

ANALYSIS

Corporate Corruption in Russian Regions

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Abstract

To understand corporate corruption in Russia and to develop both effective anti-corruption policies at the macro level and anti-corruption strategies at the firm level one has to move beyond the predominant paradigm and to disaggregate its measurement. This article outlines the results of a pilot survey of CEOs of leading companies operating in the Russian regions with regard to their use of informal practices.

Informal Practices

Russia finds itself at the bottom of the 22 assessed countries and one place below China in the Transparency International Bribe Payers Index, aimed at measuring corporate bribery abroad. It is the TI's attempt to measure the perception of corporate corruption rather than the perception of public sector corruption reflected in the aggregate Corruption Perception Index, which in 2010 ranked Russia 154 out of 178 countries with an absolute score of 2.1 on the low side of the 1 to 10 scale. In the words of IKEA founder Ingvar Kamprad, the situation in Russia is "something in a class of its own." It is not that the requisite components of the rule of law are absent in Russia; rather, the rule of law has been diverted by a powerful set of informal practices that have evolved organically in the post-Soviet milieu. John Browne, CEO of BP for twelve years, observes in his memoirs, "the problem is not the lack of laws, but their selective application. This is what creates the sense of lawlessness. While bureaucratic legalistic processes are the hallmark of Russia, you never know whether someone will turn a blind eye or whether the laws will be applied to the hilt."

Disaggregating Corruption

The global corruption paradigm that has prevailed since the 1990s is based on three premises: that corruption can be defined; that corruption can be measured; and that measurements can be translated into specific policies. Significant advances in corruption studies and anti-corruption policies have been made since then all over the world. However, the current paradigm and the use of the term "corruption" do not facilitate an understanding of the workings of corruption in Russia for three reasons.

Firstly, corruption is an umbrella term for a variety of complex phenomena associated with betrayal of trust, deception, deliberate subordination of common interests to specific interests, secrecy, complicity, mutual obligation and camouflage of the corrupt act. In order to deal with such diverse practices in an effective way, we disaggregate "corruption" into clusters of practices relevant for business in Russia.

Secondly, the concept of corruption that underlies international regulatory standards presumes completion of the transformation from what Weber described as "patrimonial power structures," where decisions made on the basis of people's relationships and traditional forms of authority, to rational-legal systems, where institutionalized rules become the foundation of governance. In terms of such transformation, the concept of corruption is modern, and the establishment of a rational legal order and the institutionalization of rules should become the norm, from which corruption is viewed as a deviation. The modernization campaign initiated in Russia by Peter the Great in the first quarter of the 18th century is one example of such a transformation. By undermining and subsequently criminalizing the custom of paying tribute to officials, he transformed what was an acceptable practice into the illegal act of bribery. Similarly, the efforts of post-communist societies (especially those aspiring to the EU membership at the time) to synchronize their legislative and institutional frameworks with those of advanced market democracies during the 1990s resulted in the recognition of practices—regarded for decades as commonplace—as corrupt, and in the development of sophisticated instruments to eradicate them. However, despite legislative and judicial reforms in contemporary Russia, sophisticated political and legal institutions have not fully replaced patrimonial governance mechanisms, which often coexist with modern practices and manipulate them. A classic example here is an elaborate set of procedures for the organization of tenders for vendors and suppliers. Tenders are formally open and competitive and conducted according to strictly followed procedures yet also manipulated to the advantage of an informally related vendor or a trusted supplier. In societies where the use of personalized trust compensates for defects of impersonal systems of trust resulting from selectivity in the workings of formal institutions, it is somewhat misleading to apply the term "corruption" as it is understood in modern societies.

Thirdly, the majority of contemporary definitions of corruption presume that there is a clear distinction between public and private realms. Corruption is thus understood as "the abuse of public office for private gain."

However, in Russia this distinction is still vague. Key actors—government officials of different levels, business owners and executives, law enforcement officers, employees of private companies and government agencies—brought up with the communist concept of “public property” under which all land, capital and other significant assets belonged to everyone as a collective owner, often struggle to draw the line between the public and private domain. In the Soviet days such practices as “taking home” valuable resources from the office or using working time to solve personal problems were commonplace at all levels of society. In the post-Soviet period, weak property rights result from the nature of privatization: understanding that fortunes are made with support of the state and informal channels means their owners cannot be fully in possession of their property. As one business tycoon acknowledged in an interview to the FT, his assets will be given up should the state require it. However, the blurred boundary between the public and the private for the benefit of the latter runs much deeper into the national psyche. For example, between the 14th and 18th centuries the so-called “*sistema kormleniia*” (feeding system), under which the tsar gave his regional representatives the right to exploit their constituencies for private gain after the state tax has been collected, constituted an important element of the governance system. Therefore it is not surprising that “internal corruption,” that is the use of corporate resources or authority which comes with the job for personal gain, is so common in Russian business.

Shifting Perspectives on Business Corruption

Depending on one’s perspective, informal practices are either associated with trust-based relationships, mutual obligations and the power of informal norms (bottom up); or they are associated with the betrayal of trust by agents who bend or break the formal rules set out by the principal (top–down). In this context one should assume that grassroots forms of corruption are not only the outcome of the misuse of corporate office for private gain, but also an expression of entitlement associated with people’s expectations regarding social (in)justice and compensation for deprivation.

Informal practices can be a response to oppressive over-regulation and extortion and thus constitute a form of collective whistle-blowing, to be considered as an indicator of administrative corruption. In certain contexts, top–down anti-corruption campaigns should be treated with suspicion, while informal practices should be viewed as being justice-driven and as having an equalizing effect on the society. In other words, we should consider informal practices as indicators pointing to the

defects in formal procedures and as the key to understanding “local knowledge,” as well as to explore their relation to “corruption”, rather than simply identifying them with the latter.

By analyzing informal practices as set strategies used by firms in Russian regions we propose to complement existing approaches to business corruption with a study that does not rely on the universal definition of “corruption.” Rather than following the top–down logic of corruption indices or governance indicators, it calls for a bottom–up perspective and shifts the focus of analysis from legal or moral prescription to a relational understanding of specific practices as “strategies of coping” with the larger system. This has the advantage of capturing a range of practices that are often omitted or misinterpreted by the current conceptualization of corruption, especially the strategies based on the manipulative use of the law and extralegal practices that attempt to redress systemic injustice, thereby embodying resistance or mobilization. Such practices are regulated by values and incentives that may not be perceived as corrupt by their protagonists, although they nourish corruption indirectly.

Business Corruption: Research Findings

Although the theme of business corruption in Russia is being widely discussed both in Russia and abroad, there are few comprehensive studies of this phenomenon. This is understandable, considering its complexity and difficulties encountered in collecting data. To a great extent, Business Environment and Enterprise Performance Surveys (BEEPS 1999, 2002, 2005, 2009—see p. 8) have identified trends in the evolution of corrupt practices. For example, the level of direct extortion attempts by organized criminal groups in such countries as Russia, Ukraine, and Belarus has declined significantly since 2000. Government officials at all levels have increased their pressure for economic gains and many former mafia figureheads have entered political life. Another tendency is that lump sum corruption has given way to more sophisticated, legalized forms of income such as shares in business and other forms of long-term participation.

Although economic corruption in Russian regions is part of a much larger phenomenon, eradication of which would require systemic changes, business owners and managers cannot wait for these changes to take place. They have to deal with corruption on a daily basis and provide immediate protection for their enterprises and stakeholders. We argue that by applying a bottom–up approach and by examining specific informal practices as “strategies of coping” with the larger system these owners and managers can build awareness, which will

serve as a foundation for development and implementation of effective and efficient anti-corruption strategies at the company level. Slicing a snake rather than dealing with it as a whole is an imperative for successfully managing corruption anywhere, but especially in the Russian regions. Applying this paradigm we would like to outline a number of important trends taking place in Russian regions and to discuss their impact on the anti-corruption strategies at the firm level.

In our study we asked CEOs, directors and owners of 49 Russian and international companies to describe to what extent their businesses are faced with informal practices at the regional level. We described informal practices in a user-friendly way, with some colloquial phrasing. We introduced the questionnaire by stating that the listed practices are common and widespread. We have also conducted pilot interviews to make sure that our list of informal practices is comprehensive and covers regional specifics competently and fully.

We have kept the questionnaire simple and focused our questions on the frequency with which informal practices are used in regional branches of the firm: systemic use (systematically), occasional use (sometimes), not used (never). Questionnaires were completed anonymously, but the firm was characterized by its size, age, sector, type of company and number of regions it works in.

Informal practices data are grouped and “tagged” for convenience. For example, the practices that have been marked as never or rarely used are tagged as “dinosaur” practices. These include extorting favors from job candidates; leasing company facilities, offices, and equipment for personal income; and paying exorbitant board of directors’ fees to cronies. Extorting bribes by the regional officials appears also to be on the way out as well.

“Predator” practices are organized around informal cash flow extorted by the state inspection organs from businesses. Practices of paying representatives of regional inspection and enforcement bodies—fire inspection, tax, customs—whether voluntarily or as a result of extortion are most systematically used, as well as paying for tax inspections with pre-agreed results and for alleviation of other forms of state control and regulation. Executives also note that companies are engaged in supporting regional governments’ pet projects and programs—serving as so-called “relational capital” in the regions.

Although predator practices are quoted as commonly used, other practices associated with “black cash” paid outside business domains (prosecutors, courts, police) tend to decrease in use with the media being an exception. “Enveloped” salaries and bonuses paid to company’s employees in order to avoid social tax are also on the decline. Thus, “traditional” forms of corruption such

as cash bribes, extortion demands and appropriation of assets give way to more subtle practices such as financing “important” projects, selecting the “right” vendors and suppliers, and selling assets to the “right” companies and at the “right” prices.

Long-term informal relationships between government officials and business executives replace the transactional approach. As one of the business owners interviewed for this article explained: “I am making one of my guys the head of strategy in a state-owned company, which is a major buyer for my products—not as a head of purchasing. I am not interested in signing a contract or even a number of contracts. I am interested in shaping the development of this industry for the next 10–20 years.” The businessman is leveraging his political connections to get this job for his protégé. The informal practices become more and more sophisticated to reflect the increasing sophistication of the Russian economy and its legal and administrative structures.

“Rat” practices refer to the use of company resources for personal gain—one of the most acute problems in corporate corruption at a firm level. These include receiving kickbacks or other informal rewards (for example, expensive gifts) by regional managers from vendors, suppliers, buyers and using company funds by heads of regional subdivisions to buy expensive cars, telephones, to pay for travel. The boundaries between “public” and “private” are still blurred in the minds of many managers and employees of Russian companies, who often use corporate resources as an additional source of income. The breathtaking stories from the early years of capitalism’s development in Russia, in which future oligarchs allegedly captured assets worth dozens of billions of dollars thanks to their social ties and special relationships, are still popular and make many managers and employees feel relatively deprived and thus justified in stealing, taking kickbacks or selling company assets for personal gain. Internal corporate corruption has become a huge challenge over the last decade and remains so for Russian business leaders. In line with the trend of sophistication, business executives no longer make company employees build dachas or refurbish apartments, but invent complex multi-step schemes to appropriate valuable assets. Thus, a group of senior executives from a publicly traded company—for which the Russian state has a majority stake—managed to consolidate private control over more than 30 firms providing them with engineering services in the regions. They achieved this by forcing their shareholders to sell significant equity stakes to “designated” (by the executives) legal entities. In negotiating these deals, the managers explained that if the vendors agreed, they would retain their contracts and would eventually become minority shareholders of

a consolidated engineering group worth over a billion dollars; if they disagreed, they would lose all their current contracts with the company.

“Penguin” practices are associated with those based on life-long ties and informal connections that account for the blurred boundaries between public and private. It is common for an informal relationship to be confused with the use of that relationship in a formal context, for example the use of informal ties and networks to secure government orders, contracts and loans from state-owned banks. The reverse trend of using company employees for personal needs—assisting family members, building and repairing houses, arranging trips and leisure activities—also occurs. The conflict of interest of regional managers, practices of employing relatives, hiring affiliated vendors are often based on “penguin” affiliations.

The survey demonstrated that practices using “informal hooks” are still in circulation, especially those associated with the use of *kompromat* and security department materials to put pressure on business counterparts, and occasionally for the purposes of internal management.

Fighting Corruption

Our study shows that foreign and Russian business firms alike implement “formal” anti-corruption strategies, such as court cases, regular audits conducted by internal control departments and investigations by security departments, development of internal policies and procedures, and training for employees and business counterparts. However, in Russia, where the governance mode carries features of “patrimonial power” and where

decisions are made on the basis of people’s relationships and traditional forms of authority, the balance between formal and informal strategies should be adjusted. Fundamental changes require a redistribution of “functions” formerly performed by the informal practices in corrupt settings. The main reason why it is so difficult to get rid of informal practices is because they are also somewhat functional for the economy. They perform the functions of “shock-absorbers” for the system—always in flux and context-bound, they adjust and readjust past-oriented informal codes and integrate them with future-oriented formal rules. They are functional for solving problems posed by defects of the legal system, and they compensate for the imperfections of Russian corporate culture.

If Russia’s corporate corruption is to be tackled, a whole set of essential functions performed by informal practices need to be dealt with. In other words, the problem is not the existence of informal practice *per se*, but their indispensability for supporting business’ daily operations, stability of cadres and the status quo of the existing system. It is generally assumed that as soon as formal rules improve, these practices will be rendered ineffective or unnecessary and disappear. It might be so, but it takes too long. We believe that simultaneous efforts of refining formal procedures and influencing informal practices will make this process faster. In the short term, it is essential to consider anti-corruption improvement in a disaggregated way, starting with a bottom-up approach to anti-corruption strategies. Companies can play a proactive and positive role in the regions, thus contributing to the overall change of business environment.

About the Authors

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Additional Reading

- Alena Ledeneva (2009) “Corruption in Postcommunist Societies in Europe: A Re-examination,” *Perspectives on European Politics and Society*, Vol. 10, No. 1, April 2009, 69–86.
- Carl Fey and Stanislav Shekshnia, “The Key Commandments for Doing Business in Russia,” Stockholm School of Economics in Russia Working Paper #7 – 102, <http://www.sseru.org/materials/wp/wp07-102.pdf>
- A. Ledeneva, S. Shekshnia, “Doing Business in Russian Regions: Informal Practices and Anti-Corruption Strategies,” *Russie.Nei.Visions*, IFRI, No. 58, March 2011.