Japanese equity market, and corporations (excluding financial institutions) held 25 percent. Foreigners currently own approximately three percent.

In both the Japanese and the German model, banks are key shareholders and develop strong relationships with corporations, due to overlapping roles and multiple services provided. This distinguishes both models from the Anglo-US model, where such relationships are prohibited by anti-trust legislation. Instead of relying on a single

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bank, US and UK corporations obtain financing and other services from a wide range of sources, including the well-developed securities market.

Composition of the Board of Directors in the Japanese model

The board of directors of Japanese corporations is composed almost completely of insiders, that is, executive managers, usually the heads of major divisions of the company and its central administrative body. If a company's profits fall over an extended period, the main bank and members of the *keiretsu* may remove directors and appoint their own candidates to the company's board. Another practice common in Japan is the appointment of retiring government bureaucrats to corporate boards; for example, the Ministry of Finance may appoint a retiring official to a bank's board.

In the Japanese model the composition of the board of directors is conditional upon the corporation's financial performance. A diagram of the Japanese model at the end of this article provides a pictorial explanation.

Note the relationship between the share ownership structure and the composition of Japanese boards. In contrast with the Anglo-US model, representatives of unaffiliated shareholders (that is, "outsiders") seldom sit on Japanese boards.

Japanese boards are generally larger than boards in the UK, the US and Germany. The average Japanese board contains 50 members.

Regulatory Framework in the Japanese model

In Japan, government ministries have traditionally been extremely influential in developing industrial policy. The ministries also wield enormous regulatory control. However, in recent years, several factors have weakened the development and implementation of a comprehensive industrial policy. First, due to the growing role of Japanese corporations at home and abroad, policy formation became fragmented due to the involvement of numerous ministries, most importantly, the Ministry of Finance and the Ministry of International Trade and Industry. Second, the increasing internationalization of Japanese corporations made them less dependent on their domestic market and therefore somewhat less dependent on industrial policy. Third, the growth of Japanese capital markets led to their partial liberalization and an opening, albeit small, to global standards. While these and other factors have limited the cohesion of Japanese industrial policy in recent years, it is still an important regulatory factor, especially in comparison with the Anglo-US model.

In contrast, government agencies provide little effective, independent regulation of the Japanese securities industry. This is somewhat ironic, because the regulatory framework in Japan was modeled on the US system by US occupation forces after the Second World War. Despite numerous revisions, the core of Japan's securities laws remain very similar to US laws. In 1971, in response to the first wave of foreign investment in Japan, new laws were enacted to improve corporate disclosure. The primary regulatory bodies are the Securities Bureau of the Ministry of Finance, and the Securities Exchange Surveillance Committee, established under the auspices of the Securities Bureau in 1992. The latter is responsible for monitoring corporate compliance and investigating violations. Despite their legal powers, these agencies have yet to exert *de facto* independent regulatory influence.

Disclosure Requirements in the Japanese model

Disclosure requirements in Japan are relatively stringent, but not as stringent as in the US. Corporations are required to disclose a wide range of information in the

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annual report and or agenda for the AGM, including: financial data on the corporation (required on a semi-annual basis); data on the corporation's capital structure; background information on each nominee to the board of directors (including name, occupation, relationship with the corporation, and ownership of stock in the corporation); aggregate data on compensation, namely the maximum amount of compensation payable to all executive officers and the board of directors; information on proposed mergers and restructurings; proposed amendments to the articles of association; and names of individuals and/or companies proposed as auditors.

Japan's disclosure regime differs from the US regime (generally considered the world's strictest) in several notable ways. These include: semi-annual disclosure of financial data, compared with quarterly disclosure in the US; aggregate disclosure of executive and board compensation, compared with individual data on the executive compensation in the US; disclosure of the corporation's ten largest shareholders, compared with the US requirement to disclose all shareholders holding more than five percent of the corporation's total share capital; and significant differences between Japanese accounting standards and US Generally Accepted Accounting Practices (US GAAP).

Corporate Actions Requiring Shareholder Approval in the Japanese model

In Japan, the routine corporate actions requiring shareholder approval are: payment of dividends and allocation of reserves; election of directors; and appointment of auditors.

Other common corporate actions which also require shareholder approval include capital authorizations; amendments to the articles of association and/or charter (for example, a change in the size and/or composition of the board of directors, or a change in approved business activities); payment of retirement bonuses to directors and auditors; and increase of the aggregate compensation ceilings for directors and auditors.

Non-routine corporate actions which also require shareholder approval include mergers, takeovers and restructurings.

Shareholder proposals are a relatively new phenomenon in Japan. Prior to 1981, Japanese law did not permit shareholders to put resolutions on the agenda for the annual meeting. A 1981 amendment to the Commercial Code states that a registered shareholder holding at least 10 percent of a company's shares may propose an issue to be included on the agenda for the AGM or EGM.

Interaction among Players in the Japanese model

Interaction among the key players in the Japanese model generally links and strengthens relationships. **This is a fundamental characteristic of the Japanese model.** Japanese corporations prefer that a majority of its shareholders be long-term, preferably affiliated, parties. In contrast, outside shareholders represent a small constituency and are largely excluded from the process.

Annual reports and materials related to the AGM are available to all shareholders. Shareholders may attend the annual general meeting, vote by proxy or vote by mail. In theory, the system is simple; however, the mechanical system of voting is more complicated for non-Japanese shareholders.

Annual general meetings are almost always pro forma, and corporations actively discourage shareholder dissent. Shareholder activism is restricted by an informal yet

important aspect of the Japanese system: the vast majority of Japanese corporations hold their annual meetings on the same day each year, making it difficult for institutional investors to coordinate voting and impossible to attend more than one meeting in person.

The German model⁵

The German corporate governance model differs significantly from both the Anglo-US and the Japanese model, although some of its elements resemble the Japanese model.

Banks hold long-term stakes in German corporations⁶, and, as in Japan, bank representatives are elected to German boards. However, this representation is constant, unlike the situation in Japan where bank representatives were elected to a corporate board only in times of financial distress. Germany's three largest universal banks (banks that provide a multiplicity of services) play a major role; in some parts of the country, public-sector banks are also key shareholders.

There are three unique elements of the German model that distinguish it from the other models outlined in this article. Two of these elements pertain to **board composition** and one concerns **shareholders' rights**:

First, the German model prescribes two boards with separate members. German corporations have a two-tiered board structure consisting of a **management board** (composed entirely of insiders, that is, executives of the corporation) and a **supervisory board** (composed of labor/employee representatives and shareholder representatives). The two boards are completely distinct; no one may serve simultaneously on a corporation's management board and supervisory board. Second, the size of the supervisory board is set by law and cannot be changed by shareholders.

Third, in Germany and other countries following this model, **voting right restrictions** are legal; these limit a shareholder to voting a certain percentage of the corporation's total share capital, regardless of share ownership position.⁷

Most German corporations have traditionally preferred bank financing over equity financing. As a result, German stock market capitalization is small in relation to the size of the German economy. Furthermore, the level of individual stock ownership in Germany is low, reflecting Germans' conservative investment strategy. It is not surprising therefore, that the corporate governance structure is geared towards preserving relationships between the key players, notably banks and corporations.

The system is somewhat ambivalent towards minority shareholders, allowing them scope for interaction by permitting shareholder proposals, but also permitting companies to impose voting rights restrictions.

The percentage of foreign ownership of German equity is significant; in 1990, it was 19 percent. This factor is slowly beginning to affect the German model, as foreign investors from inside and outside the European Union begin to advocate for their interests. The globalization of capital markets is also forcing German corporations to

⁵ The German model governs German and Austrian corporations. Some elements of the model also apply in the Netherlands and Scandinavia. Furthermore, some corporations in France and Belgium have recently introduced some elements of the German model.

⁶ The German term for joint stock corporation is *Aktiengesellschaft*; German and Austrian corporations use the abbreviation AG following their name, for example, Volkswagen AG.

⁷ In 1994, some 10 major German banks and corporations still had voting rights restrictions, although the recent trend in European Union (EU) countries has been to repeal them.

change their ways. When Daimler-Benz AG decided to list its shares on the NYSE in 1993, it was forced to adopt US GAAP. These accounting principles provide much greater financial transparency than German accounting standards. Specifically, Daimler-Benz AG was forced to account for huge losses that it could have "hidden" under German accounting rules.

Key Players in the German model

German banks, and to a lesser extent, corporate shareholders, are the key players in the German corporate governance system. Similar to the Japanese system described above, banks usually play a multi-faceted role as shareholder, lender, issuer of both equity and debt, depository (custodian bank) and voting agent at AGMs. In 1990, the three largest German banks (Deutsche Bank AG, Dresdner Bank AG and Commerzbank AG) held seats on the supervisory boards of 85 of the 100 largest German corporations.

In Germany, corporations are also shareholders, sometimes holding long-term stakes in other corporations, even where there is no industrial or commercial affiliation between the two. This is somewhat similar, but not parallel, to the Japanese model, yet very different from the Anglo-US model where neither banks nor corporations are key institutional investors.

The mandatory inclusion of labor/employee representatives on larger German supervisory boards further distinguishes the German model from both the Anglo-US and Japanese models.

Share Ownership Pattern in the German model

German banks and corporations are the dominant shareholders in Germany. In 1990, corporations held 41 percent of the German equity market, and institutional owners (primarily banks) held 27 percent. Neither institutional agents, such as pension funds (three percent) or individual owners (four percent) are significant in Germany. Foreign investors held 19 percent in 1990, and their impact on the German corporate governance system is increasing.

Composition of the Management Board ("*Vorstand*") and Supervisory Board ("*Aufsichtsrat*") in the German model

The two-tiered board structure is a unique construction of the German model. German corporations are governed by a supervisory board and a management board. The supervisory board appoints and dismisses the management board, approves major management decisions; and advises the management board. The supervisory board usually meets once a month. A corporation's articles of association sets the financial threshold of corporate acts requiring supervisory board approval. The management board is responsible for daily management of the company.

The management board is composed solely of "insiders", or executives. The supervisory board contains no "insiders", it is composed of labor/employee representatives and shareholder representatives.

The Industrial Democracy Act and the Law on Employee Co-determination regulate the size and determine the composition of the supervisory board; they stipulate the number of members elected by labor/employees and the number elected by shareholders.

The numbers of members of the supervisory board is set by law. In small corporations (with less than 500 employees), shareholders elect the entire supervisory board. In medium-size corporations (defined by assets and number of employees) employees elect one-third of a nine-member supervisory board. In larger corporations, employees elect one-half of a 20-member supervisory board.

Note these two key differences between the German model and the other two models. First, the size of the supervisory board is set by law and cannot be changed. Second, the supervisory board includes labor/employee representatives.

While the supervisory board includes no "insiders", it does not necessarily include only "outsiders". The members of the supervisory board elected by shareholders are usually representatives of banks and corporations which are substantial shareholders. It would be more appropriate to define some of these as "affiliated outsiders".

For a pictorial explanation of board composition in the German model, please refer to the diagram of the German model at the end of this article.

Regulatory Framework in the German model

Germany has a strong federal tradition; both federal and state (*Laender*) law influence corporate governance. Federal laws include: the Stock Corporation Law, Stock Exchange Law and Commercial Law, as well as the above-mentioned laws governing the composition of the supervisory board are all federal laws. Regulation of Germany's stock exchanges is, however, the mandate of the states.

A federal regulatory agency for the securities industry was established in 1995. It fills a former void in the German regulatory environment.

Disclosure Requirements in the German model

Disclosure requirements in Germany are relatively stringent, but not as stringent as in the US. Corporations are required to disclose a wide range of information in the annual report and/or agenda for the AGM, including: corporate financial data (required on a semi-annual basis); data on the capital structure; limited information on each supervisory board nominee (including name, hometown and occupation/affiliation); aggregate data for compensation of the management board and supervisory board; any substantial shareholder holding more than 5 percent of the corporation's total share capital; information on proposed mergers and restructurings; proposed amendments to the articles of association; and names of individuals and/or companies proposed as auditors.

The disclosure regime in Germany differs from the US regime, generally considered the world's strictest, in several notable ways. These include: semi-annual disclosure of financial data, compared with quarterly disclosure in the US; aggregate disclosure of executive compensation and supervisory board compensation, compared with individual data on executive and board compensation in the US; no disclosure of share ownership of members of the supervisory board, compared with disclosure of executive and director's stock ownership in the US; and significant differences between German accounting standards and US GAAP.

One key accounting difference in Germany is that corporations are permitted to amass considerable reserves. These reserves enable German corporations to understate their value. This practice is not permitted under US GAAP.

Until 1995, German corporations were required to disclose shareholders holding more than 25 percent of the total share capital. In 1995, this threshold was lowered to 5 percent, bringing Germany in line with international standards.

Corporate Actions Requiring Shareholder Approval in the German model

The routine corporate actions requiring shareholder approval under the German model are: allocation of net income (payment of dividends and allocation to reserves); ratification of the acts of the management board for the previous fiscal year; ratification of the acts of the supervisory board for the previous fiscal year; election of the supervisory board; and appointment of auditors.

Approval of the acts of the management board and supervisory board are basically a “**seal of approval**” or “**vote of confidence**.” If shareholders wish to take legal action against individual members of either board or against either board as a whole, they refrain from ratifying the acts of the board for the previous year.

In contrast with the Anglo-US and the Japanese models, **shareholders do not possess the authority to alter the size or composition of the supervisory board. These are determined by law.**

Other common corporate actions which also require shareholder approval include capital authorizations (which automatically recognize **preemptive rights**, unless revoked by shareholder approval); affiliation agreements with subsidiaries; amendments to the articles of association and/or charter (for example, a change of approved business activities); and increase of the aggregate compensation ceiling for the supervisory board.

Non-routine corporate actions which also require shareholder approval include mergers, takeovers and restructurings.

Shareholder proposals are common in Germany. Following announcement of the agenda for the meeting, shareholders may submit in writing two types of proposals. A **shareholder counterproposal** opposes the proposal made by the management board and/or supervisory board in an existing agenda item and presents an alternative. For example, a counterproposal would suggest a dividend higher or lower than that proposed by the management board, or an alternative nominee to the supervisory board. A **shareholder proposal** requests the addition of an issue not included on the original agenda. Examples of shareholder proposals include: alternate nominees to the supervisory board; authorization of a special investigation or audit; suggestions to abolish voting rights restrictions; and recommendations for changes to the capital structure.

Provided that such proposals meet legal requirements, the corporation is required to publish these shareholder proposals in an amended agenda and forward them to shareholders prior to the meeting.

Interaction among Players in the German model

The German legal and public-policy framework is designed to include the interests of labor, corporations, banks and shareholders in the corporate governance system. The multi-faceted role of banks has been described above.

On the whole, the system is geared towards the interests of the key players. There is, nevertheless, some scope for participation by minority shareholders, such as the above-mentioned provisions concerning shareholder proposals.

There also exist several obstacles to shareholder participation, especially in terms of banks' powers as depositories and voting agents.

The majority of German shares are issued in bearer (not registered) form. Corporations with bearer shares are required to announce their annual general meeting in an official government bulletin and forward the annual report and agenda for meeting to custody banks. The banks forward these materials to the beneficial owners of the shares. This often complicates the procedure for receipt of materials, especially for foreign shareholders.

In Germany, most shareholders purchase shares through a bank, and banks are permitted to vote the shares of German they hold on deposit. The procedure is as follows: The beneficial shareholder grants a general power of attorney to the bank, and the bank is permitted to vote the shares for a period up to 15 months. The corporation sends the meeting agenda and annual report to its custody bank. The bank forwards these materials and its (the bank's) voting recommendations to the German shareholder. If the beneficial shareholder does not provide the bank with his/her specific voting instructions, the bank may vote the shares according to its own interpretation. This leads to a potential conflict of interest between the bank and the beneficial shareholder. It also increases the potential voting power of the bank, because some shareholders might not provide specific voting instructions and the bank may exercise the votes according to its interpretation. Because the level of individual share ownership in Germany is very low, this is not a huge problem. Nevertheless, it reflects a certain pro-bank and anti-shareholder tendency of the system.

Other obstacles to shareholder participation include the above-mentioned legality of voting right restrictions, and the fact that shareholders may not vote by mail. As noted above, shareholders must either attend the meeting in person or to be represented in person, i.e., by their custodian bank.

Despite these obstacles, minority German shareholders are not inactive. In fact, they often oppose management proposals and present a wide range of counterproposals and proposals at the AGMs and EGMs of many German corporations each year. In Austria, minority shareholders are less active, perhaps because the Austrian government is, directly or indirectly, a large shareholder in many companies.

Conclusion

The article has introduced each model, describe the constituent elements of each and demonstrate how each developed in response to country-specific factors and conditions. It should reflect the fact that it is not possible to simply select a model and apply it to a given country. Instead, the process is **dynamic**: the corporate governance structure in each country develops in response to country-specific factors and conditions.

With the globalization of capital markets, each of these three models is opening (albeit slowly) to influences from other models, while largely retaining its unique characteristics. Legal, economic and financial specialists around the world can profit from a familiarity with each model.

ANGLO-US CORPORATE GOVERNANCE SYSTEM (THEORY)

(A System of Checks and Balances)

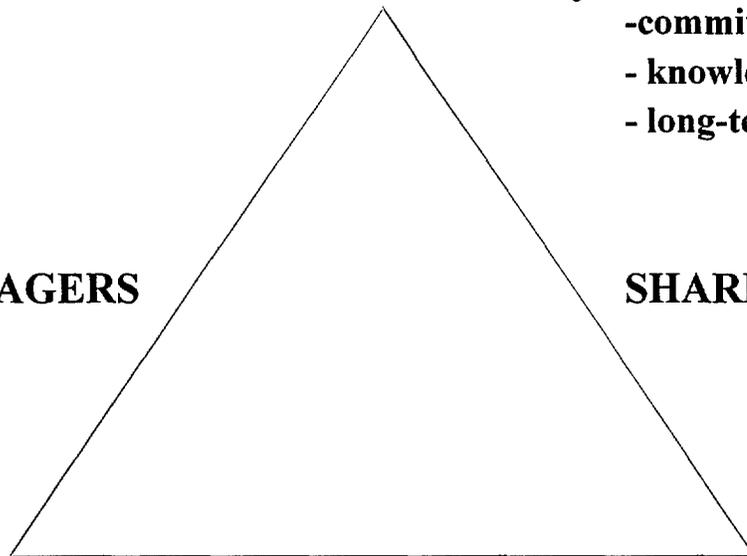
Responsible for company's daily operations and daily affairs. Provides and updates conditions and incentives for company's performance.

Powerful (in theory) because they elect board and vote at AGMs. In order to exert influence, they should be:

- committed
- knowledgeable
- long-term.

MANAGERS

SHAREHOLDERS



BOARD OF DIRECTORS

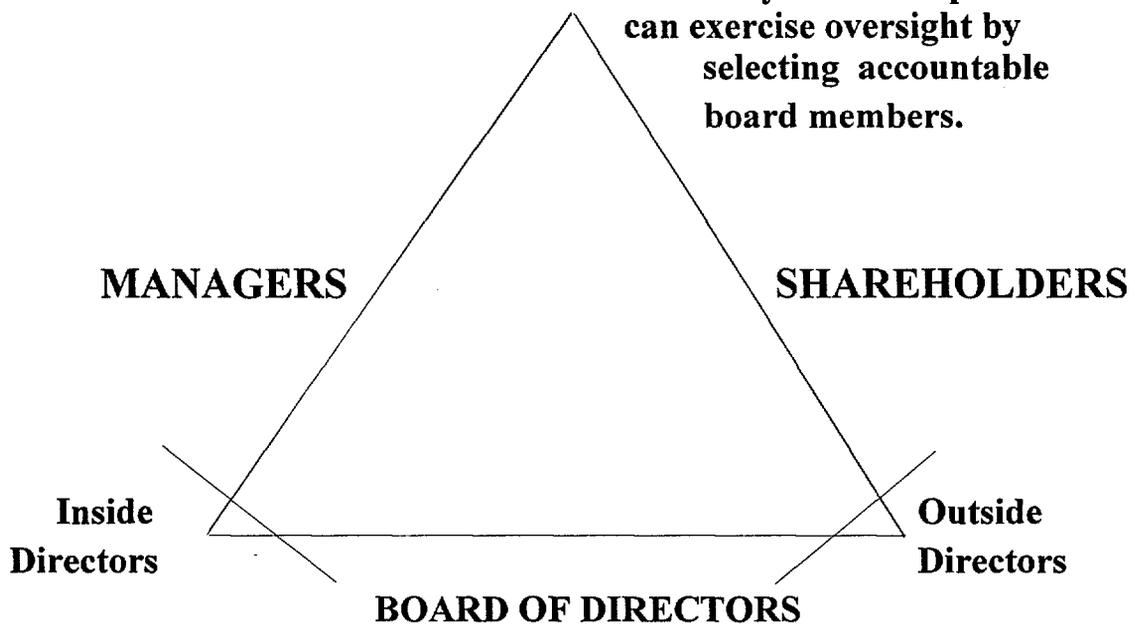
Role as: filter
monitor
overseer

The board is "the source and focus of proper accountability of management to shareholders."

ANGLO-US CORPORATE GOVERNANCE SYSTEM (PRACTICE)

A small, powerful group with access to information and control of daily affairs of the company. But - they must report to board and shareholders.

A diverse and relatively powerless group with one common goal - they want to see good financial performance. But - they control capital and can exercise oversight by selecting accountable board members.



A small group of some 12 members (U.S. average) who are potentially uninformed and unmotivated. A potential rubber stamp. But - they are mandated with outside review and oversight and are accountable to shareholders.

DIVERSIFIED MONITORING IN ANGLO-US CORPORATE GOVERNANCE

EX-ANTE MONITORING

INVESTMENT
FUND(S)

VENTURE
CAPITAL
FUNDS

INTERIM MONITORING

INVESTMENT
FUND(S)

RATING
AGENCIES

AUDITORS

EX-POST MONITORING

AUDITORS

TAKEOVER
SPECIALISTS

SHAREHOLDERS

GENERAL MEETING
OF SHAREHOLDERS
(Annual or Extraordinary)

BOARD OF DIRECTORS

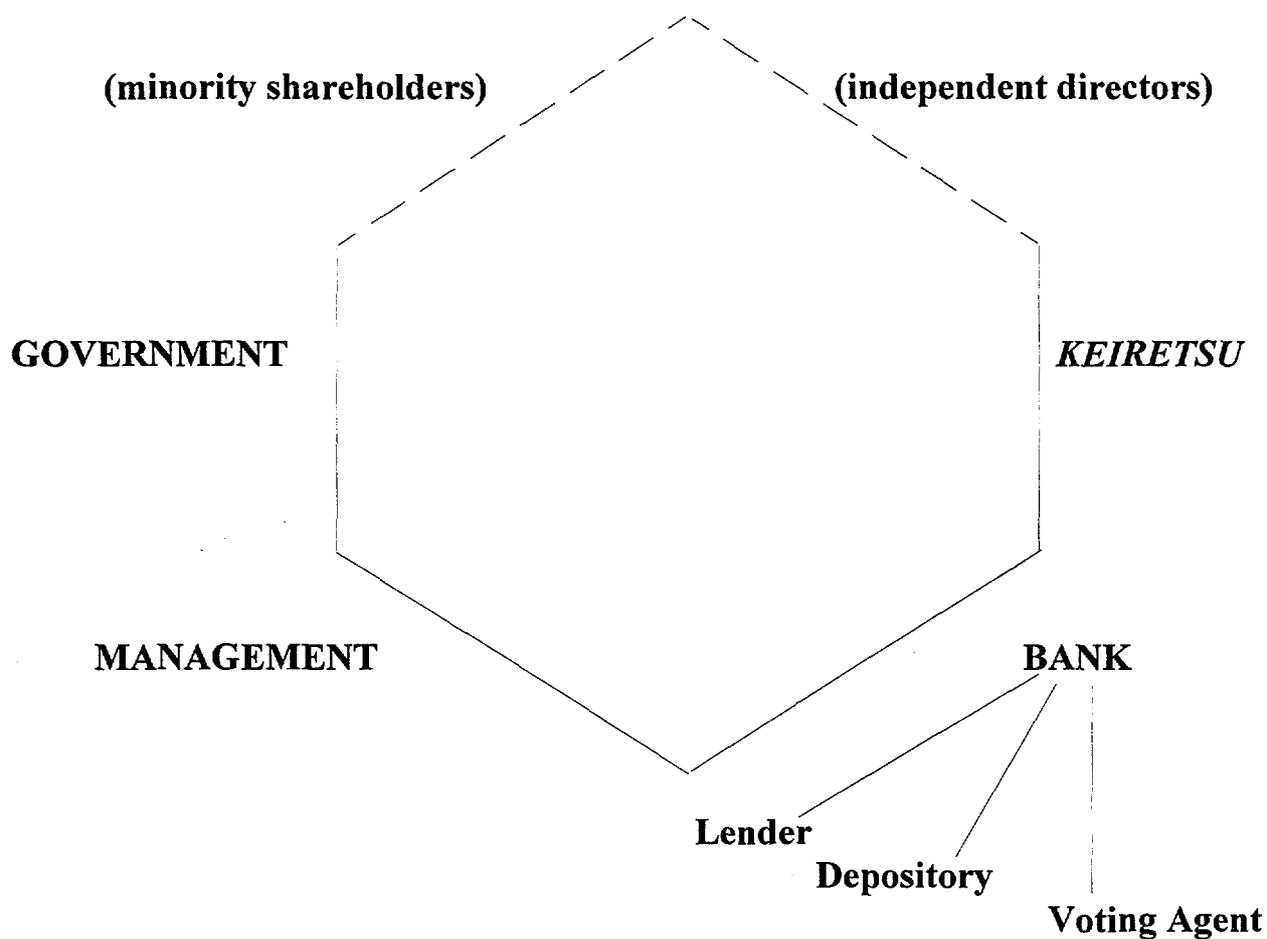
MANAGEMENT

212

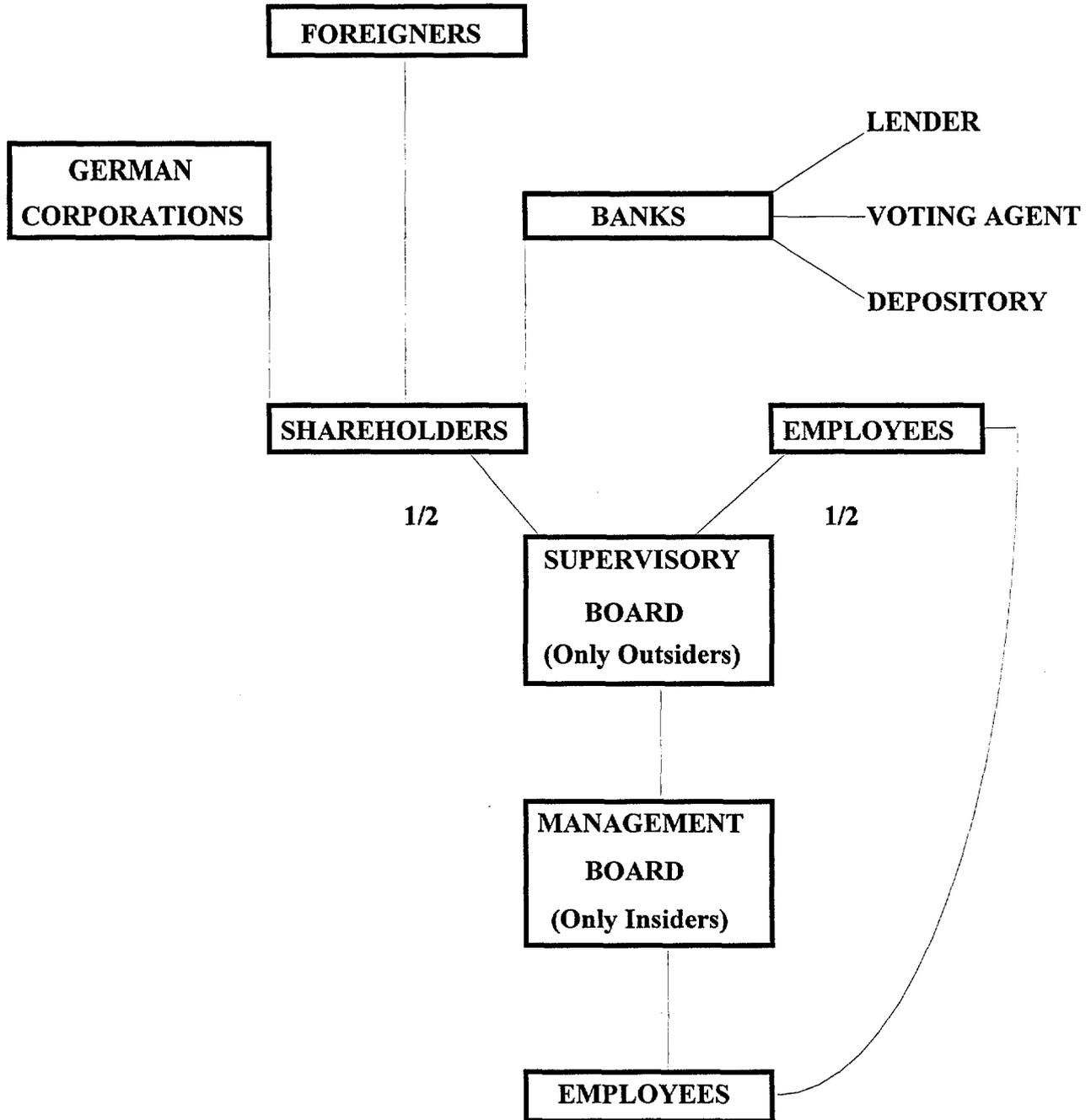
JAPANESE CORPORATE GOVERNANCE SYSTEM

A large board of directors (of as many as 50 members)
usually contains only insiders

When a company's financial performance is poor, majority shareholders
send representatives to the company's board of directors



GERMAN CORPORATE GOVERNANCE SYSTEM



**General Motors' Board Guidelines on
Significant Corporate Governance Issues
Issued 1994**

During the late 1980s and early 1990s, US institutional investors, shareholder activists and shareholders' rights organizations criticized corporate governance practices at US vehicle manufacturer General Motors (GM). Specifically, some shareholders maintained that GM's board of directors was not accountable to shareholders, but instead served as a "rubber stamp" for management's proposals.

Following extensive and sometimes heated dialogue among shareholders, GM's management and board of directors, the company responded by issuing its own "Guidelines on Significant Corporate Governance Issues."

Most US institutional investors view GM's proactive move as a precedent in improving board accountability and company-shareholder relations.

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1. Selection of Chairman and CEO

The Board should be free to make this choice any way that seems best for the Company at a given point in time.

Therefore, the Board does not have a policy, one way or the other, on whether or not the role of the Chief Executive and Chairman should be separate and, if it is to be separate, whether the Chairman should be selected from the non-employee Directors or be an employee.

2. Lead Director Concept

The Board adopted a policy that it will have a Director, selected by the outside Directors, who will assume the responsibility of chairing the regularly scheduled meetings of outside Directors or other responsibilities which the outside Directors as a whole might designate from time to time.

Currently, this role is filled by the non-executive Chairman of the Board. Should the Company be organized in such a way that the Chairman is an employee of the Company, another director would be selected for this responsibility.

3. Number of Committees

The current committee structure of the Company seems appropriate. There will, from time to time, be occasions in which the Board may want to form a new committee or disband a current committee depending upon the circumstances.

The current six Committees are Audit, Capital Stock, Director Affairs, Finance (Incentive and Compensation), and Public Policy.

4. Assignment and Rotation of Committee Members

The Committee on Director Affairs is responsible, after consultation with the Chief Executive Officer and with consideration of the desires of individual Board members, for the assignment of Board members to various committees.

It is the view of the Board that consideration should be given to rotating committee members periodically at about a five-year interval, but the Board does not feel that such a rotation should be mandated as a policy since there may be reasons at a given point in time to maintain an individual Director's committee membership for a longer period.

5. Frequency and Length of Committee Meetings

The Committee Chairman, in consultation with Committee members, will determine the frequency and length of the meetings of the Committee.

6. Committee Agenda

The Chairman of the Committee, in consultation with the appropriate members of management and staff, will develop the Committee's agenda.

Each Committee will issue a schedule of agenda subjects to be discussed for the ensuing year at the beginning of each year (to the degree these can be foreseen). The forward agenda will also be shared with the Board.

7. Selection of Agenda Items for Board Meetings

The Chairman of the Board and the Chief Executive Officer (if the Chairman is not Chief Executive Officer) will establish the agenda for each Board meeting.

Each Board member is free to suggest the inclusion of item(s) on the agenda.

8. Board Materials Distributed in Advance

It is the view of the Board that information and data that are important to the Board's understanding of the business be distributed in writing to the Board before the Board meets. The Management will make every attempt to see that this material is as brief as possible while still providing the desired information.

9. Presentations

As a general rule, presentations on specific subjects should be sent to the Board members in advance so that Board meeting time may be conserved and discussion time focused on questions that the Board has about the material. On those occasions in which the subject matter is too sensitive to put on paper, the presentation will be discussed at the meeting.

10. Regular Attendance of Non-Directors at Board Meetings

The Board is comfortable with the regular attendance at each Board meeting of non-Board members who are members of President's Council.

Should the Chief Executive Officer want to add additional people as attendees on a regular basis, it is expected that this suggestion would be made to the Board for its concurrence.

11. Executive Sessions of Outside Directors

The outside directors of the Board will meet in Executive Session three times each year. The format of these meetings will include a discussion with the Chief Executive Officer on each occasion.

12. Board Access to Senior Management

Board members have complete access to GM's management.

It is assumed that Board members will use judgement to be sure that this contact is not distracting to the business operation of the Company and that such contact, if in writing, be copied to the Chief Executive and the Chairman.

Furthermore, the Board encourages the management to, from time to time, bring managers into Board meetings who: (a) can provide additional insight into the items being discussed because of personal involvement in these areas; and/or (b) represent managers with future potential that the senior management believes should be given exposure to the Board.

13. Board Compensation Review

It is appropriate for the staff of the Company to report once a year to the Committee on Director Affairs the status of GM Board compensation in relation to other large US companies.

Changes in Board compensation, if any, should come at the suggestion of the Committee on Director Affairs, but with full discussion and concurrence by the Board.

14. Size of the Board

The Board presently has 14 members. It is the view of the Board that a size of 15 is about right. However, the Board would be willing to go to a somewhat larger size in order to accommodate the availability of an outstanding candidate(s).

15. Mix of Inside and Outside Directors

The Board believes that as a matter of policy there should be a majority of independent Directors on the GM Board (as stipulated in By-law 2.12). The Board is willing to have members of management, in addition to the Chief Executive Officers, as Directors.

But the Board believes that management should encourage senior managers to understand that Board membership is not necessary or a prerequisite to any higher management position in the Company. Managers other than the Chief Executive Officer currently attend Board meetings on a regular basis even though they are not members of the Board.

On matters of corporate governance, the Board assumes decisions will be made by the outside directors.

16. Board Definition of What Constitutes Independence for Outside Directors

GM's By-law defining independent directors was approved by the Board in January 1991. The Board believes there is no current relationship between any outside director and GM that would be construed in any way to compromise a Board member being designated independent. Compliance with the By-law is reviewed annually by the Committee on Director Affairs.

17. Former Chief Executive Officer's Board Membership

The Board believes this is a matter to be decided in an individual instance. It is assumed that when the Chief Executive Officer resigns from that position, he/she should offer his/her resignation from the Board at the same time. Whether the individual continues to serve on the Board is a matter for discussion at that time with the new Chief Executive Officer and the Board.

A former Chief Executive Officer serving on the Board will be considered an inside director for purposes of corporate governance.

18. Board Membership Criteria

The Committee on Director Affairs is responsible for reviewing with the Board on an annual basis the appropriate skills and characteristics required of Board members in the context of the current make-up of the Board. This assessment should include issues of diversity, age, skills such as understanding of manufacturing technologies, international background, etc. – all in a context of an assessment of the perceived needs of the Board at that point in time.

19. Selection of New Director Candidates

The Board itself should be responsible, in fact as well as procedure, for selecting its own members. The Board delegates the screening process involved to the Committee on Director Affairs with the direct input from the Chairman of the Board as well as the Chief Executive Officer.

20. Extending the Invitation to a New Potential Director to Join the Board

The invitation to join the Board should be extended by the Board itself, by the Chairman of the Committee on Director Affairs (if the Chairman and CEO hold the same position), the Chairman of the Board, and the Chief Executive Officer of the Company.

21. Assessing the Board's Performance

The Committee on Director Affairs is responsible to report annually to the Board an assessment of the Board's performance. This will be discussed with the full Board. This should be done following the end of each fiscal year and at the same time as the report on Board membership criteria.

This assessment should be of the Board's contribution as a whole and specifically review areas in which the Board and/or the management believes a better

contribution could be made. Its purpose is to increase the effectiveness of the Board, not to target individual Board members.

22. Directors Who Change their Present Job Responsibility

It is the view of the Board that individual directors who change the responsibility they held when they were elected to the Board should volunteer to resign from the Board.

It is not the view of the Board that the directors who retire or change from the position they held when they came on the Board should necessarily leave the Board. There should, however, be an opportunity for the Board via the Committee of Director Affairs to review the continued appropriateness of Board membership under these circumstances.

23. Term Limits

The Board does not believe it should establish term limits. While term limits could help insure that there are fresh ideas and viewpoints available to the Board, they hold the disadvantage of losing the contribution of directors who have been able to develop, over a period of time, increasing insight into the Company and its operations and, therefore, provide an increasing contribution to the Board as a whole.

As an alternative to term limits, the Committee on Director Affairs, in consultation with the Chief Executive Officer and the Chairman of the Board, will review each director's continuation on the Board every five years. This will also allow each director the opportunity to conveniently confirm his/her desire to continue as a member of the Board.

24. Retirement Age

It is the view of the Board that the current retirement age of 70 is appropriate.

25. Formal Evaluation of the Chief Executive Officer

The full Board (outside directors) should make this evaluation annually, and it should be communicated to the Chief Executive Officer by the (non-executive) Chairman of the Board or the Lead Director.

The evaluation should be based on objective criteria including performance of the business, accomplishment of long-term strategic objectives, development of management, etc.

The evaluation will be used by the Incentive and Compensation Committee in the course of its deliberations when considering the compensation of the Chief Executive Officer.

26. Succession Planning

There should be an annual report by the Chief Executive Officer to the Board on succession planning.

There should also be available, on a continuing basis, the Chief Executive Officer's recommendation as to his successor should he/she be unexpectedly disabled.

27. Management Development

There should be an annual report to the Board by the Chief Executive Officer on the Company's program for management development.

This report should be given to the Board at the same time as the Succession Planning report, noted above.

28. Board Interaction with Institutional Investors, the Press, Customers, etc.

The Board believes that the Management speaks for General Motors. Individual Board members may, from time to time, meet or otherwise communicate with various constituencies that are involved with General Motors. But, it is expected that Board members would do this with the knowledge of the management and, in most instances, at the request of management.

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Press Coverage of Corporate Governance in Russia

The following articles demonstrate the interest of the Russian and financial press in Russian corporate governance issues. The articles are referenced here according to specific areas of interest.

Russia's Joint Stock Company Law

"Issues Raised by Russia's Joint Stock Company Law." *World Securities Law Report*. December, 1996.

Analyzes the new law and its implications.

Corporate Governance - Relationship Between Good Governance and Market Valuation

"Who Becomes Bankrupt?" *Izvestia*. November 14, 1996. Moscow.

Argues that the way for Russian companies to succeed is to practice "good governance;" if managers are unwilling to practice "good governance," their companies will face bankruptcy.

"In Russia Everybody Has a Price." *Economist*. April 15, 1996. London.

Questions whether Russian companies will respect the rights of outside, minority shareholders; investigates the relationship between good corporate governance and the "worth of a firm."

Martin, Peter. "Keeping it All in the Family." *The Financial Times*. May 4-5, 1996. London.

Questions whether outsiders can get a fair deal in emerging economies; argues that emerging markets need to be more responsive to investor protection if they want to attract more investors.

"Shareholder Revolt." *Business Week*. September 18, 1995. New York.

Presents examples of poor corporate governance across Europe, and describes how investors are increasingly speaking out and calling for change.

Corporate Governance - Cumulative Voting

"Vladivostok Man." *The Economist*. October 26, 1996. London.

Discusses the law on "cumulative voting" that provides for a form of corporate proportional representation. At the end of last year, only 2/5 of Russia's larger firms were using cumulative voting to elect directors; such instances show why foreign investors are wary of investing in Russian companies.

Corporate Governance - Shareholders' Rights

"Balancing Stockholder Rights and Effective Corporate Governance." *Capital Markets Report*. December 19, 1996. Moscow.

Explores shareholders' rights related to "controlling persons" as defined by Russian legislation and analyzes the effects of these rights on the market.

Disclosure of Information in the US - New Share Issues

Victor Karetnikov, "New Share Issues - American Style," *Dyelovoi Express*. February 19, 1997. Moscow.

Explains the procedures for new share issues in the US and the disclosure requirements set by the US Securities and Exchange Commission (SEC).

Disclosure - VimpelCom on the New York Stock Exchange

Livov, Michael. "NYSE: Russia goes." *Cevodnya*. November 11, 1996. Moscow.
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All three articles discuss the debut of Wall Street's first Russian company, Vimpel-Communications.

Disclosure - FCSM Rules

"Russia - Federal Commission Issues Rules on Disclosure, Custodial Services." *World Securities Law Report*. December, 1996.
Explains the FCSM's approval of new rules requiring greater disclosure by issuers of securities and bonds as well as those governing custodial services.

Disclosure - Russian ADRs

"Your Guide to ADRs and GDRs." *The Financial Times*. November 8, 1996. London.
Explains the basics of ADRs and GDRs.

Thornhill, John. "Russian Market's Fortunes Revealed in ADRs." *The Financial Times*. December 3, 1996. London.
Explains Russian companies' interest in issuing ADRs; managers realize they must restate their accounts in order to access international markets.

"Spotlight on American Depository Receipts." *Capital Markets Report*. December 5, 1996. Moscow.
Discusses ADRs in general, and Russian ADRs in particular.

Miscellaneous Articles

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Exposes the relationship between executive compensation and corporate governance.

COMMENT AND ANALYSIS

X Issues Raised by Russia's Joint Stock Company Law

By Philippe Max, Clifford Chance, Moscow. The firm's Moscow office may be contacted by telephone at (7 501) 258-5050 and by fax at (7 501) 258-5051.

Russia's federal Law on Joint Stock Companies ("the Law"), which entered into force on January 1, 1996 (see *WSLR*, February 1996, p. 8), established a new regime governing this common corporate form in Russia (see analysis at *WSLR*, May 1996, p. 29).

This article focuses on two main provisions of the Law—those concerning interested parties and major transactions—that have raised many issues since its adoption.

Interested Parties

Under Article 81 of the Law, a member of the board of directors of a Russian joint stock company, a person holding a position in another management body, or a shareholder or shareholders owning jointly with an affiliate 20 percent or more of the company's voting shares shall be considered to have an interest in a company transaction if they or their families:

- 1) are a party to such a transaction or participate in it as a representative or intermediary;
- 2) own 20 percent or more of the voting shares of a legal entity party to the transaction; or
- 3) occupy positions in the management bodies of a legal entity party to the transaction.

If an interested party, as described above, is involved in a transaction of a company with fewer than 1,000 shareholders owning voting shares, the decision to enter into the transaction must be adopted by a majority vote of company directors who do not have an interest in the transaction.

For a company with 1,000 or more shareholders, the transaction must be approved by a majority vote of disinterested independent directors. An independent director is a board member who is not also an executive officer of the company.

To enter into a transaction in which one has an interest, the board of directors must demonstrate that the company will receive not less than market value for the alienated property or services rendered, or that the acquisition value of the property or services does not exceed market value. In both cases, market value is determined according to the procedures contained in Article 77 of the Law.

Shareholder Participation

However, in the following instances, the decision for the company to enter into a transaction in which a person has an interest must be adopted by the share-

holders meeting by a majority vote of the shareholders who do not have an interest in the transaction:

- 1) the payment amount for the transaction and the value of the property that is the subject of the transaction exceed 2 percent of the company's assets; or
- 2) the transaction involves the placing of company voting shares in an amount exceeding 2 percent of the voting shares previously placed by the company.

Exceptions to the need for shareholder approval are provided if the transaction is a loan granted to the company by the interested party, or is conducted in the ordinary course of business between the company and another party and occurs prior to the moment at which the person is deemed to be interested. In this case, although a decision of the shareholders meeting is not required, it is not clear whether a decision of the board of directors is still required. Since the Law is silent, it is recommended that the board approve the decision.

Appropriate Governing Body

The Law provides that if all members of the board of directors are deemed to be interested parties, the transaction may be completed by a decision of the general shareholders meeting adopted by a majority vote of shareholders who are not interested in the transaction. However, the Law does not provide for the situation where all shareholders would be considered interested parties, for example, if the sole shareholder of a joint stock company wants to double the size of the charter capital of the company. The Law also provides that the Federal Securities Commission and the Russian government may establish other procedures, which suggests that they may have some oversight capacity, although we are not aware of any such formal capacity being exercised. No other procedures have yet been issued.

Interest in a Major Transaction

If a transaction in which one has an interest is defined as a major transaction connected with the acquisition or transfer of property by the company, as discussed further below, the major transactions provisions of the Law also apply. In this event, the transaction must be adopted by a shareholders meeting by a three-quarters majority vote of the shareholders present owning voting shares (the super-majority required for the approval of a major transaction). If a conservative reading of the Law is made, only shareholders who are not interested parties should vote at the meeting.

A person having an interest in a company transaction must divulge to the board of directors, audit commission, and auditor of the company information concerning:

- 1) legal entities in which they independently or jointly own 20 percent or more of the voting shares;
- 2) legal entities in which they hold management positions; and
- 3) transactions known to them that are under way or proposed in which they could be considered to have an interest.

If a transaction in which one has an interest is completed in violation of the above requirements, it may be invalidated by a Russian court, with the interested party liable for any losses suffered by the company.

Major Transactions

A major transaction by the company connected with the acquisition or the alienation of property or the distribution of common shares must be adopted by the board of directors or the shareholders meeting, depending on the value of the property acquired or sold, or the quantity of common shares distributed.

The following are major transactions:

- 1) those involving the acquisition or alienation of property by the company if the value of the property constitutes more than 25 percent of the balance-sheet value of the company, with the exception of transactions completed in the course of conducting usual economic activity; and
- 2) those involving the distribution of common shares or preferred shares converted into common shares constituting more than 25 percent of the common shares previously distributed by the company.

The company board of directors shall determine the value of the property in accordance with Article 77 of the Law. The company's governing body charged with adopting the decision to enter into a major transaction depends on the value of the property acquired or sold or the quantity of common shares distributed.

If the property is valued at between 25 percent and 50 percent of the balance-sheet value of company assets as of the date of adopting the decision to complete the transaction, the decision shall be adopted unanimously by the board of directors. If the board cannot reach a unanimous decision, it may submit the question on completing the major transaction for a decision at the general shareholders meeting.

If the property is valued at more than 50 percent of the balance-sheet value of company assets, the decision must be adopted by the shareholders meeting by a

three-quarters majority vote of shareholders present and owning voting shares.

Issue of Capital

The Law does not specify which company governing body is authorized to approve a major transaction involving an issue of capital (insofar as it is within the declared shares approved by the shareholders). The Law refers only to property constituting a certain percentage of balance-sheet asset value. Therefore, while the drafting is unclear on this point, prudence dictates that the placement of shares should be subject to the same thresholds as those applicable to the acquisition or sale of property. In other words, if the contemplated placement involves more than 25 percent but less than 50 percent of the shares previously distributed by the company, the board of directors should approve the issue of shares; if the contemplated placement involves more than 50 percent, the increase should be approved by the shareholders meeting, although this will be subject to any prior approval given by the shareholders at the time the declared shares were created.

Takeover Provisions

The Law contains two provisions that apparently are intended to protect shareholders of Russian joint stock companies in the event of a takeover attempt.

The first provides that a party who intends independently or jointly with an affiliate to acquire 30 percent or more of the distributed common shares of a company with more than 1,000 shareholders owning common shares, including the number of shares belonging to the party, must send the company a written announcement of the intention to acquire these shares within 30 days prior to the date of acquisition.

The second provision requires that a party who independently or jointly with an affiliate, has acquired 30 percent or more of the placed common shares of the company must propose, within 30 days of acquisition, that shareholders sell their common shares to this party at a price not lower than the average-weighted acquisition price of the shares of the company over the six months preceding the date of acquisition. The shareholders do not have to sell their shares, but the purchaser must acquire any shares submitted to it. The company charter or a decision of general shareholders meeting may exempt the purchaser from this duty.

This second provision seems to apply to all joint stock companies notwithstanding the number of shareholders, although reading both provisions together suggests that the second provision should apply only to companies with more than 1,000 shareholders.

14 ноября 1996 года, четверг

Кто стал банкротом?

Елена ЯКОВЛЕВА,
«Известия»

Без языка

Игорь Кортунов занимался частным бизнесом. «Аз-буки-веди» его занятий — перед тем как провести сделку и потратить деньги, надо посчитать: а мне вообще-то денег на этот месяц хватит? Не посчитавши или посчитавши неаккуратно, чем будет платить долги — жди в гости бандитов.

Бизнес у него был серьезный и выгодный, вскоре он купил большой пакет акций тихо загибающегося кабельного завода и сел в директорское кресло. И по старой бизнес-привычке («перед тем, как провести сделку, надо посчитать») полез в заводские бумаги. С большим недоумением обнаружил: в 1990-м на заводе еще что-то считали, в 1991-м — кое-как, 1992-м бросили.

Бандиты в гости не приезжали. По мнению Анатолия Кудинова и Петра Сазонова, Кортунов, которому они помогают вытаскивать завод из кризисной ситуации, — белая ворона.

Большинство старых директоров те самые финансовые бумаги, которые искал Кортунов, не интересуют. Прежде всего по той простой причине, что они их читать не умеют. А не умеют читать такие бумаги, значит, не знают, куда тратить деньги предприятия. Приходит один зам к директору, говорит: надо купить металл. Действительно, говорит директор, надо, купи. Вослед другой: надо купить станок. Купи, отвечает убежденный замом директор. Через неделю третий: зарплату нужно заплатить. Тоже нечего возражать: плати. А бухгалтер бодро: а у нас денег нет. Директор смущен и обижен: как это нет? Да вот, отвечает ему, металл купили, станок. Оказывается, прежде чем купить металл и станок, надо было, заглянув в финансовую отчетность, «взвесить» цену такого решения и подумать, стоит ли.

А для большинства старых российских директоров в бухгалтерские бумаги заглядывать, читать их или вовсе, не приведи Бог, писать — занятие глубоко оскорбительное. У него всю жизнь для этого счетовод был. Он же, директор, до такого никогда не опускался. Он этого просто не умеет. У него есть пульт в кабинете, он умеет кнопки на нем нажимать, вызывать секретаршу, замов, по столу кулаком стучать, премии кого-то лишать, то есть «управлять по отклонениям». А еще — назначать замов, пускать цехи,

«Известия» писали о смелой гипотезе питерских социологов и консультантов по управлению (группа «Альт»), получившей достаточное подтверждение, о том, что в российской экономике не как исключение, а как явление существуют успешные предприятия. Основная причина успеха — искусное управление.

Регулярно объявляемые ВЧК в последнее время списки банкротов побуждают с той же внимательностью и под тем же углом зрения взглянуть на предприятия неуспешные. Московские консультанты по управлению (группа «Конверсконсалтинг») Анатолий Кудинов и Петр Сазонов согласились препарировать опыт неудачного управления на российских предприятиях.

делать тракторы. В былые времена умел выбивать ресурсы в главке, помнил тысячи наименований деталей, следил, как отгружается продукция. Он всегда командовал людьми, а через них процессами. А тут вдруг оказывается: надо знать экономику процессов. И понимать, что такое прямые и косвенные переменные затраты, затраты на содержание и эксплуатацию оборудования, цеховые затраты, какова их экономическая природа, то есть знать «язык бизнеса».

— Мы знакомы с директорами, которые умеют читать финансовые документы, — рассказывает Петр Сазонов и Анатолий Кудинов. — Но их все-таки немного.

Одна из самых показательных иллюстраций — генеральный директор чебоксарского завода «Промприбор» с гордо-стылым рассказывает: у меня прибыль 22 миллиарда в год. А ему объясняют: и 70 миллиардов дефицит платежного оборота, в котором «утонула» эта прибыль. Стало быть, эти 22 миллиарда прибыли ты «окунул» в приобретение сырья, материалов и прочие расходы, излишние для получения результата, а проще говоря — потратил деньги зря.

То может научить директора считать?

Многие наши предприятия как лодки без руля и без ветрил, и даже без весел, их куда-то сносит. Директора не умеют читать финансовые бумаги, учиться этому не хотят, а стало быть, не хотят управлять делом, предприятием.

Раньше над ними было «око государево»: через того же бухгалтера оно следило за каждым винтиком и каждой гайкой своей неприкосновенно социалистической собственности.

Теперь собственник поменялся, почему он не следит за финансовым состоянием предприятия и спящим на дне лодки управляющим?

Сегодня в большинстве случаев два основных типа собствен-

ника — либо трудовой коллектив предприятия, либо некая частная фирма со сторон.

Трудовой коллектив — собственник «размазанный», трудно представить его эффективным и грамотным контролером директора.

Но и «размазанный» собственник, по идее, должен реализовать свой интерес через совет директоров. Хотя в доморощенном совете директоров часто под стать директору не умеют читать финансовую отчетность.

Интереснее, когда собственник посторонний. Совет директоров «Норильского никеля» продемонстрировал, что он может контролировать финансовое состояние системы и устанавливать нормы для управления.

Нормативы эти не так уж и сложны. Для начала достаточно одного параметра — эффективности использования капитала.

Логика разговора с директором такова: мы вкладываем в производство 20 миллионов долларов. По сравнению с процентной ставкой на рынке ценных бумаг тут риск выше, поэтому, будьте добры, обеспечьте нам норму прибыли на собственный капитал — 14 процентов, а на вложенный — 13,2. Задача ясна? Решайте. Зарывайтесь в финансовые бумаги, намечайте стратегию... А мы, совет директоров, пошли водочку пить...

Но пока таких советов директоров, как заводских управленцев, умеющих читать финансовые отчеты, все-таки не очень много.

Налоговая инспекция — вот другой контролер за эффективностью управления. Это хоть и прищуренное по сравнению с прошлой эпохой, а все-таки «око государево». Но отсутствие Налогового кодекса и предостережения о том, какой должна быть налоговая политика в стране, куца инструкций, перечеркивающих законы, внесудебная реализация исков налоговой инспекции (такого в уважающих себя государствах не встретишь) толкают предприни-

мателя на жульнические отношения с ней. В результате единственное, чего добиваются наши налоговые инспектора, так это сильного искажения достоверности в финансовой отчетности. И, стало быть, государство не может толком заглянуть через налогового инспекцию в дела завода.

Что остается? Общество? Гражданин? Но загляни он никуда, допустим, в качестве потенциального инвестора в открытое акционерное общество и попроси на проходной балансы за последний квартал, как минимум покрутят у виска, как максимум — побыют.

Воровать легче, чем управлять

Когда директор перестает понимать проблемы завода, не представляет, как сделать его работу успешной, не знает финансового управления, ему остается одно — тихо воровать.

Модель воровства обычно незамысловата. Заводская продукция отгружается в соседний город и продается некоей фирмочке, возглавляемой сыном, зятем, приятелем директора завода, по цене на 30–50 процентов ниже рыночной (иногда даже ниже себестоимости). Фирмочка, естественно, реализует ее по нормальной цене, прибыль, полученная от разницы в цене, делится пополам с директором. Сейчас в столице куда ни оглянись, наткнешься на маленькую конторку из двух человек (как правило, директора и бухгалтера), реализующую всю продукцию какого-нибудь великого сибирского «... нефтегаза» и подолгу держащую его без зарплаты. А пригрозит Чубайс такому директору банкротством и потерей управленческого кресла, тот вряд ли испугается. У него уже давно на Кипре миллионов 150–200 долларов отложено на именном счету. Детям и внукам хватит.

Самое страшное, когда у таких занятых тихим хобби воровства директоров оказываются в руках конкурентоспособные производств с новейшим обо-

рудованием. И все они дрейфуют к разорению...

Как остановить этот дрейф? Для того чтобы управленческое поколение сменилось само собой, нужно как минимум 25 лет, считают Анатолий Кудинов и Петр Сазонов.

Но есть, конечно, серьезные «ускорители» этого процесса. Во-первых, недовольные трудовые коллективы, готовые для смены не внушающей им доверия власти как к забастовке, так и к акционерному собранию. Во-вторых, новые собственники из коммерческих структур, способные либо заменить управленцев, либо сесть в это самое директорское кресло, как Игорь Кортунов.

Хотя тут нужны оговорки: в российской бизнес-среде немало бизнесменов скорой выпечки по формуле: «Два-три воровские сделки, и вот у меня уже и особняк в Лондоне». Такие в директорские кресла вряд ли полезут. Потому что надо иметь великое желание и великое мужество отяготившись вопросом, сразу принимающим форму голодной боли: как мне заплатить зарплату двум тысячам человек?

И главное, непонятно, ради чего. Ради благополучия моей семьи? Так это благополучие нынче быстрее и эффективнее обеспечивается посредством выше описанного воровства. Ради великой России (как когда-то американцы ради великой Америки, немцы — ради великой Германии)? Но величия России не видно, кругом бардак. И за державу не обидно никому.

Явление пострашнее воровства — размыивается, разлагается мораль бизнеса, мораль дела. Вот наградить сегодня престижно, а вытасщить завод из долгой ямы, увы...

И государство во главе этого разложения. Потому что не желает и не умеет защищать законные права собственников и, наоборот, имеет желание их умеренно грабить. Проблему серого российского «нала» породило само государство, обладая каждой банкой проданной, к примеру, геологу тушенки 28-процентным отчислением в пенсионные фонды, потом активно разворывающиеся. Налог на превышение уровня зарплаты, толкавший к той же обналчке, тоже вело государство...

Между тем основа морали в бизнесе — справедливое решение. И прежде всего — государства.

Может быть, каста чиновников должна смениться, как каста несостоятельных директоров на заводах? Но если последний вытесняет забастовки и новые частные собственники, то кто и что сменил наших чиновников?

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In Russia everybody has a price

UST IILMSK

FOR most of the 15,000 medium and large companies which were auctioned off in the first stage of Russia's mass-privatisation programme, which ended in June 1994, this is the month they hold their first annual shareholders' meetings. And in most privatised companies the state and workers control the largest blocks of shares. So the way shareholders' meetings are conducted will answer one big question about shareholder capitalism in Russia: is there any chance that the rights of outside, minority shareholders will be respected?

The meeting on April 8th of Irkutsk-energo, one of Russia's largest producers of hydroelectric power, would suggest that the only thing outside shareholders have to worry about is staying awake. Shareholders' meetings enable Russians to indulge two of their passions: bureaucracy and voting. Although there was nothing particularly controversial on the seven-point agenda, the meeting dragged on for over eight hours, lengthened by regular breaks to enable shareholders to smoke and plot outside the auditorium.

The directors had cunningly decided to hold the meeting in Ust Ilimsk, a grim town 800 kilometres (500 miles) north of

Irkutsk, the company's base, in order to force its workers, who own 30% of outstanding shares, to choose representatives. If they had all turned up at the meeting, it would have taken a week.

The main piece of business was to elect a new board. Under Russian law, privatised companies are supposed to have nine directors, of whom only three work for the company. The top three executives were voted on to the board with nobody voting against them. The question was who should become the non-executive directors. The state, which still owns 40% of Irkutskenergo, has the right to nominate two non-executive directors. The general director (ie, the firm's boss) then nominated cronies to fill the remaining four places.



Interestingly it was the union representatives who were least happy with this arrangement. "We need at least one real outsider to watch what the other directors are up to," said one union man. That suited Brunswick, a Moscow-based stockbroker, whose foreign clients own 12% of Irkutskenergo. It nominated as a non-executive director James Rogers, the number two at CINenergy, the 13th-largest utility in America. Mr Rogers finished first in the voting, winning 20% of the votes cast. Although three management cronies also won places, Vladimir Ribalko, a pensioner whom the managers had nominated to "represent the interests of other pensioners" (a poor excuse: the real reason was that, before retirement, he ran the company) failed to get elected.

However, it wasn't just novelty value that persuaded Russia's worker-shareholders to vote for a foreign director. Hard to credit, but they could simply have been impressed by his business acumen. Two sets of comparative statistics suggest that a little foreign expertise could help. CINenergy has capacity to generate 11,000 MW; Irkutskenergo can churn out 13,000 MW. The market capitalisation of the American firm is \$3 billion, but the Russian firm is worth less than \$150m. Mr Rogers is going to be clocking up a lot of frequent-flyer miles on Aeroflot trying to work out how he can close that gap.



Peter Martin

Keeping it all in the family

Can outsiders get a fair deal in the emerging economies?

The Albanian stock exchange opened for trading on Thursday. Oh sure, you say, another boring east European bourse. An opening ceremony at which the country's president praises "an historic occasion"; a trading floor in the basement of the central bank; an initial list of government debt and privatisation certificates. Run of the mill stuff.

Before you yawn, though, just think for a moment. This is a country, after all, which banned private cars until 1990, proclaiming itself the only exponent of "authentic socialism". Cement output went into building 500,000 pillboxes (one for every six people) against an invasion nobody could be bothered to mount. Workshops made spare parts for long-obsolete Chinese equipment, unavailable since the two countries fell out in 1978. If Albania can be an emerging economy, so can my potting shed.

Albania is an extreme case, but it has one characteristic in common with other emerging (and emerged) economies: sheer implausibility. Three and a half decades ago, who would have picked Singapore as one of the growth poles of south-east Asia?

Still, to use a phrase familiar to faithful readers of this column, you would have to take a very Long View indeed to see Albania as a

fully developed market economy. But that is irrelevant. It is precisely that decades-long scope for rapid expansion that makes emerging economies so attractive. It offers the western investor the opportunity to tap into much greater growth potential than can be achieved by the mature economies back home.

How easy, though, will the western investor find it to tap into the growth of emerging economies? Even if local regulations allow investment by outsiders, will there be the equity offerings that really allow full participation in local growth? And will investors in whatever vehicles there are be given equitable treatment by insiders?

In Europe's first period of rapid growth, in the 19th and early 20th centuries, there was little scope for outside equity investors. Family businesses grew largely on the back of retained earnings; external finance came from bank loans and, to some extent, from bond issues. Only the great booms - railways, for instance - tapped the equity market on a large scale. And, of course, investors sucked in during these often had very unhappy experiences to report.

There are parallels here with the difficulty many western investors find in investing in true growth stocks in the strongest emerging economies, those of

south-east Asia. Just as in 19th-century Europe, many of the best investment opportunities are in the hands of family-owned groups.

Such firms are likely to be tempted to offer equity to outsiders only when the deal is really too good to refuse - during a market boom which automatically stacks the deck

Unless you get your timing right, you will end up buying in just as the locals are selling

against the new investors.

Still, a study a year or so ago by Cambridge economist Ajit Singh showed that, for those big emerging-markets companies which have succumbed to the temptations of a public listing, net external finance was remarkably high by western standards.

The typical British company gets between a quarter and a half of its net addition to long-term capital from external debt or equity. For the sample of 100 emerging markets companies he studied, the ratio is more like half to three-quarters, with equity providing the lion's share.

So today's emerging

markets are more like the US, which, during its boom period of the late 19th century, relied much more heavily on stock market capital than did Europe. That sounds like an encouraging parallel: if buying a basket of emerging market stocks will expose you to the AT&Ts, Coca-Colas and General Electrics of the 21st century, you can afford to pick up the odd buggy-whip manufacturer as well.

But the real surge in selling US stock to external investors came as part of the great industrial reorganisations of the period. These were notorious not merely for their creation of monopolies but also for the stock market manipulation they involved.

That leads back to the question of whether western investors seeking to profit from the growth of emerging economies can expect to get equitable treatment any more than the innocent investor in Jay Pisk's Wall Street.

In one sense, the situation is incomparably better: there is now widespread acceptance of basic investor protection regulations, and most markets pay at least lip service to these principles - some very much more than that. But today's emerging markets remain biased inherently towards insiders, if only because of the tight family control under which many publicly-quoted groups are still held.

That family control, those political connections, that deep understanding of local business habits - this is partly what attracts outsider investors into the stock in the first place. They are ill-placed to complain if it goes hand in hand with a willingness to exploit those advantages in dealings with fellow shareholders as much as with competitors.

Does it matter, anyway? In an economy growing at three times the rate of a western one, even losing half your profits growth to insiders still leaves you with half as much again as the growth you could get at home.

A diversified buy-and-hold strategy in developing markets might expose you to the pitfalls of the local markets, but it will also expose you to the growth. Over the long run, the growth is likely to win out - as long as you avoid attempting to market-time the emerging markets cycle. Unless you get your timing exactly right, you will end up buying in as the locals are selling, and selling out as they are picking up the pieces from wounded overseas investors.

So the question is: how long is your long term? If it is long enough to encompass Albania, it is probably long enough to cope with anything. By the way, I've got a very interesting potting shed you might like to consider ...

EUROPE

SHAREHOLDER REVOLT

From Barcelona to Bonn, cozy dealings are under attack—and the balance of corporate power may shift.

It was supposed to be another mega-deal, no questions asked. On Sept. 1, Fiat, Pirelli, and all-powerful Mediobanca announced that Gemina, an investment company under their control, would acquire the assets of the collapsed Ferruzzi empire. Overnight, Gemina would become Italy's No. 2 conglomerate—with the Agnellis and other magnates calling the shots.

Yet, for once, questions were asked. Minority shareholders, fund managers, and financial analysts are erupting over the Gemina deal, charging inadequate disclosure and backroom manipulation. "At this point, we've been reduced to spectators," gripes Stefano Pizzamiglio, a fund manager at investment company Finanza & Futuro Holding, which owns 3.4% of Gemina.

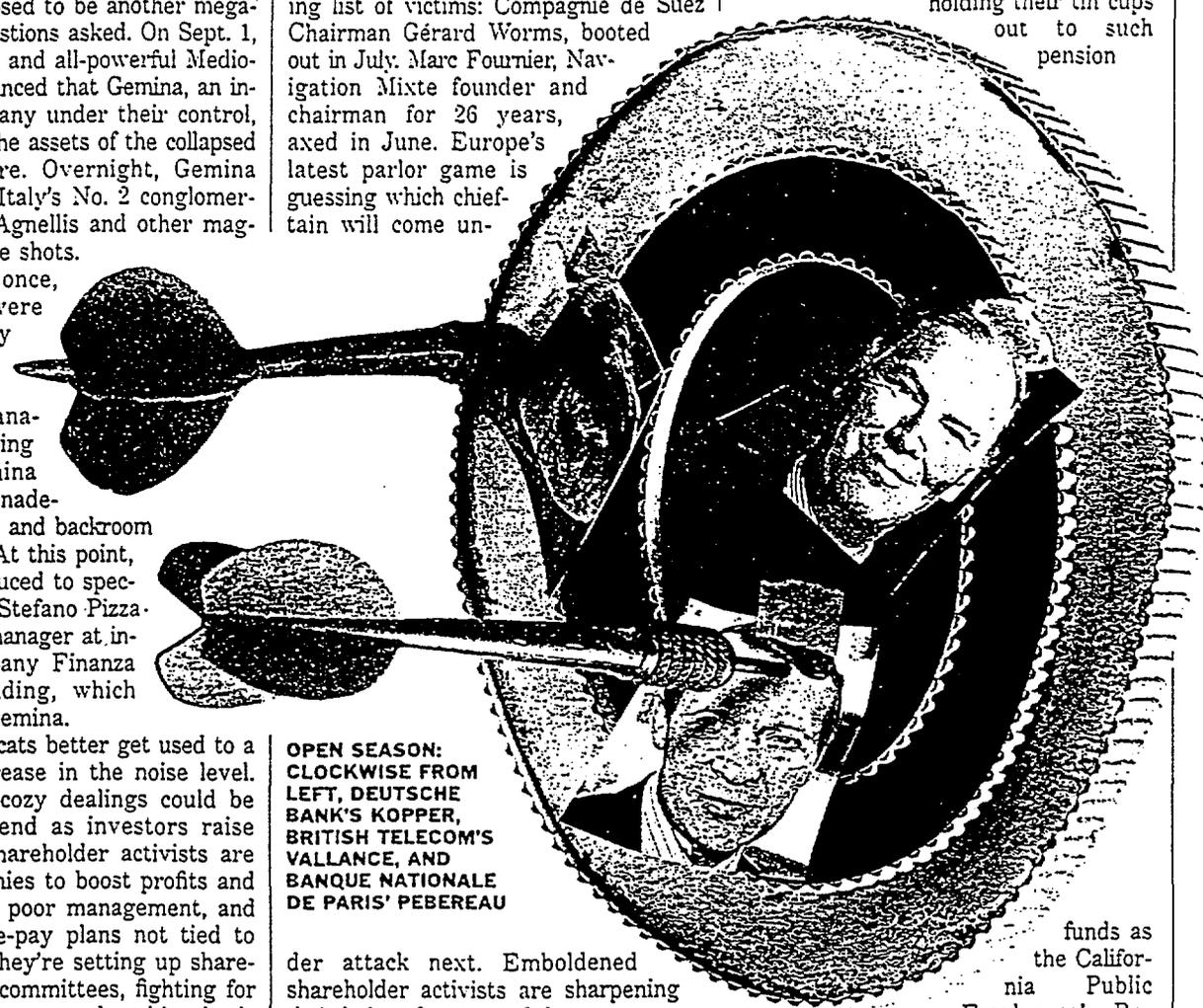
Europe's fat cats better get used to a permanent increase in the noise level. Their days of cozy dealings could be coming to an end as investors raise their voices. Shareholder activists are pushing companies to boost profits and dividends, oust poor management, and scrap executive-pay plans not tied to performance. They're setting up shareholder-defense committees, fighting for their rights in court, and seeking basic securities-law changes. Even Europe's holding companies, famous for their love of entrenched management, are urging companies in their portfolios to boost returns.

Corporate Europe needs the wake-up call. Minority shareholders have few rights. Assets are trapped in underperforming companies. Hostile takeovers

are almost impossible. Company reports are often opaque, if not misleading. And voting rights are stacked in favor of incumbent executives who sleep easily knowing that large blocks of their companies' shares are in friendly hands.

Yet activists can already claim a growing list of victims: Compagnie de Suez Chairman Gérard Worms, booted out in July. Marc Fournier, Navigation Mixte founder and chairman for 26 years, axed in June. Europe's latest parlor game is guessing which chief-tain will come un-

shareholder revolt will change the balance of power in Corporate Europe. One reason is the need to please a powerful new class of investors. No longer can governments and domestic institutions satisfy European companies' capital demands. Instead, companies are holding their tin cups out to such pension



OPEN SEASON: CLOCKWISE FROM LEFT, DEUTSCHE BANK'S KOPPER, BRITISH TELECOM'S VALLANCE, AND BANQUE NATIONALE DE PARIS' PEBEREAU

der attack next. Emboldened shareholder activists are sharpening their knives for some of the most powerful barons of all, including Deutsche Bank CEO Hilmar Kopper, Mediobanca Chairman Enrico Cuccia, Banque Nationale de Paris' Michel Pébereau, and British Telecommunications Chairman Iain Vallance.

The movement is young. And so far, it has seen more defeats than victories. But if present trends continue, the

funds as the California Public Employees' Retirement System (CalPERS), which just voted to increase from \$11 billion to \$18 billion the amount it invests in European equities.

Of some \$500 billion in stock issued by Europe's newly privatized companies, about 20% went to U.S. institutions, which demand more transparency and better returns than most European

COLLAGE BY ELIETH WEINSTEIN. CLOCKWISE FROM LEFT: PHOTOGRAPHS BY PAULUCK LA BARCA, MARK THRESDORF/KATZSAND, SOULIMANSIPA

companies have ever been subject to. Privatization has also created a small army of domestic investors, many of whom are learning to band together or to enlist the aid of shareholder activists. The result will not be a wholesale adoption of the U.S. system. But more companies will allow independent outsiders to sit on boards and question management decisions. They also will be under pressure to more openly disclose operating results, strategic goals, and even their mistakes.

The battle has recently been hottest in France. Over the past decade, France has evolved from a *dirigiste*, state-dom-

inated system to a capitalist halfway house.

The biggest companies continue to hold major stakes in one another, and a small cadre of executives dominates the system at the top, many pledging not to interfere in each other's businesses. With few pension funds and mutual funds in France to buy shares in privatized companies, the government has sold key stakes in former state companies to industrial holding companies to keep these assets in French hands.

NO VISION. Now, this cozy system is unraveling. In June, banking giant Compagnie Financière de Paribas, insurer Allianz, and other shareholders ousted the management of Navigation Mixte, an unwieldy \$3.1 billion holding company with interests ranging from aircraft to perfumes to orange groves, because they believed founder and longtime Chairman Fournier had no strategic vision. "We couldn't get any indication from Fournier as to where the company was going," complains Paribas Chairman André Lévy-Lang. "We were not satisfied with the status quo."

An even more monumental revolt followed at Suez, the giant of French holding companies. Chairman Worms was forced out for failing to give shareholders an adequate return on their investment, an argument rarely heard in a country where directors don't have a legally binding fiduciary duty to protect investors.

Other motives may have been at play. Observers believe that BNP Chairman Pébereau, who led the attack, most likely was eyeing Suez's Banque Indosuez, an investment bank with a valuable Asian franchise.

Ironically Pébereau may be the next target. Some insiders think another reason he was eager to get his hands on Suez was that the merger would distract attention from BNP's own troubles, including poor profitability, problems with real estate holdings, and a languishing share price since the bank's privatization. Foreign fund managers are already complaining.

not whether to change, but how much and how fast. Yet its minority shareholders can be legally treated as second-class citizens, such as when the März Group, the country's second-largest brewer, sold off a Hamburg brewery late last year. März Group got \$523 per share. But minority holders got only \$396 a share, based on an accountant's report that shares were worth 25% less.

Germany's corporate boards are also under attack. At one level is the supervisory board, made up of business, bank, and union representatives. They appoint the chief executive, vet his executive nominations, and are supposed to scruti-

nize strategy. But they meet only once a quarter and are dependent on information fed to them by the second tier, the management board. Critics find the system too lax and blame it for spectacular scandals, including Metallgesellschaft's oil-derivatives losses, which required a \$2.5 billion bank bailout.

HOT SEAT. Many fingers point at Germany's most powerful institution, Deutsche Bank, for its failure to detect the problem. Deutsche Bank was Metallgesellschaft's largest creditor, and the bank's corporate-finance chief, Ronaldo H. Schmitz, chaired MG's supervisory board. More recently, Deutsche Bank has also been in the hot seat over a string of fiascos at Daimler Benz.

In late June, Daimler warned of severe losses for 1995, just

four weeks after predicting a rosy future at an annual meeting. The strong mark is partly to blame, but some believe Daimler's problems go to the heart of the corporate-governance system. "It's all one big ingrown club, a classic old-boy network," says University of Chicago Graduate School of Business Professor Merton H. Miller, who has studied the German model. "You cover up for one another. There's no one to say 'you blew it,' and you never have to admit your mistakes."

No doubt, Deutsche Bank's hold on Germany Inc. is tight. Its board members have seats on more than 100 large

Why Europe's Shareholders Are Up In Arms

THE CHARGES

CORPORATE INCEST

Banks and companies hold large passive stakes in one another and sit on each other's boards, giving managers little incentive to boost shareholder value

MINORITY ABUSES

In mergers, minority shareholders often get no offer at all or a lower price than majority shareholders do

PRIVATE FIEFDOMS

Bosses have named family members as successors, renamed companies after themselves, and arranged deals to benefit friends

LACK OF TRANSPARENCY

Company statements hide major problems, from underfunded pensions to financial irregularities

UNEVEN VOTING RIGHTS

Forget one share, one vote—longtime and inside shareholders often get better voting rights than individual shareholders

WHO'S TARGETED

Deutsche Bank-Daimler Benz, Suez-Banque Nationale de Paris-UAP

März Group, LaFarge-Coppée, Lagardère Groupe, Société Générale

Danone, Pinauff-Printemps-Redoute, Lagardère, Laura Ashley, Mediobanca

Gemina, Daimler Benz, Banco Español de Crédito

Danone, Elf Aquitaine, RWE, Investor

DATA: BUSINESS WEEK

In the end, what's important is that cracks are opening in the *noyau dur*, or hard core, of stable shareholders that protects French managers from the ravages of market forces. Now, France's business chieftains are on notice that they, too, must watch their companies' performance or suffer the fate of Fournier and Worms. Paribas' Lévy-Lang is concerned. "I'm not satisfied and neither are my shareholders, because the share price is too low and our earnings are, too. The message we're getting is that we need more focus," he says.

Like France, Germany is debating

International Business

companies in which it holds stakes, including 24% of Daimler, the country's largest company. Deutsche Bank CEO Kopper chairs Daimler's supervisory board and sits on seven other boards as well. Critics allege he can't possibly have the time to do each job well. Moreover, of the 20 executives on Daimler's supervisory board, only two have experience running a major manufacturer. Even though Deutsche Bank failed

to prevent Daimler's missteps, its attitude toward governance issues is undergoing a sea change. It has reduced its Daimler stake, from 28% to 24.4%, and says it plans to scale back holdings in other companies as well. Its mutual-fund arm, with \$77 billion invested, now sends representatives to speak at the annual meetings of BASF, Hoechst, and a dozen others to push for better returns. In Britain, which led Europe in agi-

tating for shareholder rights, activists are homing in on new targets. Among the big issues are pay packages and option plans executives are rewarding themselves. High on the hit list: the generous bonus of British Telecom's Vallance.

In Italy, by contrast, change is far slower than in the North. Total stock market capitalization amounts to just 18% of gross national product, compared with 130% in Britain. Despite the rising assertiveness of outside shareholders and fund managers, it will take longer to crack the iron grip that the state and a small clique of powerful industrial heads have on most of Italian industry. The system leaves the stock market undeveloped and minority shareholders powerless.

A key obstacle to reform is the secretive merchant bank Mediobanca and its 57-year-old Chairman Cuccia. Mediobanca is the hub of Northern Italy's industrial dynasties and the driving force of the private sector. It has stakes in many blue-chip Italian companies, and they in turn have stakes in Mediobanca. The web of interlocking shareholders acts in concert when choosing boards and voting on management decisions, such as Gemina's takeover of Ferruzzi, which affects 30% of all shares traded on Milan's stock exchange.

FUTURE BLOCK. Critics allege that by grabbing shares of newly privatized banks and installing its own managers, Mediobanca is preventing Italy from reaping the benefits of privatization. In July, Italian antitrust authorities launched a probe into whether Mediobanca is hindering competition. Mediobanca would not comment.

Clearly, Europe is only in the early stages of what will be a long campaign to bring its corporate oversight up to the expectations of global investors. That may mean taking painful steps, such as changing accounting practices, laying off workers, and moving production outside of the country.

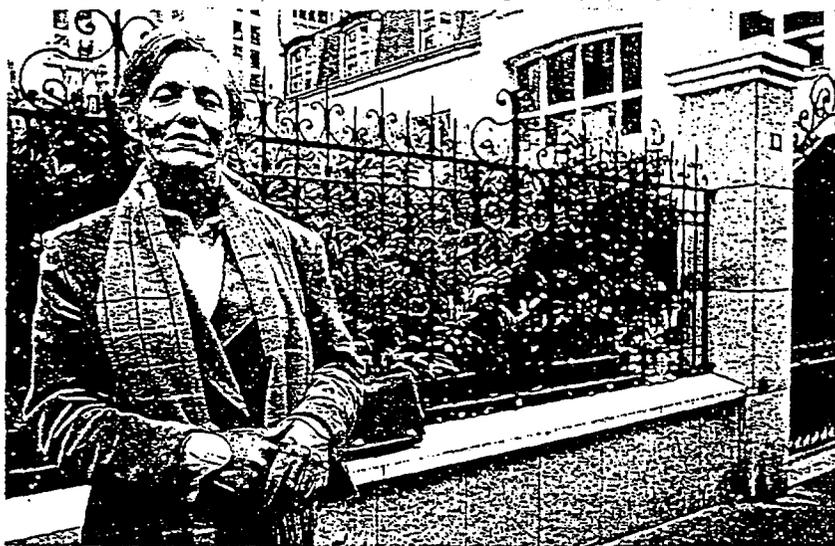
It will also mean revealing treasured secrets, as Jérôme Monod, chairman of France's Lyonnaise des Eaux has decided to do. With 28% of his shareholders outside France, Monod announced on Sept. 4 that he will publish his salary and stock options in the company's annual report beginning next spring. That a leading French executive has taken such a step proves that Europe's shareholder revolt is far more than a fleeting trend. It is penetrating the inner sanctums of Europe's corporations.

By Paula Dwyer in London, with Christina Bennett in Rome, Marsha Johnston in Paris, Julia Flynn in London, and Karen Lowry Miller in Bonn

CIToyENS! TO THE CORPORATE BARRICADES!

If the lofty executives who run France's old-boy companies are taking more notice of shareholders, it's due largely to a petite, 53-year-old economist named Colette Neuville. From her 19th-century farmhouse near Chartres, where she lives with her retired civil-servant husband and several cats, Neuville is campaigning to force new account-

The cream of French business has come under Neuville's attack, in and out of court: Pinault-Printemps-Redoute, Euro Disney, and Banque Paribas-Stern. Mistreatment of minority shareholders in takeovers is a common complaint. Her campaigns have led regulators to tighten takeover rules, and executives credit her with making *le corporate governance* an is-



COLETTE NEUVILLE

She has attacked the elite of France Inc. Takeover rules, as a result, have been strengthened

ability on a reluctant France Inc.

The feisty mother of five jumped into the governance game in 1990, when a Paris brokerage that held her modest stock account went broke. She formed an association to rescue small clients' savings. It snowballed into France's first big shareholder advocacy body: the Association for the Defense of Minority Shareholders.

sue. Recently she was named a director of the investment bank Paribas.

Crusading is Neuville's second career. She did economic research for a French tiremaker and NATO before staying home for 20 years to raise her children. She owns few shares herself, she says, because of her modest means: "We live off my husband's pension, and I travel second-class with a family discount." She'll never get French executives to follow suit. But as France's godmother of governance, Neuville is forcing fresh air into a musty system.

* By Stewart Toy in Paris

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Vladivostok man

Russian firms would sooner have a vodka tax than a foreigner on the board. Why, then, make an exception for Andrew Fox?

THERE are many examples of optimism in business. Few match pitching up in a freighter at Vladivostok and declaring that Russia's Far East, a place that even crime-seasoned Muscovites approach with caution, is about to boom—particularly if you were previously employed as a bond trader in the comparative comfort of the City of London and your Russian connections are minimal. Nevertheless, this is precisely what Andrew Fox did in 1991 when just 28 years old.

Since then this rather unassuming Englishman can claim a degree of success. He started a stockbroker, Tiger Securities, and with partners put \$50,000 into a scattering of local firms during Russia's first wave of privatisation in 1993. At the time, equity was absurdly cheap: \$400 bought Mr Fox 22% of an engineering firm that now, he says, makes profits of more than \$20,000 a month. He also paid 1.5 cents each for shares in a cement company; they peaked a year later at \$6. In mid-1994 his First Vladivostok Fund raised \$12.4m at what proved to be the height of Russia's first stockmarket boom. The funds' investors have not yet made the fortunes that Mr Fox hoped, partly because the Russian stockmarket has been so unstable and partly because the country's Far East has yet to thrive in the way he expected; but neither have they lost their shirts.

In the meantime, despite operating in the sort of town where a foreign investor poking his nose into local companies might soon find it broken, the mild-mannered Mr Fox has become a fixture of the local economy. He holds seats on the boards of some 20 companies, including the huge Far Eastern Shipping Company and the Vladivostok Trade Port, which occupies four kilometres (2.5 miles) of the city's waterfront. Mr Fox has even been welcomed on to the board of the Vladivostok Stock Exchange and a once-secret defence-engineering firm, DalPribor, which used to make electronic snooper-buoys that track submarines. Now, with Mr Fox's help, DalPribor is trying to make hair dryers instead.

Most other foreigners can only dream of such representation. Russian boards are still dominated by bosses reluctant to concede places to outside shareholders in general, and to foreigners in particular. They and their workers fear, with reason, that the entry of an outside shareholder could eventually mean sacking and restructuring. And since managers and workers control 60% of the average Russian company, they can often block the way.

In theory, shareholders' rights are protected by a law on "cumulative voting", introduced in 1993, which provides



for a form of proportional representation: if there are ten seats on the board, a shareholder who owns 10% of the firm should be sure of at least one of them. Around two-fifths of Russia's larger firms were using cumulative voting to elect directors by the end of last year, up from a mere 7.5% in May 1994. That was enough to keep the proportion of outside directors rising—though the figures also show that employees and managers were, if anything, tightening their equity control over the firms in which they worked.

Informal barriers against foreigners can be even higher. For instance, Boris Jordan, the American boss of a Moscow investment bank, Renaissance Capital, recently found himself temporarily denied a visa to re-enter Russia after he had led a group of investors pressing unsuccessfully

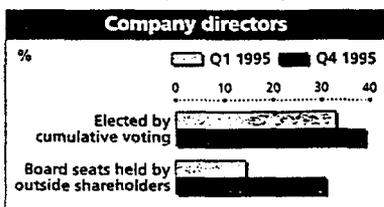
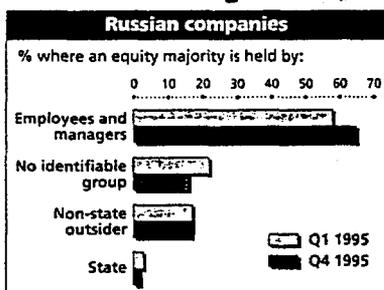
for board seats at a big metals firm, Novolipetsk, where outsiders had accumulated 44% of the shares. Although Russian assets are extremely cheap by any international measure and Russian firms are desperate for capital, such incidents explain why many foreign investors are wary of investing in them.

Is that Armani or your money?

If Mr Fox's uniqueness largely reflects the short-sightedness of Russian industry, it also says a little about other foreign investors in Russia. In Moscow, his counterparts are notable mostly for the size of their bodyguards and apartments. Set against these Guccied carpetbaggers, the slightly scruffy Mr Fox, who aspires to be a "soft and fluffy" person with whom to deal, is endearingly local. He encourages hard-pressed managers to lift their heads briefly above the daily fight for survival, and to develop some sort of strategy for their company that might even attract new capital. "I say to them: today we are the directors, we represent the owners of the company; today we are not the managers. Let's talk about what would happen if we did have some money. Humour me."

Indeed, Mr Fox's real secret is his incurable optimism—in particular about the prospects for the Russian Far East, which, for all its mineral wealth, has remained one of the poorest and worst-run regions of the country. This summer it was wracked by strikes and energy shortages that promise a difficult winter ahead. Nor does the rest of Russia offer much to lift the mood: GDP shrank by 5% in the year to September, and doubts over Boris Yeltsin's fitness to rule mean that the stockmarket is volatile. Small wonder if the struggling firms of Vladivostok feel the need for at least one person in the boardroom, foreigner or not, who is certain things will soon pick up.

A revolution begins?



Source: "Corporate ownership and corporate governance in the Russian Federation", Federal Commission on the Capital Market May 1996

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Balancing stockholder rights and effective corporate governance

During the past three years there has been increasing pressure on Russian lawmakers to protect stockholders from "controlling persons" in the context of acquisitions and mergers, whether such control results from ownership of a block of stock or from other relationships, including key positions in management of Russian joint-stock societies (sometimes referred to as "stock companies") or through management contracts.

The President and Parliament have responded by passing several enactments protecting the rights of such stockholders. Most of these provisions are contained in Part I of the Civil Code, the 1995 Law on joint-stock societies and two Presidential Edicts. This article is one in a series which will explore these rights in detail and analyse their effect on the market.

Many investors are now asking whether this protective legislation goes too far - impeding the ability of management of Russian stock companies to take the business decisions necessary to ensure growth and to best serve the stockholders generally. As more stockholders become aware of these statutory protections, the full impact of this legislation will be felt.

In addition to various preemptive rights to purchase newly issued stock (certain of which may be set forth in a company's charter and other which may not be waived, ie they are imperative statutory rights regardless of whether they are set forth in the charter), stockholders have the following rights in the context of an acquisition as set forth in the Russian Federal Law on Joint-Stock Societies. Our next articles will compare these rights to those in other Russian legislation - some of which are contradictory.

Large-scale transactions

Articles 75 and 78-80 of the law on joint-stock societies provide stockholders with the right to vote on certain "large-scale" transac-

tions (including acquisitions or mergers) - basically transactions the subject of which is property whose value exceeds 50% of the balance sheet value of the assets of the company. Also, stockholders voting against, or not participating in, the voting with respect to such a large-scale transaction, the reorganisation of the company or changes in the charter of the company which limit their rights have the right to demand the company to purchase all or part of their stock at market value.

The 30% Rule

The law on joint-stock societies also contains provisions more expressly protecting the stockholder from a "corporate raider". Persons intending to acquire 30% or more of the common stock of a company with more than 1,000 common stockholders must provide 30 days notice to the company and any such potential acquirer of more than 30% common stock must offer to purchase the stock belonging to other stockholders at a price not less than the average weighted price for the stock purchased by the acquirer during the prior six month period (ie prior to the acquisition of the 30%). This stockholder right may be waived by amendment to the company's charter or vote of disinterested stockholders.

The 30% rule may pose special problems in the context of privatisation. For example, an investor who successfully tenders to purchase a strategic bloc of stock of a company undergoing privatisation will often pay a premium in the form of an investment programme. If the 30% rule were applied to later purchases of stock by such an investor, it is not clear whether the investor would be required to offer to other stockholders a purchase price based on an inflated purchase price (ie the nominal purchase price paid for stock purchased from the State Property Fund and the commitment to be paid to the target company in the related investment agreement).

In the absence of assurance that the 30% rule would not apply, investors must thus take care to time such purchases after the expiration of a six-month period. It is advisable for investors planning to participate in a commercial competition or investment tender as part of the privatisation process, prior to submission of a bid, to discuss these issues and the issues described below with the State Property Fund and the State Property Committee and to request that the charter of the target company be amended to clarify these issues.

An even more worrisome question is whether the 30% rule could be applied in the context of the investor who is tendering to purchase from the State a strategic block of stock of a company undergoing privatisation if the block is equal to 30% or more of the common stock or together with stock purchased by the investor at auction would equal 30% or more, ie are such tenderers required to offer to purchase the stock of other stockholders.

Where the block is equal to 30% or more it may be argued that the privatisation legislation prevails and the 30% rule does not apply - but this argument is more difficult to make if the investor's holdings equal or exceed 30% due to separate purchases of stock sold through auctions. Many equally challenging questions arise regarding application of the 30% rule outside of the privatisation process.

The next article in this series will treat "control person liability" set forth in the law on joint-stock societies and other legislation protecting shareholder rights (in particular the Civil Code).

By William E Butler and Maryann Gashi-Butler. Professor Butler is Dean of the Faculty of Law, Moscow Higher School of Social and Economic Sciences; Maryann Gashi-Butler is an experienced CIS international transactions lawyer, both having been active in this fi since 1987.

List of Legislation

Decree of the Government of the Russian Federation	31 October 1996	No. 1299	confirming various statutes regulating the conduct of competitions/auctions and licensing. These detailed regulations call for the creation of a commission to supervise competitions and auctions of import and export quotas and the new procedures for awarding licenses and quotas with respect to foreign trade.
Decree of the Government of the Russian Federation	21 November 1996	No. 1378	"Concerning the Creation Under the Minister of Finance of the Russian Federation of a State Organisation On the Formulation of a State Fund of Precious Metals and Precious Stones". This decree was adopted pursuant to the President's August edict calling for a general restructuring of Federal organs of power. Additional regulations have recently been adopted relating to the operations by banks in precious metals.
Russian Federation Federal Law	21 November 1996	No. 129-FZ	"Concerning Bookkeeping Accounts (Accounting)". This law (only recently signed by the President - but adopted by the Parliament during Spring 1996) and various recently issued regulations fundamentally change requirements applicable to foreign companies operating through representation offices or branches - essentially increasingly significantly accounting requirements to the level of that required for Russian companies. They contain other important changes which increase reporting requirements for all entities (Russian and foreign companies). Additional recently adopted legislation relates to accounting for VAT and excise taxes.
Decree of the Government of the Russian Federation	23 November 1996	No. 1407	"Concerning the Confirmation of the Statute Concerning Licensing of Realtor Activity". This decree regulation activities of realtors, defines such activities very broadly and reflects the general movement towards closer regulation of professional activities in Russia.

НОВЫЙ ВЫПУСК АКЦИЙ ПО-АМЕРИКАНСКИ

Федеральные законы США, регламентирующие продажу новых выпусков акций, требуют от эмитентов тщательной подготовительной работы и значительных затрат.

Во время бума 20-х годов продажа многих новых акций сопровождалась массой обнадеживающих обещаний, в которых фактическая информация занимала лишь незначительную часть. Это положение изменилось в 1933 году, когда Конгресс издал Закон о ценных бумагах (Truth in Securities Act). После этого в 1943 году был также проведен Закон о биржах, и в тот же год для управления на базе обоих законов Конгресс учредил Комиссию по ценным бумагам и биржам (Securities & Exchange Commission — SEC).

SEC требовала полного раскрытия соответствующих фактов, прежде чем компания открыто предложит свои акции или облигации публике. Компания обязана представить подробный документ о регистрации ценных бумаг, где дается детальная информация о всех параметрах ее финансового положения: активы и обязательства, чем она владеет и размер ее долга. Также представляется документация по прибылям и убыткам за последние несколько лет. Вместе с этим компания должна указать как все выпуски и условия своих ценных бумаг, которые находятся в обращении, так и список должностных лиц и директоров вместе с окладами высшей пятерки, получающих свыше \$5 000 в качестве совокупного вознаграждения. Кроме того, указывается список всех лиц, державших более 5% любого из выпусков компаний, и, наконец, компания должна описать все свои операции.

Данные предоставляются в виде печатного проспекта, Комиссия следит, чтобы он был доступен любому возможному покупателю нового выпуска. Обычно требования к представлению проспекта имеют силу для публичных акционерных компаний в течение 40 дней после начала продаж, для компании, впервые предлагающей публике ценные бумаги, предусматривается 90-дневный срок.

Перед назначением цены нового выпуска обычно печатается предварительный эскиз проспекта. Эскизы, еще не рассмотренные SEC, называются «кочушки» («red herrings»). На заре своей деятельности Комиссия часто считала их просто рекла-

мой, предназначенной не столько для предоставления информации, сколько для отвлечения читателей от фактов, к которым, возможно, у SEC могли бы возникнуть претензии. Как правило, предварительный эскиз распространяется среди подписчиков и синдиката по сбыту. Но поскольку есть возможность, что некоторые копии могут попасть к публике, на обложке отмечается красным шрифтом, что проспект еще не подвергался анализу SEC.

Обычный объем проспекта — 20—30 страниц, но бывает и больше. Однако некоторым хорошо зарекомендовавшим себя компаниям и службам, ответственным определенным высоким стандартам финансовой ответственности, Комиссией разрешен выпуск кратких проспектов. В 1970 году SEC ослабила правила и распространила привилегию на компании, имеющие твердое финансовое положение и зарегистрировавшие устойчивую прибыль в течение нескольких лет.

Пока условия нового выпуска исследуются Комиссией, ни один брокер или дилер не имеют права представлять публике какую-либо дополнительную информацию или даже высказывать свое мнение о нем. В качестве рекламы он может опубликовать проспект или детальное изложение своих соображений. Кроме этого, он может воспользоваться только единственным способом рекламы. Это так называемое «надгробье» (tombstone) — реклама, в которой указывается только название выпуска, его цена, размер, имена андеррайтеров и дилеров, связанных с ними.

Иногда в газете «Wall Street Journal» или других крупных изданиях можно встретить несколько странную, на первый взгляд, рекламу, которая, с одной стороны, объявляет о новом выпуске, с другой, констатирует, что он уже полностью продан. Дело в том, что, когда новый выпуск полностью продан с опережением графика предложения публике, синдикаты андеррайтеров рекламируют его из соображений престижа.

Далее. Трудности компании могут не закончиться, даже если она выполнила все требования SEC. У большинства штатов

также имеются законы, обуславливающие регистрацию и продажу новых ценных бумаг. Независимо от того, что многие требования законов («законов чистого неба» — blue sky laws) весьма схожи с требованиями Комиссии, тем не менее они способны создать компании массу неприятностей и существенно увеличить дополнительные юридические и административные расходы.

Таким образом, все вышеописанные процедуры превращают подготовку к продаже нового выпуска в весьма дорогостоящее мероприятие. Счета за подготовку всех необходимых форм и выпуск проспекта могут достигать сотен тысяч долларов. Однако федеральный закон, как и законы в большинстве штатов, обеспечивает «лазейку» для небольших компаний. В частности, если цена нового выпуска не превышает \$1,5 млн., компании требуется оформить для SEC краткую регистрационную форму. Это называется оформлением по Правилу «А». Исходя из него, компании могут ограничиться распространением объявления о размещении. Если стоимость выпуска составляет менее \$100 тыс., то не требуется даже объявления. В то же время для выпусков, которые могут быть классифицированы как частное вложение капитала (обычно такой выпуск покупают не более 35 человек), а не как выпуски, открытые для публики, регистрации в SEC не требуется вообще.

Конечно, правило «полной огласки» в большей степени помогает защитить инвестора. Однако часто считают, что SEC слишком активна в этом направлении. Данное правило может отпугнуть многие компании от привлечения подобным путем новых средств для развития. Одновременно запрет на распространение какой-либо информации о компании в тот момент, когда проспект ее нового выпуска акций находится на рассмотрении Комиссии, может лишить ее инвесторов существенной информации на весь период проверки. Запрет пропаганды нового выпуска — безусловно, разумное правило, но его применение подчас создает серьезные трудности для инвесторов.

Виктор КАРЕТНИКОВ

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NYSE: русские идут

Спрос на российские бумаги созрел

МИХАИЛ ЛЬВОВ

ЛЮБОЙ, кому сегодня доступен Reuters или, например, программа CNN с бегущей вверху строкой котировок Нью-Йоркской фондовой биржи, может, дождавшись в афганском порядке буквы V, обнаружить котировку VIP. Этим весьма удачным сокращением теперь обозначается компания «Вымпелком» (крупнейший в России оператор сотовой связи — торговая марка «Би-Лайн»), первая после восьмидесятилетнего перерыва российской компания, включенная в листинг крупнейшей в мире фондовой биржи.

На Нью-Йоркской фондовой бирже котировка около 3 тыс. компаний, из них иностранных 250. Общая капитализация всех этих компаний достигает 30 трлн долл.

«Русскому дню» на NYSE предшествовало шоу с русскими плясками и пенем под балалайку. Надо было видеть, как разномышленные американские брокеры хлопали в такт «Калинку». Над главным входом на биржу был вывешен довольно внушительных размеров российский триколор.

15 ноября вместе с «Вымпелкомом» на бирже дебютировали еще три компании, однако интерес к российским акциям оказался несопоставимо большим. Как уже отмечалось, заявки при предварительном размещении превысили 1,1 млрд долл., что в 11 раз превосходило номинал объявленной эмиссии. Увеличить его не представлялось возможным ввиду сложности и длительности отечественных, а не американских процедур. Наверное, в этом не было и особого смысла: возможности компании по эффективному освоению привлеченного капитала не безграничны, и лучше поддерживать устойчивый курс акций на бирже, оставляя возможность для следующих эмиссий. По тем

же причинам нет смысла сильно завышать начальную цену размещения, хотя это и позволял объем первоначального спроса. Андеррайтеры (координаторы первичного размещения) — московская компания «Ренессанс Капитал» и американская «Дональдсон Лэфкин и Джерретт Секьюритиз Корп.» — более всего опасались «перегрева» акций в первые дни торгов. Таким образом, рост котировки акций VIP к окончанию первого дня торгов на 40% по отношению к первоначально объявленной цене размещения в 20,5 долл. за акцию можно считать предельно допустимым. Однако даже такой рост стал на NYSE рекордом месяца, уже после установления первой котировки более 18 долларов за акцию брокеры с восклицаниями типа «O, my God!» засуетились вокруг «русской стойки». На следующий день нью-йоркские газеты вышли с заголовками в стиле «Русские идут!».

Президент «Вымпелкома» Дмитрий Зимин — классический отечественный ученый-оборонщик, по отношению к которому крайне трудно применить традиционные характеристики «нового русского», был заметно потрясен всем этим ажиотажем. На пресс-конференции после начала торгов г-н Зимин, как бы оправдываясь за свой очевидный коммерческий успех, произнес: «Мы оборонщики — зарплату не платили, куда нам было еще податься?» Теперь руководители «Вымпелкома» склонны готовиться к известным проблемам на Родине. «Вымпелком», превратившийся в публичную компанию с рыночной капитализацией, превышающей, например, капитализацию «Норильского никеля», может столкнуться с согласованным отечественным требованием «подделиться», причём объединяющим



Уильям Дональдсон, бывший председатель Нью-Йоркской биржи (слева), и Дмитрий Зимин, президент «Вымпела», с супругой

незамысловатую братву с политическими начальниками местного и федерального уровней. К тому же теперь достаточно озонного глумления, но громкого слова любого ответственного хозяина региона, где «Би-Лайн» предоставляет свои услуги, чтобы поставить под угрозу биржевые котировки «Вымпелкома».

Потенциальный спрос на российские акции весьма велик: по объявленным за прошлый год результатам по доходности, приближающейся к 100%, мы заняли второе место в мире после Венгрии. И несметные полчища мелких игроков склонны заказывать своим брокерам «русские бумаги». С одной стороны, нет оснований надеяться, что это обстоятельство сильно поможет большинству российских промышленных компаний, страдающих от дефицита капиталовложений. Причина — крайне низкая их ликвидность, вызванная специфической российской «стабилизационно-политикой». С другой — фавориты этой странной политики — российские банки — не имеют никаких шансов присоединиться к международному рынку капиталов с плотностью, близкой к той, с которой они присоединяются к национальному бюджету. С точки зрения западного рынка, эти инфузорные финансовые образования представляют собой исключительно этно-монологический интерес.

Коммерческий успех акций «Вымпелкома», позволивший компании собрать на рынке более 115 млн долл. и заработать различным биржевым игрокам только на первом дне торгов около 30 млн долл., объясняется к тому же повышенным интересом к телекоммуникационным компаниям. Их акции всегда продаются с повышающим коэффициентом, в нашем случае еще более значительным авиду «антикварного состояния» — российского рынка связи, гарантирующего возможности очень быстрого развития.

И в удачном подборе и подготовке компании, и в тщатель-

но продуманной тактике первичного размещения большая заслуга принадлежит «Ренессанс Капиталу», ставшему в прошлую пятницу по сути именинником фондового рынка. После успеха «Вымпелкома» предполагается вывести на публичные биржевые торги акции еще как минимум двух российских компаний. Вероятнее всего, это будут «ЛУКОЙЛ» и «Ростелеком».

Специалисты считают также большой удачей, что первой российской компанией на бирже стала от рождения частная (учредители — оборонные институты РТИ, НПО «Вымпел», НИИ «Гиперсвязь», ВГТРК, 32% акций принадлежит американской компании FCI Wireless), а не «приватизированная» компания, не имеющая при себе традиционного охвата социальной ответственности, «этичных культур», пионерских лагерей на тысячах посадочных мест и т. д., к тому же с самого начала осуществлявшая бухгалтерию и аудит в соответствии с американскими стандартами. «Вымпелком» представил инвесторам весьма внушительную норму прибыли; причем важно, что в данном случае речь идет о реально оплаченной прибыли. В силу известных особенностей российского рынка возможность получать реальные деньги за свои услуги в «реальном секторе» сегодня обладают только компании — экспортеры и продавцы конечных товаров и услуг населению. Остальные производящие компании вынуждены довольствоваться низкокликантными денежными суррогатами, слабо интересующими потенциального западного инвестора. Можно заметить, что эйфория по поводу возможностей привлечения с мирового рынка весьма дешевых капиталов, вызванная явным успехом публичного размещения акций «Вымпелкома», обречена иметь весьма избирательный характер, пока платежная система России находится в нынешнем вырожденном состоянии.

Сегодня, 20.11.96 стр 5

The Moscow Times
Business &

SATURDAY,
NOVEMBER 16, 1996

VimpelCom Is Russia's NYSE Debut

COMBINED REPORTS

The facade of the New York Stock Exchange was adorned with a Russian flag Friday to signal the debut of Wall Street's first Russian company, Vimpel-Communications.

Preceded by a group of folk dancers and accompanied by former Russian prime minister Yegor Gaidar, VimpelCom, Moscow's top cellular phone company, made an impressive start by attracting \$110.7 million from investors.

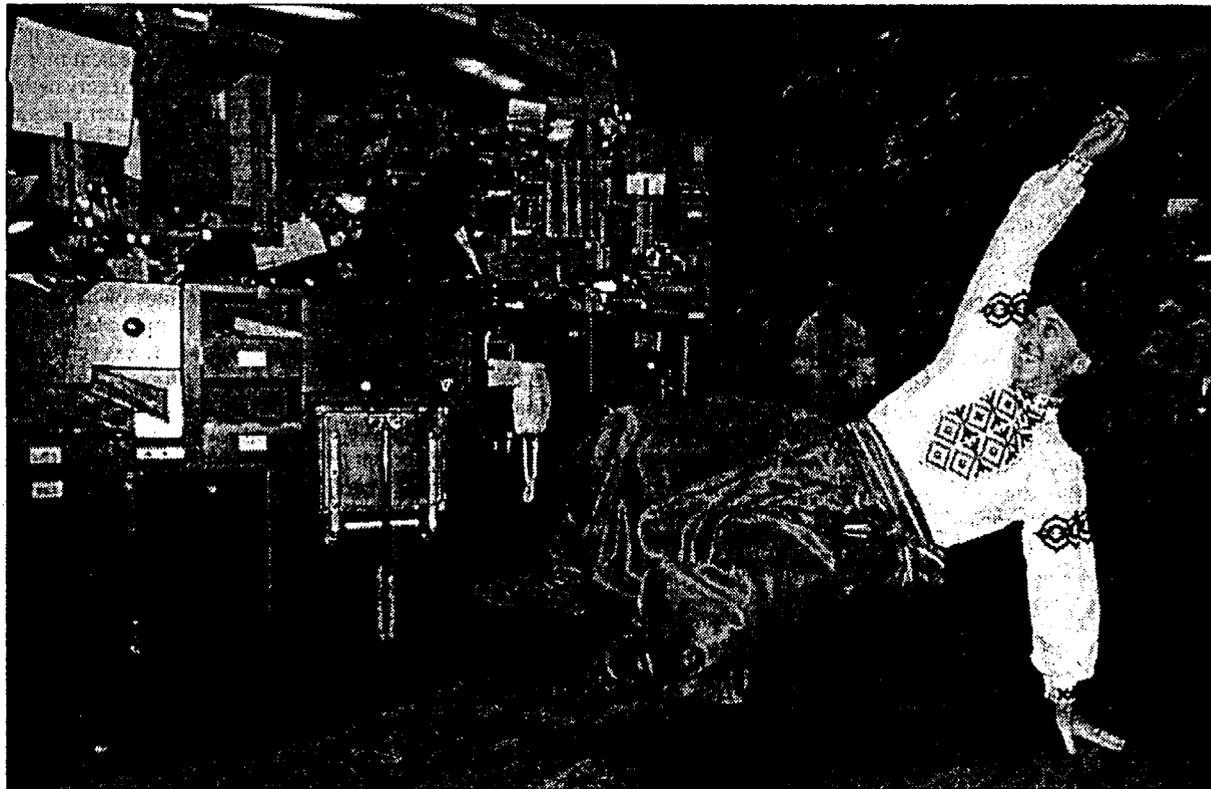
VimpelCom is not the first Russian company to seek foreign financing. But until now none had managed to clear all the accounting and legal obstacles for a listing on the New York Stock Exchange.

The company's stock is trading as American Depositary Receipts, or ADRs, each representing three-quarters of an underlying VimpelCom share.

Opening at \$20.50 the VimpelCom ADRs sold briskly and had posted a gain of \$8.25 to \$28.75, by midday.

"What we are seeing today is investor enthusiasm and a very successful deal," said Alan Apter of Renaissance Capital, one of the lead banks for the offering.

ADRs, which must be approved by the U.S. Securities and Exchange Commission, allow investors in the United States to buy dollar-denominated foreign shares while avoiding the custodial and settlement problems in the issuer's country.



PETER MORGAN / REUTERS

A Russian dancer performing on the floor of the New York Stock Exchange during ceremonies marking the listing of VimpelCom.

A number of Russian firms have issued lower-level ADRs, but VimpelCom is the first to qualify for so-called Level 3 receipts, which are traded the most freely and can be used to raise new capital.

Since starting operations in

Moscow using the Beeline trademark in 1994, VimpelCom's subscriber base has grown to 45,000 customers. Its president Dmitry Zimin was in New York for the stock debut.

The company is being touted as the best way to quench Russia's powerful

thirst for telecommunications after 70 years of rationing. In Moscow alone, 165,000 requests for telephone line installation are languishing.

As a result, more and more Russians are turning to cellular telephones. (AFP, MT)

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The Russians arrive at the New York Stock Exchange

NEW YORK (Reuters) — Vimpel-Communications A.O. became the first Russian company to break into the bastion of American capitalism on Friday with a listing on the New York Stock Exchange, and its stock soared in heavy trading.

Within hours after Russian dancers performed on the floor of the exchange to mark the event, the wireless telephone company's US shares soared from \$8.75 to \$29.25.

It was among the most active

issues with more than 4 million shares traded by mid-afternoon.

"I'm very proud that it's our company to make this breakthrough and be listed on the New York Stock Exchange," Dmitri Zimin, Vimpel-Comm's president and chief executive, told reporters.

He and exchange officials hailed the filing as a historic step for the growing Russian private sector after seven decades of Communist rule.

The room at the NYSE where

the news conference was held included a memento of capitalism's earlier links with Russia — a large urn made by the famed Faberge workshop and presented by Tsar Nicholas II for the sale of Siberian railroad bonds at the turn of the century.

Analysts said Russian stocks such as Vimpel-Comm carried risks tied to politics and the economy in Russia. But they said the apparent success of the offering pointed to NYSE listings for other Russian companies.

Dmitri Vasiliev, the head of the Russian Securities and Exchange Commission, said: "Our task now is to continue down this road with our colleagues at the New York Stock Exchange and the Securities and Exchange Commission to assure that other Russian companies enter the capital markets."

Vimpel-Comm serves the Moscow region and has licenses for the capital and St. Petersburg areas. It was formed in 1992 as a unit of Vimpel

Corp., a military contractor.

Run by former Soviet military engineers, it has about 45,000 customers in Moscow, or 59 per cent of that market. Vimpel-Comm recorded \$100 million in revenues last year and has 630 employees.

Privately held FGI Wireless Ltd. of Chicago owns about 20 per cent of the stock. FGI Chairman Augie Fabela II is Vimpel-Comm's chairman.

The company offered 5.4 million American Depository

Receipts (ADRs), as the US shares are known, in New York, representing about 20 per cent of its total stock.

Fabela said Vimpel-Comm decided to be listed on the NYSE, because Russian markets still lacked enough capital. The company is not listed on the Moscow exchange but he said it "absolutely" would trade there.

"It's a matter of the right time," said Fabela. A secondary offer of shares was not planned within the next year, however.

Eastern and Central Europe

X ■ RUSSIA

Federal Commission Issues Rules On Disclosure, Custodial Services

MOSCOW—Russia's Federal Commission for the Securities Market, in a move seen as an attempt to further strengthen its status as Russia's chief securities market regulator, has approved new rules requiring greater disclosure by issuers of securities and bonds and governing custodial services.

Under the new disclosure rules, issuers are obliged to describe in share prospectuses their activities and types of products and services, and provide information about their major suppliers of raw materials, markets, and competitors.

Share prospectuses must be accompanied by the issuer's financial report, endorsed by an independent auditor, under the new regulation.

Separately, under the "Temporary Regulation on Depository Activity on the Securities Market in the Russian Federation and the Licensing Procedure Thereof," the commission proclaimed itself the sole body responsible for the licensing of depositories.

At present, commercial banks—whose activities are regulated by Russia's Central Bank—act as depositories for company shares and bonds.

Bankers Protest Temporary Regulation

The commission's action triggered protests from bankers, who said they were concerned the commission may try to edge banks out of the custodial market.

Acting under Russia's new law on the securities market, the securities commission announced November 4 the award of the first six depository licenses, none of which went to a bank.

Andrei Kozlov, deputy chairman of the Central Bank, told reporters November 13 the bank was offended at being left out of drafting the provisional securities regulation.

Previously, the head of the securities commission, Dmitry Vasiliev, had accused the Central Bank of attempting to "monopolize all decisions related to the securities market." Kozlov said the Central Bank did not question the commission's regulatory authority over the securities market, but was expecting a general license from the commission to exercise control over the activities of banks on the securities market.

Under existing legislation, the securities commission is authorized to assign other organizations regulatory functions on the securities market, and even to empower them to issue licenses.

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In a conciliatory statement November 13, the securities commission said the "permanent regulation [on depository activity] can be worked out jointly by the Federal Commission on the Securities Market and the Central Bank of Russia and adopted as a result of mutual agreement."

The Temporary Regulation will remain in effect until a permanent depository infrastructure is established.

Proposal for Single Depository

Another bone of contention between the two regulatory bodies was Vasiliev's proposal to set up a single national depository for corporate equities and government securities.

The securities commission, which wants to control the central depository, believes the creation of a single depository is vital for efficient trading in securities.

Vasiliev told a meeting of 116 representatives of 65 regional securities commissions November 12 that if the Central Bank persisted in its objections to the creation of such a depository, it would be possible to set up two central depositories. Under such an arrangement, the Central Bank would be responsible for a government bond depository, while the commission would oversee a depository for corporate securities.

Securities commission officials contacted by BNA declined to provide any further details or comment on the proposal. However, a November 15 announcement by the Commission indicated that the decision to establish a central securities depository "is designed to support the development of the Russian capital market and lower risks to domestic and foreign investors." The announcement said the depository "is to be created in accordance with international practices and Group of Thirty recommendations."

"In other developed and developing markets," the announcement continued, "the establishment of a central depository has resulted in a considerable improvement in the investment climate and increased investment activity. In Russia, it is expected that this project will reduce risk and encourage the Russian securities circulation to return to the on-shore market. In addition, it is expected that the central depository will raise the quality of depository services nationwide and encourage the use of uniform standards for securities custody."

"The introduction of standard approaches to information disclosure by issuers will increase the transparency of the Russian securities market," according to the commission. "In addition, the central depository will accelerate securities settlement periods, lowering the costs of securities transactions and increasing liquidity."

The resolution establishes a Working Group to prepare the documents and regulations necessary to establish a central depository for corporate securities. The Working Group will be headed by Vasiliev and will include representatives of the State Legal Administration of the Chairman of the Russian Federation, the Federal Agency for Government Communications and Information of the President of the Russian Federation, the Central Bank of the Russian Federation, the Finance

Ministry of the Russian Federation and other ministries and agencies, and representatives of issuers, Russian and foreign securities market participants, and independent experts.

Depositories, Management Companies Receive Licenses

In addition, the Commission announced November 6 that the following organizations have been granted licenses to carry out depository activities in the Russian securities market:

ZAO "Primorsky tsentralny depozitarny", Vladivostok;

AOZT "Regionalny depozitarny tsentr", Yekaterinbourg;

ZAO "Raschetno-depozitarnaya organizatsia", Novosibirsk;

ZAO "Depozitarno-kliringovaya kompania", Moscow;

Ob'edinenie yuridicheskikh lits "Depozitarno-raschetny soyuz", Moscow; and

ZAO "Sankt Petersburgsky Raschetno-depozitarny tsentr", St. Petersburg;

In addition, the following management companies have been granted licenses to exercise trust management of assets of Russian unit investment funds:

ZAO "Ob'edinennaya Finansovaya Gruppy Invest", Moscow; and

ZAO "Upravlyayuschaya kompania paevymi investitsionnymi fondami "Montes Auri", Moscow.

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Your guide to ADRs and GDRs

Samer Iskandar explains what they are and who might need them

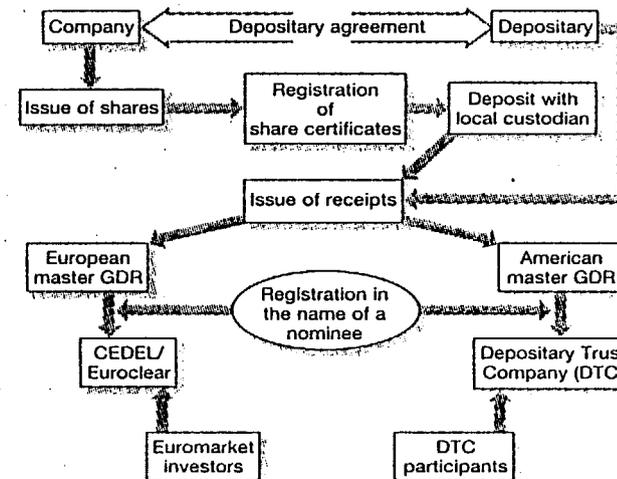
Q: Investors often mention ADRs and GDRs. What exactly are they?

A: These acronyms refer to a family of instruments called Depositary Receipts. They are receipts for shares of a foreign company, often listed in a stock exchange that is not easily accessible to non-resident investors.

The underlying shares remain in safe-keeping with a bank in the issuer's home market, but the receipt itself may be traded elsewhere. Dividend payments are usually in US dollars, and DRs can be issued with, or without, the voting rights of the underlying stock.

American Depositary Receipts - also called American Depositary Shares - are traded in New York. Similar instruments listed on other stock exchanges, such as London or

Issuance of Depositary Receipts



Source: Flemings

Luxembourg, are called Global Depositary Receipts.

DRs can normally be converted back into the ordinary shares, although this process can sometimes be costly and time consuming.

Q: Why not directly buy the shares themselves?

A: Depositary receipts are often an attractive alternative to the ordinary shares when international investors have little confidence in the ability of domestic institutions to safeguard securities. They allow investors to circumvent problems caused by poor or unwieldy

settlement systems.

When investors buy and sell DRs, settlement may be through Cedel and Euroclear, the European clearing banks (for GDRs), or DTC, the US settlement system (for ADRs).

The use of DRs can also offer international investors access to equity markets which would otherwise be out of reach - for example when local legislation places restrictions on the foreign ownership of shares.

One further advantage is the elimination of currency transfers. Buyers of an Egyptian GDR, for example, do not have to worry about changing Egyptian pounds into their home currency when they receive dividends or sell their stake. These transactions are arranged by the depositary bank, with payments made in US dollars.

Q: Can anybody buy DRs?

A: In most countries, yes. In the US, however, investment in foreign securities is more tightly regulated than elsewhere. The vast majority of US-listed DRs consist of

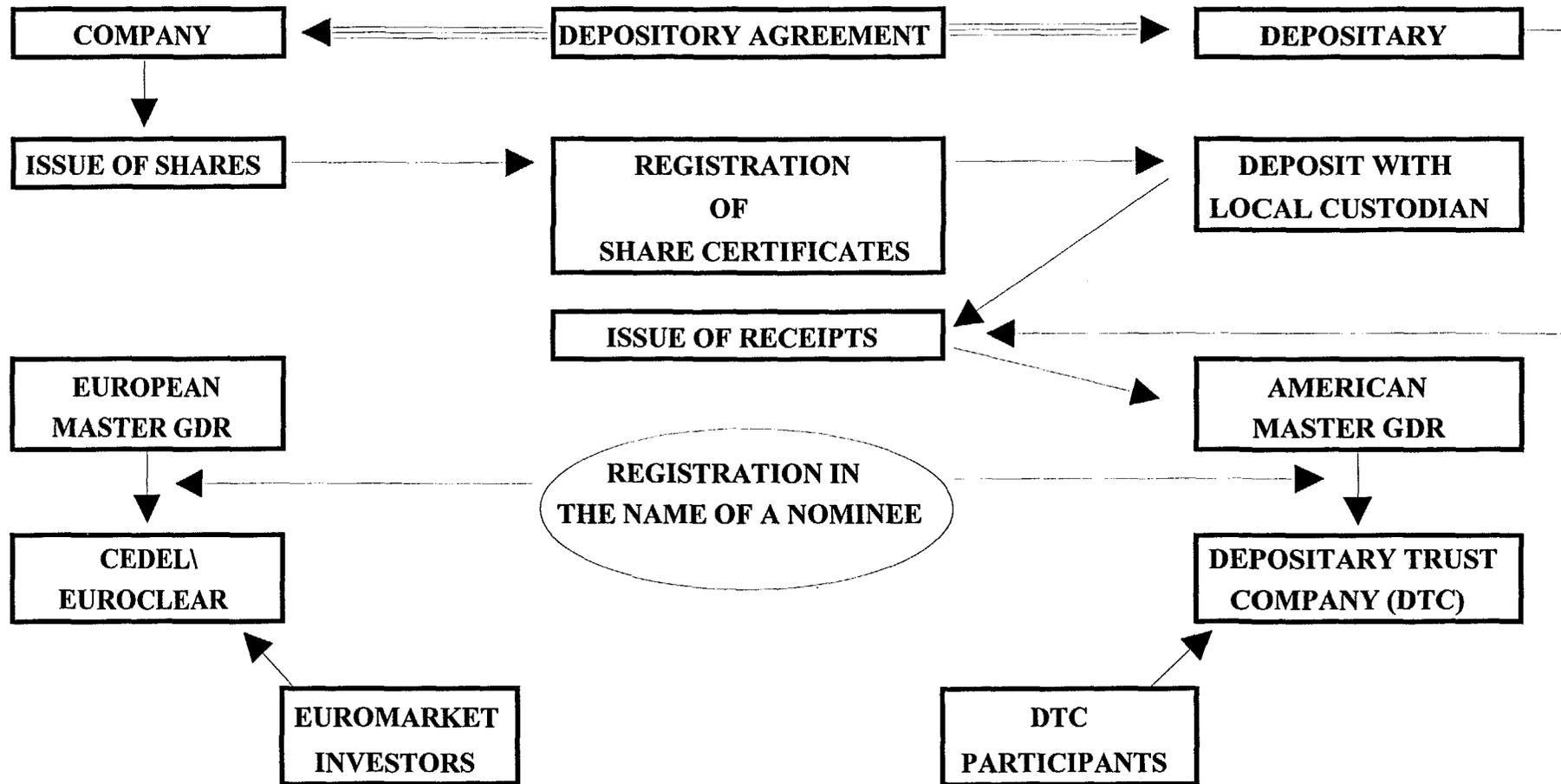
so-called Level 1 offerings. They are offered under the Securities and Exchange Commission rule 144a, which requires that the products be sold only to "qualified investors" - usually institutional buyers as opposed to individuals. Level 2 - and Level 3 - DRs are accessible to most US investors, but their issuance is more complicated because the issuing company must comply with strict SEC reporting requirements.

Q: Who still buys the local shares?

A: Institutional investors with the capacity to handle international transactions in the different currencies involved.

Because of costs related to issuance and safe-keeping, DRs are often slightly more expensive than the share they represent. Holders of GDRs by Egypt's Commercial International Bank, for example, have to pay a premium of roughly 6 per cent over the price of the share on the local market.

GUIDE TO ADRs and GDRs



** Please refer to Appendix 8

** Diagram created from "Your Guide to ADRs and GDRs." The Financial Times. November 8, 1996. London.

Russian market's fortunes revealed in ADRs

Russia's equity market offers seemingly fantastic long-term potential, but in a country where information is scarce and events unpredictable, stockpicking is a special challenge.

Take the recent case of Kominet, one of Russia's privatised oil producers: its share price rose fivefold to almost \$25 in 1994.

But then an oil pipeline leak - and the revelation that a new share issue had been distributed secretly to selected investors - sent its shares plummeting. They currently trade at below \$2.

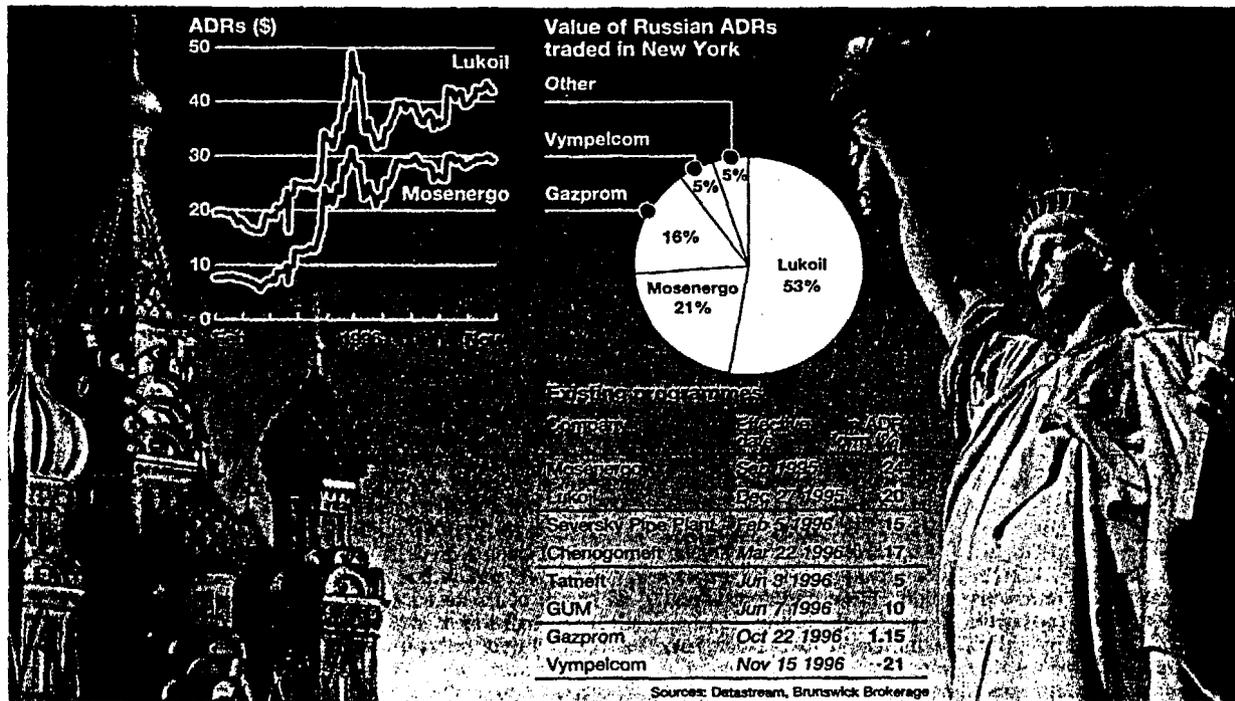
One unusually reliable indicator in recent months has been the behaviour of Russian companies that have issued American Depositary Receipts (ADRs). All eight of them have seen their share prices rocket.

ADRs, which are created by bundling up domestically traded shares into internationally tradeable packages, count technically as US securities.

This allows them to be bought by a far broader range of mainstream funds than just high-risk investors in emerging markets.

Brunswick Brokerage, a Moscow-based securities house, suggests investors would have made handsome returns this year by buying domestic shares of companies that announced they were going to issue ADRs, then surfing the resulting liquidity wave when the international proxy shares started trading.

Since their ADRs were issued, the shares of Tatneft,



a regional oil producer, have risen three and a half times. Those of Seversky Pipe Works rose more than three times, and those of Lukoil, Russia's biggest oil producer, have more than doubled. Total value of Russian ADRs is now more than \$2.5bn.

The cause of these price movements is, of course, more complex in practice than in theory. Almost all Russian shares surged when it became clear that President Boris Yeltsin would be re-elected.

Companies that issue ADRs are also more likely to be run by progressive man-

agers who are actively restructuring their companies.

Moreover, any investment decision based solely on liquidity arguments is likely to prove highly suspect. Underlying fundamentals are still important.

"If you just looked at those companies that issued ADRs, you would have missed the best returns in the market this year," says Mr Alex Knaster, head of the Moscow office of CS First Boston, the international investment bank.

"The biggest run-up has been in the shares of second-tier telecoms and energy

companies and preferred stocks," he says, although he concedes that such illiquid shares will be far more difficult to sell if the market turns nasty.

So far, Russia's privatised companies have only issued level-one ADRs approved by the US Securities and Exchange Commission, which demands that all information disclosed to the Russian market should be made available to international investors.

However, several companies are planning to issue more sophisticated level-three ADRs next year, which

will require much fuller disclosure and doubtless lead to more discriminating investment decisions.

The SEC demands that companies produce three years of US GAAP-standard accounts before issuing level-three ADRs, although this would enable them to obtain a full New York Stock Exchange listing and raise fresh capital abroad through a public offering.

Lukoil is believed to be planning to raise more than \$1bn abroad next summer by selling 15 per cent of its shares on the back of a level-three ADR listing.

"The interest among com-

panies in Russia to issue ADRs has been phenomenal," says Mr Christopher Kearns, an assistant vice-president at the Bank of New York, which acts as the depositary bank for all the Russian ADRs issued so far.

"The appetite from companies to bring their accounts to a level where they can truly access international markets is very encouraging."

As the Russian stock market develops and domestic demand deepens, it will in theory become increasingly hard for foreign investors to ride the ADR liquidity wave.

"The novelty factor of ADRs will fade away. We will see less of a dramatic price impact when companies issue them in future, and it becomes easier to invest directly in the underlying stock in Russia," says Mr Par Mellstrom, head of research at Brunswick.

Yet these first Russian ADRs could still experience one final liquidity surge if, as seems likely to be the case, the Russian equity market is included in the International Finance Corporation's investable securities index next year.

Emerging market fund managers wishing to track the benchmark IFC index would be obliged to invest a proportion of their funds in Russia, though they could be left scabbling for suitable stock.

Only ADRs offer a safe and liquid enough means through which they could invest in scale.

John Thornhill

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Spotlight on American Depository Receipts

Until recently, participation in Russia's lucrative but volatile equity market remained a mystery to the international financial community, open to only the most sophisticated emerging market investors. However, in 1995 the Russian electric utility Mosenergo issued the first Russian American Depository Receipt (ADR) in conjunction with the Bank of New York, thus beginning a trend which has allowed a number of Russian firms to make their first foray into the American capital markets.

Issuing and Trading ADRs

An American Depository Receipt is issued by an American depository institution, denominated in dollars, and represents one or more shares of a foreign corporate entity which have been deposited with a local custodian in the home country of the entity.

The GDR, or Global Depository Receipt, is identical to the ADR, with the word global used only when it is preferred for marketing purposes. In the case of Russia, the ADR is created by the US depository institution (in each case to date the Bank of New York) and issued to the foreign (US) purchaser. The transaction proceeds as follows. The purchaser's broker buys the underlying Russian securities through a licensed Russian broker, and subsequently directs that the stock be deposited with a custodial agent of the ADR issuing bank. The broker initiating the transaction will convert the USD received from the purchaser into roubles and pay the local broker for the shares. On the day that the shares are delivered to the custodian, this institution notifies the depository bank. When notification is received, the ADRs are issued and delivered to the broker initiating the transaction, who in turn delivers the securities to the investor. Each ADR issued typically represents several shares - for example a US\$ 100 ADR may represent four US\$ 25 ordinary shares in the Russian domestic equity market.

Once an ADR is issued, it can be freely sold to other investors in the United States in an intra-market transaction. Such transactions are settled in the same manner as any other share purchase - in dollars on T + 3 - and account for 95% of ADR trading. Consequently, one of the depository institution's most crucial roles is that of stock transfer agent and registrar. Cancellation of an ADR works in a fashion similar to the purchase transaction. The owner's broker may sell the ADR to another US investor in an intra-market transaction, or may sell the shares in the home market (in this case Russia) in a cross-border transaction.

Once again going through the local Russian broker, the US broker sells the shares and then surrenders the ADRs to the depository bank. The depository institution cancels the ADR and instructs the custodian to deliver the shares held to the local broker, who will arrange for the conversion of roubles into dollars to be returned to the ADR holder.

Level 1 ADRs

As the quality of most financial information disseminated by Russian firms is rudimentary and confusing, the majority of companies issuing ADRs utilise the Level I programme, which is the simplest method for a foreign company to gain access to the American capital markets.

Level I ADRs trade over-the-counter (OTC) in the "pink sheet" market and consequently the issuing company is exempted from compliance with many of the reporting and disclosure requirements set forth in the 1934 Securities Exchange Act. This exemption in essence allows the foreign issuer to enjoy the benefits of a publicly traded security while continuing to use the current financial reporting process. To issue a Level I ADR, a Russian company must do the following:

- File its financial statements (utilising current reporting methods rather than GAAP standards) in English with the SEC, as well as provide information as requested to appropriate Russian regulatory authorities
- Execute a standard contract with the issuing depository institution enumerating the rights and responsibilities of each party
- File a Form 6 registration statement with the SEC

Level 2 and 3 ADRs

Level 2 and 3 ADR programmes require a Russian firm to meet additional reporting requirements for listing on NASDAQ or other exchanges. The Level 2 programme requires registration under the 1934 Securities Exchange Act, whereas the Level 3 programme entails a full public offering with the concomitant reporting requirements including three years of financial statements according to US GAAP standards and a due diligence process similar to that required for any US public offering.

Rule 144A Private Placements

Rule 144A allows Russian firms to raise capital via private placements to qualified institutional buyers (QIBs) while avoiding the high costs and extensive disclosure requirements required in Level 2 and 3 programmes. Once these unregistered securities are placed with eligible purchasers, they may not be sold to the public for at least two years, although they may be sold to other qualified buyers.

Benefits of ADRs

The issue of American Depository Receipts has a number of advantages for both Russian issuers and the investing public. Via an ADR, a Russian company may gain its first introduction to international capital markets while raising public awareness of the firm, demonstrating its increasing financial sophistication, and reaching a much broader range

of investors. Presumably, an ADR issue will signal to the market that a firm actively seeks out and values Western investors, and is willing to work towards meeting international standards of financial disclosure. Issue of an ADR can also increase liquidity for a company's shares in the domestic market, while positively impacting the domestic share price.

Russia's ADRs

A number of Russian firms have issued ADRs or are currently in the process of doing so. The first company to approach the international capital markets was Mosenergo, with a 144A private placement of US\$ 22 million in September of 1995.

The first Level I programme was initiated in December of 1995 by LUKoil, and other issuers include: GUM, Chernogorneft, Tatneft, Seversky Tube Works, Rostelecom, and Sun Brewing. Other issues in the world include Inkobank, Bank Menatep, Bank Vozrozhdeniye, Megionneftegaz, UES, and Surgutneftegaz. Indeed, the market for Russian company ADRs has become one of the world's fastest growing, and these ADRs have recently been outpacing other ADR issues in terms of price appreciation. Given the history of price appreciation on the issues and the effect on the domestic market, an investor could have profited handsomely by purchasing domestic market shares on companies announcing new ADR issues. While an issue may not give a Russian firm immediate access to new foreign equity, an ADR programme can position a company to work toward the opportunity to later raise capital abroad, and, as Russian enterprises evolve, the market should see continued emphasis on the issuance of American Depository Receipts.

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The Moscow Times

Monday, January 6, 1997

Stockholders Sue Ovitz

■ LOS ANGELES (AP)—Stockholders have sued the Walt Disney Co., contending that Michael Ovitz doesn't deserve a multimillion-dollar severance package for his 14-month tenure as the company's No. 2 executive.

The suit claims that Ovitz, once heralded as Hollywood's most powerful dealmaker, was "undistinguished and unproductive" as Disney's president. The lawsuit said his severance deal was worth "\$130 million or more."

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