

Doing Business in Russian regions: Informal Practices and Anti-Corruption Strategies



Alena Ledeneva,
Stanislav Shekhnia

March 2011

Ifri is a research center and a forum for debate on major international political and economic issues. Headed by Thierry de Montbrial since its founding in 1979, Ifri is a non-governmental and a non-profit organization.

As an independent think tank, Ifri sets its own research agenda, publishing its findings regularly for a global audience.

With offices in Paris and Brussels, Ifri stands out as one of the rare French think tanks to have positioned itself at the very heart of European debate.

Using an interdisciplinary approach, Ifri brings together political and economic decision-makers, researchers and internationally renowned experts to animate its debates and research activities.

The opinions expressed in this article are the authors' alone and do not reflect the official views of their institutions.

Russia/NIS Center

© All rights reserved – Ifri – Paris, 2011

ISBN: 978-2-86592-834-7

IFRI
27 RUE DE LA PROCESSION
75740 PARIS CEDEX 15 – FRANCE
TEL. : 33 (0)1 40 61 60 00
FAX : 33 (0)1 40 61 60 60
E-MAIL : ifri@ifri.org

IFRI-Bruxelles
RUE MARIE-THERESE, 21
1000 BRUXELLES
TEL. : 32(2) 238 51 10
FAX : 32 (2) 238 51 15
E-MAIL : info.eurifri@ifri.org

WEBSITE : www.ifri.org

Russie.Nei.Visions

Russie.Nei.Visions is an online collection dedicated to Russia and the other new independent states (Belarus, Ukraine, Moldova, Armenia, Georgia, Azerbaijan, Kazakhstan, Uzbekistan, Turkmenistan, Tajikistan and Kyrgyzstan). Written by leading experts, these policy-oriented papers deal with strategic, political and economic issues.

This collection upholds Ifri's standards of quality (editing and anonymous peer-review).

If you wish to be notified of upcoming publications (or receive additional information), please e-mail: info.russie.nei@ifri.org

Previous editions

- I. Dezhina, “[Developing Research in Russian Universities](#),” *Russie.Nei.Visions*, No. 57, December 2010;
- O. Bagno, Z. Magen, “[The Influence of Russian Political Parties in Israeli Foreign Policy](#),” *Russie.Nei.Visions*, No. 56, December 2010;
- A. Kreutz, “[Syria: Russia’s Best Asset in the Middle East](#),” *Russie.Nei.Visions*, No. 55, November 2010.

The archive of *Russie.Nei.Visions* papers can be found by clicking on the following link:

<http://www.pearltrees.com/ifri.russie.nei/651883/>

Authors

Professor Alena V. Ledeneva is Professor of Politics and Society at the School of Slavonic and East European Studies, University College London, UK. She studied Economics at the Novosibirsk State University (1986) and Social and Political Theory at the University of Cambridge (Newnham College, M.Phil. 1992; Ph.D. 1996). She is author of a number of books: *How Russia Really Works* (Cornell University Press, 2006); *Unwritten Rules* (Centre for European Reform, 2001); *Russia's Economy of Favours* (Cambridge University Press, 1998) and many articles, as well as co-editor of *Bribery and Blat in Russia* (Macmillan, 2000) and *Economic Crime in Russia* (Kluwer Law International, 2000). Her expertise is on Russian cases in London courts; corruption; informal economy; economic crime; informal practices in corporate governance; role of networks and patron-client relationships in Russia and other postcommunist societies.

Dr Stanislav Shekhnia is an Affiliate Professor of Entrepreneurship at INSEAD and a Program Director at the INSEAD Global Leadership Center in Fontainebleau. His research concentrates on leadership, leadership development and effective governance within emerging markets and organizations. S. Shekhnia is a senior partner at Ward Howell Zest Leadership Talent Equity, which has offices in Moscow, Paris, St. Petersburg, Kyiv, Almaty. Dr Shekhnia is the author, co-author or editor of seven books, including *Coaching: How to Manage Free People* (Moskva, Alpina 2010), *The New Russian Business Leaders* (Edward Elgar 2004 with M. Kets de Vries, K. Korotov, E. Florent-Treacy), *Corporate Governance in Russia* (Edward Elgar, 2004, with S. Puffer and D. McCarthy). His articles appeared in many journals (*The Academy of Management Executive*, *The European Management Journal*, *Harvard Business Review Russia* etc.).

Contents

SUMMARY	4
INTRODUCTION	5
DISAGGREGATING CORRUPTION	7
Shifting perspectives on business corruption	9
Business and Corruption in Russia, Existing Studies and Lessons to be Learned.....	10
INFORMAL PRACTICES IN RUSSIAN REGIONS: RESEARCH FINDINGS	13
ANTI-CORRUPTION STRATEGIES IN RUSSIAN REGIONS.....	19
CONCLUSION: DEVELOPING EFFECTIVE ANTI-CORRUPTION STRATEGIES	23

Summary

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

Introduction

Russia finds itself at the bottom of the twenty two assessed countries—one place below China—in the latest 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, where in 2010 Russia is placed 154 out of 178 countries with an absolute score 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. As John Browne, ex-CEO of BP 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.”¹

When executive seminars participants share their free associations on hearing the phrase “business in Russia,” “corruption” consistently tops the list. Senior managers from different countries have a strong perception that business in Russia is being done in a particular environment, where “corrupt” practices are widespread and even considered “normal.” Press publications and anecdotes that get passed from one businessman to another with a wry smile portray companies operating in Russian regions—especially foreign ones—as the principal victims of a rampant corruption, which is impossible to fight and should be accepted as a way of life. Some sources estimate “the corruption component” to represent 20-30% of the total cost of doing business in Russia.²

We believe that the picture is more complex. Businesses have no choice but to get involved with regional governments and

A summary of this study was published in *Russian Analytical Digest*, No. 92, 22 February 2011, <www.res.ethz.ch/analysis/rad/details.cfm?lng=en&id=127028>.

¹ J. Browne, *Beyond Business: An Inspirational Memoir from a Visionary Leader*, London, Weidenfeld and Nicolson, 2010.

² *Biznes i Korruptsiia: Problemy i Protivodeistviia* [Business and Corruption: Problems and Counteractions], Moskva, Indem, 2006.

legislators, regulatory and controlling bodies, police and courts. They finance pet projects for regional officials, share sensitive information with law enforcement bodies and negotiate administrative positions for their representatives. By engaging in such practices, these businesses become important “makers” of corrupt customs. Large and small companies suffer significant financial losses not only and—in many cases—not so much from corrupt officials, but also from their own managers and employees, who engage in a range of informal practices from taking vendors’ kickbacks to appropriating company assets for personal use. At the same time many businesses fight both external and internal corruption effectively by applying a wide range of strategies at a firm level and using informal networks to reinforce application of existing laws. We argue that in order to gain insights into this complex picture and to develop effective anti-corruption strategies, it is essential to inquire whether the globally recognized definition of corruption applies in Russian regional contexts and to “disaggregate” the term.³

³ A pre-paradigm formula $C=M+D-A$ (corruption equals monopoly plus discretion minus accountability) suggested by Robert Klitgaard in his book *Controlling Corruption*, University of Berkeley CA, University Press, 1988.

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.⁴ Since then, significant advances in corruption studies and anti-corruption policies have been made all over the world.⁵ 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.⁶ In order to deal with such diverse practices in an effective way, we disaggregate “corruption” into clusters of informal practices, widespread yet specific for businesses in Russian regions.

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 a transformation, the concept of corruption is modern, and 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. Between the 14th and 18th centuries the so-called “*systema kormleniia*” (feeding system), under which the Tsar gave his regional representatives a right to exploit their constituencies for private gain after the state tax has been collected, constituted an

⁴ A. Ledeneva, “Corruption in Postcommunist Societies in Europe: A Re-examination,” *Perspectives on European Politics and Society*, Vol. 10, No. 1, April 2009, p. 69–86.

⁵ D. Kaufmann, “Corruption: The Facts,” *Foreign Policy*, No. 107, Summer 1997, p. 114–131; V. Tanzi, “Corruption Around the World,” *IMF Staff papers*, Vol. 45 No. 4, December 1998; S. Rose-Ackerman, *Corruption and Government: Causes, Consequences, and Reform*, Cambridge, Cambridge University Press, 1999.

⁶ S.H. Alatas, *Corruption: Its Nature, Causes and Functions*, Aldershot, Avebury, 1990.

important element of the governance system.⁷ By undermining and subsequently criminalizing the custom of paying tribute to officials, Peter the Great transformed what was an acceptable practice into the illegal act of bribery.⁸ Despite legislative and judicial reforms in contemporary Russia, sophisticated political and legal institutions have not fully replaced patrimonial governance mechanisms, which often co-exist with modern practices and manipulate them. A classic example here is an elaborate set of procedures for 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 defective impersonal systems of trust (resulting themselves from the selective workings of formal institutions), it is somewhat misleading to apply the term “corruption” as it is understood in modern societies.

Thirdly, 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 good, 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.⁹ 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. 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.

⁷ V. Klyuchevskii, *Kurs russkoi istorii. Sochinenia v 9 tomakh* [A Course in Russian History in Nine Volumes], Vol. 2, Moscow, Mysl, 1987.

⁸ S. Lovell, A. Ledeneva, and A. Rogachevskii (eds.), *Bribery and Blat in Russia*, London, Macmillan, 2000.

⁹ A. Ledeneva, *Russia’s Economy of Favours*, Cambridge, Cambridge University Press, 1998.

Shifting perspectives on business corruption

Depending on 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 thus a form of collective whistle-blowing. In this respect, they should be considered an indicator of administrative corruption rather than one of its elements. 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. As Steven Lovell put it:

"Informal practices—whether or not one chooses to condemn them as corrupt—exist not because people are trying to con one another but because they allow people to get things done in environments where formal rules and structures work imperfectly (if at all)." ¹⁰

In Russia "informal practices" are not only forms of compliance and complicity with the corrupt system—the so-called "the system made me do it" phenomenon.¹¹ They are also forms of everyday resistance to ineffective governance of state institutions and reactions to large-scale political corruption. Understanding informal practices as responses to the "injustice" and "unfairness" of the system helps us to reassess—from a bottom-up perspective—the existing gap between formal rules and the ways things are done in practice. In Russia, it is still essential to distinguish between legality, as the formal system of justice, and justice as a motive and frame of individual mobilization—the gap that is often defined in terms of dichotomies universalist vs. particularistic, a-contextual vs. contextual, rules vs. relationships.¹² Different countries and regions have different formal "capacities for justice." Defects in formal capacities create contexts in which

¹⁰ S. Lovell, "Power, Personalism, and Provisioning in Russian History," *Kritika: Explorations in Russian and Eurasian History*, Vol. 9, No. 2, Spring 2008, p. 373-388.

¹¹ R. Karklins, *The System Made Me Do It: Corruption in Post-Communist Societies*, London, M.E. Sharpe, 2005.

¹² F. Trompenaars and C. Hampden-Turner, *Riding the Waves of Culture: Understanding Diversity in Global Business*, London, McGraw-Hill, 1998, p. 29-50.

alternative or “practical” understandings of justice operate. Rather than lapsing into these dichotomies we explore the ways of combining the formal and the informal by players in their daily operations.

Business and Corruption in Russia, Existing Studies and Lessons to be Learned

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, yet they nourish corruption indirectly.¹³

Although the theme of business corruption in Russia is being widely discussed both in Russia and abroad, there are few detailed studies of this phenomenon. This is understandable, considering its complexity and the difficulties encountered in collecting data. In a study of Swedish companies in Russia, analysts identify three modes of market entry for foreign companies: export, joint venture, and direct investment; as well as three stages at which anti-corruption strategies are formed: planning, implementation and operations.¹⁴ They found that Swedish companies operating in Russia attributed little importance to the issue of corruption during the planning stage. However, many of these firms did encounter corruption at later stages of market penetration, and were forced to rethink their strategies accordingly. According to the survey presented in the paper, 25% of respondents said that they had encountered corruption during implementation, and 42% said that they had encountered it during operation. The authors concluded that corruption is regarded as an important obstacle for conducting business by Swedish companies operating in Russia, and affects these companies’ strategies to a great extent.

¹³ For the range of practices see A. Ledeneva, *How Russia Really Works*, Ithaca and London, Cornell University Press, 2006.

¹⁴ *The Impact of Corruption on Entry Strategy: A Study of Swedish Companies in Russia* by F. Gyllenstedt, S. Kuprienko, F. Sjölander at the Jönköping International business school, January 2008.

Dr Elena Denisova-Schmidt argues that the preferred and most corruption-free method for Swiss firms to enter Russian markets is through fully-owned subsidiaries, since this gives them the greatest degree of control over operations.¹⁵ However, in practice it requires the assistance of local consulting agencies, which provide help in the areas where corruption is most likely to exist. Under the JV model a Russian partner typically takes care of these aspects—usually in a non-transparent manner—which creates certain vulnerability for the business. In his study of a wider range of foreign companies working in Russia, James Henderson relies on his survey data to argue that the mastery of “local knowledge” constitutes the know-how of local partners in this JV model, while foreign partners tend to provide technological know-how.¹⁶ Oksana Green in her study of business corruption emphasizes the role of local networks and their necessity for operating in Russia.¹⁷ All these researchers suggest that foreign companies make the development of anti-corruption strategies a mandatory element of their pre-entry planning process.

Having conducted a study of 36 foreign companies operating in Russia, Carl Fey and Stanislav Shekhnia argue that “business practices that appear corrupt by Western standards are still omnipresent in Russia” and that to be competitive, foreign companies must be proactive in dealing with these business practices.¹⁸ They distinguish four strategies for managing corruption in Russia: 1) outsourcing activities to other firms which are likely to engage in corruption, 2) pre-empting corruption by suggesting ways in which to cooperate on their own terms, 3) suspending entry at the point of a corrupt encounter, and 4) abstaining from business deals where corruption is unavoidable.

An immediate concern is whether the strategies such as pre-empting or outsourcing constitute a form of corruption in their own right, and whether companies inevitably compromise their ethical standards when working in Russia. The authors argue that if the foreign company is transparent about its ethical norms and standards, sensitive issues are not hidden but are explained to stakeholders and dealt with in an accountable way. Foreign companies can engage

¹⁵ E. Denisova-Schmidt, "Korruption und informelle Praktiken im Geschäftsleben in Russland. Fallbeispiele aus der Sicht ausländischer Unternehmer" [Corruption and Informal Practices in Russia. Case Studies as Seen by Foreign Entrepreneurs] in *Russland-Analysen*, No. 210, 2010, p. 8-10; E. Denisova-Schmidt, "Human Resource Management in Russia: Some Unwritten Rules," *WU Online Papers in International Business Communication*, Series One: Intercultural Communication and Language Learning, No. 7, 2011, (forthcoming).

¹⁶ J. Henderson, Joint Venture Firms and Local Knowledge in Russia, London, UCL PhD thesis, 2010.

¹⁷ O. Shmulyar-Green, *Entrepreneurship in Russia: Western Ideas in Russian Translation*, Gothenburg Studies in Sociology, No. 40, University of Gothenburg, 2009.

¹⁸ C.F. Fey and S. Shekhnia, The Key Commandments for Doing Business in Russia, 2011 (forthcoming).

Russian counterparts by building up relational capital within their own ethical guidelines and help educate the former about the latter. Developing legitimate corridors of interaction with local actors in corrupt contexts should inform anti-corruption thinking.

The head of the INDEM Foundation and specialist on Russia's political corruption, Georgy Satarov identifies three groups of strategies businesses in the Russian regions use to deal with corruption.¹⁹ The first group includes self-inflicted constraints on business conduct such as knowing, monitoring and following formal rules, and sharing information and experience. The second group of strategies includes collective business activities: clubs, associations, "legal ambulance" and court expertise, educational programs and exchanges of strategies between firms. The third group includes so-called political and management strategies aimed at transformation of state institutions, such as lobbying. The INDEM study provides numerous examples where both large and small Russian businesses have managed corruption effectively.

¹⁹ G. Satarov, S. Parkhomenko, D. Krylova, and Yu. Rostovikova, *Business vne korruptsii: rukovodstvo k deistviyu* [Business Beyond Corruption: Guidelines for Action], Moscow, Indem, 2007. For more information see <www.indem.ru>.

Informal Practices in Russian Regions: Research Findings

Economic corruption in Russian regions is part of a much larger phenomenon, eradication of which would require some fundamental systemic changes to take place; business owners and managers cannot wait for this to happen, since 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 the development and implementation of effective and efficient anti-corruption strategies at company level. Slicing a snake rather than dealing with it 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.

To a great extent, Business Environment and Enterprise Performance Surveys, conducted by the World Bank and the EBRD (BEEPS 1999, 2002, 2005, 2009) have identified trends in the evolution of corrupt practices.²⁰ 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. Yet, government officials at all levels have increased 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.

To complement BEEPS surveys we asked CEOs, directors and owners of 33 Russian and international companies in 2010 to describe to what extent their businesses are faced with informal practices at the regional level. We called the first group “dinosaur”

²⁰ For an overview of other measurements of corruption, see S. Knack, “Measuring Corruption in Eastern Europe and Central Asia: A Critique of Cross-Country Indicators,” *World Bank Policy Research Working Paper*, No. 3968, July 2006, <www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2006/07/13/000016406_20060713140304/Rendered/PDF/wps3968.pdf>.

practices, since the survey participants marked them as never or rarely used while they used to be widespread during the early stage of market economy development in Russia.²¹

**Table 1.1 Number of Companies Facing “Dinosaur” Practices
(presented in the order of frequency of use)**

Practice	Systematically	Sometimes	Never
Extorting favors from job candidates	0	0	33
Leasing company facilities, offices, and equipment for personal income	0	3	30
Paying exorbitant board of directors' fees to cronies	0	4	29
Extortion of bribes by regional officials	2	4	27

“Predator” practices are set around informal cash flow extorted from businesses by the state controlling organs. Practices of paying representatives of regional control 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, such as sport, health and educational projects—serving as so-called “relational capital” in the regions.

**Table 1.2 Number of Companies Facing “Predator” Practices
(presented in the order of frequency of use)**

Practice	Systematically	Sometimes	Never
Bribing representatives of regional control and enforcement bodies – fire inspection, police, customs, etc.	7	13	11 ²²
Extortion by the regional control and enforcement bodies – fire inspection, police, customs, etc.	5	24	4
Use of “telephone law” – informal pressure from federal and regional officials	3	16	17
Pressure from regional governments to finance their pet projects and programs	2	16	15
Paying for tax and other inspections with pre-agreed results	0	7	26

Although predator practices are commonly used, practices associated with “black cash” paid outside the business domain tend

²¹ A. Ledeneva, *op. cit.* [13].

²² Where the number of answers does not amount to 33, questionnaires were not answered fully.

to decline in use, with the exception of the media. 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.

**Table 1.3 Number of Companies Facing “Black Cash” Practices
(presented in the order of frequency of use)**

Practice	Systematically	Sometimes	Never
Paying for mass media coverage	7	21	5
“Buying” court decisions	5	7	21
Payment of cash salaries and bonuses to avoid social charges	4	8	21
Paying or providing services (trips abroad, medical etc) to the members of a regional executive body	3	13	17
Paying prosecutors or police to open or close criminal investigations	2	8	23
Subsidies and tax allowances from regional authorities	2	9	22
Paying or providing services (trips abroad, medical etc) to the members of a regional legislative body	0	9	24

The survey and the interviews demonstrate that 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 a head of strategy in a state-owned company, which is a major buyer for my products—not a head of purchasing. I am not interesting 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, its legal and its administrative routines. As an illustration of that trend, while working on this paper one of the authors received an invitation from a Russian financial-industrial group to write a case study about the abuse of shareholders’ rights at a large metals company, where the group is fighting for control of the board of directors and the CEO job.

“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 in Russian regions. In our survey more than half of respondents reported that each of such practices is present in their companies.

**Table 1.4 Number of Companies Facing “Rat” Practices
(presented in the order of frequency of use)**

Practice	Systematically	Sometimes	Never
Regional managers receiving kickbacks or other informal rewards (for example, expensive gifts) from vendors, suppliers, buyers	1	19	13
Selecting winners of open tenders on the basis of informal relationships and agreements	1	16	16
Heads of regional subdivisions using company funds to buy expensive cars, telephones, to pay for travel, etc.	0	18	15

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 special relationships, remain popular and make many managers and employees feel relatively deprived and thus justified in stealing, taking kick-backs 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. It has also become more sophisticated. Business executives are now less likely to use company employees to build their dachas or refurbish their apartments and are more likely to invent complex multi-step schemes to appropriate valuable assets. As we learned both from our interviews and from the press, a group of senior executives from one publicly traded company—of which the Russian State is a majority shareholder—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 1 billion US dollars; if they disagreed, they would lose all their current contracts with the company.

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

**Table 1.5 Number of Companies Facing “Penguin” Practices
(presented in the order of frequency of use)**

Practice	Systematically	Sometimes	Never
Using company employees for personal needs (assisting family members, building and repairing houses, arranging trips and leisure activities)	1	26	6
Conflict of interest of regional managers, employing relatives, hiring affiliated vendors	1	25	7
Use of informal ties and networks to secure government orders, contracts and loans from state-owned banks	4	16	13

The majority of businesses operating in Russian regions are both “victims and villains” of corruption. Whereas executives can easily recognize corrupt practices when exercised by competitors and government officials, they are often in denial of their own involvement in similar activities. They sustain their self-image by focusing on the goals achieved by the involvement in informal practices and by downplaying the means with which these goals achieved. When executives recognize informal practices, they justify them by the necessity for business, by competition or by corrupt environment. Yet in daily operations many informal practices are misrecognized and divorced from “corruption.” The misrecognized character of informal practices accounts for their pervasiveness, on the one hand, and the lack of attention to them on the other. For example, to promote competitiveness of their companies managers engage in so-called hook practices such as creating and applying informal leverage—using sensitive information, compromising documents or other forms of informal influence—against their competitors, employees, and regional decision-makers, that can be considered corrupt by modern standards.

**Table 1.6 “Hook” Practices
(presented in the order of frequency of use)**

Hook practices	Systematically	Sometimes	Never
Using such informal tools as <i>kompromat</i> and security department's materials against competitors	3	11	19
Using such informal tools as <i>kompromat</i> and security department's materials to put pressure on regional officials	3	4	26
Using such informal tools as <i>kompromat</i> , <i>krugovaya poruka</i> and security department's materials for managing employees	0	7	26

Fundamental change requires a redistribution of the “functions” 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” within the system—always in flux and context-bound, they adjust and readjust the past-oriented informal codes and integrate the future-oriented formal rules. They are functional for solving problems posed by the legal system, and they compensate for the deficiencies of Russian corporate culture.

If Russia’s corporate corruption is to be changed, a whole set of functions performed by informal practices need to be dealt with otherwise. In other words, the problem is not the existence of informal practices but their indispensability for supporting daily business operations, stability of cadres and the status quo of the existing system. It is generally assumed that, as soon as formal rules improve, these informal practices will be rendered unnecessary and disappear. It might be so, but it takes too long. We believe that simultaneous effort to reform formal procedures and to influence informal practices will make this process much faster. In the short term, it is essential to consider the issue of anti-corruption improvement in a disaggregated way, starting with a bottom-up approach to anti-corruption strategies.

Anti-Corruption Strategies in Russian Regions

In a second part of our CEO survey we asked our respondents about their strategies for combating corruption. Our first important finding is that the absolute majority of them consider corruption (both external and internal) to be a serious threat to business, and take specific, systematic action to deal with it. As we demonstrated earlier, those actions can often manifest themselves in frequently used informal practices. For example, many CEOs reported having used their informal networks and “telephone law” to put pressure on regional officials to force them to comply with the existing law and to enforce it in specific cases. In many companies, security departments collect sensitive information about employees and major counterparts—so-called *kompromat*—which is used to deter these parties from employing corrupt practices against the company’s interests. Another systematically used anti-corruption strategy is the internal audit (Table 2.1). At the same time we see a strong trend of increasing application of “modern” anti-corruption strategies, such as open transparent tenders, comprehensive procurement manuals and policies and procedures (P&Ps).

**Table 2.1 Strategies Used most Systematically
(organized in the order of frequency of use, numbers of companies)**

Strategies	Systematically	Sometimes	Never
Use of internal audit service to identify internal abuses and violations	24	5	4
Creation and dissemination of internal policies and procedures setting out detailed rules for working with contractors, such as holding tenders among suppliers and contractors	22	7	4
Use of the security department to detect and stop internal abuses and theft	21	4	8
Use of high-profile campaigns, events and sponsorship to promote the company’s interests and image	19	11	3
Active briefing of partners on company rules and standards on working with contractors, government and regulatory agencies and the mass media	14	14	5

Widespread strategies—those used either systematically or occasionally by the majority of companies—include staff training and various forms of appeal to higher authorities, courts or the media.

**Table 2.2 Widespread Strategies
(organized in the order of frequency of use, numbers of companies)**

Strategies	Systematically	Sometimes	Never
Training of managers and regional staff in the internal rules of interaction with their counterparts	16	13	4
Engagement of top management of partner companies in countering unscrupulous actions by their regional representatives	9	21	3
Use of courts to counter unscrupulous actions by regional authorities or regulatory agencies	10	15	8
Use of the media to counter unscrupulous actions by regional authorities or regulatory agencies	8	12	13
Formal approaches to federal officials to counter unscrupulous actions by regional authorities and regulatory agencies	7	12	14

At the same time the survey demonstrated that contextual factors such as industry, region, company's shareholding structure, its size and stage of development have an impact on the anti-corruption strategies. For example, some companies—mostly public companies with some foreign ownership—create corporate codes of conduct (CCCs), although their use and effectiveness are somewhat limited, but about as many companies—mostly Russian and of smaller size—report that they never use them (Table 2.2). We called this group—polar strategies—the ones systematically used only by some companies.

Table 2.3 Polar Strategies that Used Systematically by Some Companies but Never used by Others (numbers of companies)

Strategies	Systematically	Sometimes	Never
Creation and dissemination of Codes of Corporate Behavior	17	1	15
Allocation of annual budget for developing informal relationships with representatives of regional authorities and regulatory agencies	13	6	14
Allocation of an annual budget for developing informal relations with representatives of the regional media and regulatory agencies	12	3	18
Proactive proposals to regional authorities and regulatory agencies on cooperation programs and methods	11	9	13

Infrequently used strategies include those emerging in issue-specific contexts, such as a “buffer strategy” for purchasing a license, entering a new region, acquiring a significant asset (land or factory)

and/or those representing unusual patterns of behavior, such as exchange of information with other companies (Table 2.4). Their infrequent use does not diminish the overall impact of some of these strategies—buffer strategy or use of informal power channels—since companies may use them only for important occasions when the stakes are high.

Table 2.4 Infrequently Used Strategies

Strategies	Systematically	Sometimes	Never
"Buffer" strategy – the use of subcontractors, agents and third parties to work with regional authorities and regulatory agencies	3	23	7
Exchange of information with other companies about unscrupulous businesses, regional authorities and regulatory agencies	2	20	11
Use of informal channels ("telephone rule" and verbal instructions) in order to pressurize regional authorities into countering unscrupulous actions and enforcing the law	7	11	15

Interestingly, horizontal cooperation does not play an important role in the anti-corruption strategies of the companies we surveyed. They do not systematically exchange information and they are even more reluctant to build alliances with others (see also Table 2.5). We believe that this reflects the lack of tradition of collective action in Russia as well as predominantly vertical mental models of power among Russian executives. Finally, only three companies mentioned the use of religious institutions in promoting company interests in the regions, which probably represents the actual role of the church in the contemporary Russian business.

Table 2.5 Rarely Used Strategies

Strategies	Systematically	Sometimes	Never
Creation of alliances with other companies in the region to counter unscrupulous actions by representatives of the authorities or the regulatory agencies	2	6	25
Engagement of representatives of religious institutions in promoting the company's interests in the regions	0	3	28

In spite of the fact that many companies operating in the regions actively take specific actions to prevent corrupt acts, only a handful of them have a comprehensive anti-corruption strategy, which includes a clear definition of what is and what is not considered corruption, states explicit goals in this area, defines the rules and assigns responsibility and accountability. One such exception is a large oil and gas company operating in more than ten Russian

regions. They have identified a limited number of priorities (preventing kickbacks to company employees from vendors and conflict of interest of its employees), set clear rules and expectations and communicated them both to employees and vendors, included respective key performance indicators (KPIs) into the annual performance contracts of concerned managers, and made specific instruments such as anti-corruption hotlines, video-taping of contract negotiations, and on-request anti-corruption audits available to external and internal actors. The senior leadership proclaimed anti-corruption strategy their top priority and engaged on a regular basis in educating employees and suppliers how to recognize corruption, to prevent it and to fight it. The company made “integrity” (*dobrosovestnost*) one of its four core values and assesses its executives’ behavior against it on an annual basis.

As often happens in Russia, such top-down campaigns produce some excesses at the level of rank-and-file executors. For example, the security department conducted an anti-corruption audit at one of the Siberian subsidiaries and charged local managers with corruption on the basis that some of their relatives worked for the subsidiary. In doing so, Moscow-based auditors overlooked the fact that the company was the only employer in the area. Most of anti-corruption hotline calls turn out to be unrelated to corruption. However, the strategy bears tangible fruit. As one executive notes: “When I warned a vendor, who came to persuade me to give him a contract with inflated prices citing connections to our shareholders. I told him that we are being filmed. He laughed and pressed on with the blackmail. When I played back the video to him, his face changed and he began to beg me to destroy it.” On the large scale the company has the lowest cost of capital investment per ton of oil in the Russian market, which according to its executives reflects much lower level of vendors’ kickbacks.

Conclusion: Developing Effective Anti-Corruption Strategies

It is fair to suggest that responsibility for changing Russia's corrupt business environment should not be loaded onto each individual company. Yet it is possible to create a corporate climate within a firm, which is conducive to such a change, if leadership and resources are put behind it. We suggest that practical steps are taken in the following directions.

First, the formal constraints notoriously associated with informal practices have to be identified and lobbied. Predatory practices point clearly to the sources of corruption at the regional level. Establishing channels for bottom-up feedback relating to these organs could potentially minimize the intrusive behavior of the state officials. Possible channels include: use of social media to reveal corrupt practices (i.e. Alexey Navalny with Transneft),²³ corruption hotlines, reporting corruption to the federal level and building coalitions with other business.

Second, the informal constraints tied up with traditional patterns such as patronage, dependence on informal relationships to gain access to resources and services—penguin practices—should be targeted. This can be done by introducing an internal company debate on the role of informal constraints, by demonstrating a clear divide between the public and the private. Conducting opinion polls can serve educational purposes as well as using press and social media informational channels in order to raise awareness of the informal practices and campaign against them. However, the most effective tool is the personal example set by company bosses.

Third, a framework set out to motivate social actors, professionalism and productive values at every level will facilitate a major change. People have an enormous potential for ingenuity, which is often “wasted” on outwitting the system. It can become a

²³ Alexey Navalny, a lawyer and blogger who in November 2010 accused former executives at Russia's state-owned pipeline company, Transneft of embezzling around \$4 billion of public funds during the construction of the East Siberian Pacific Ocean pipeline. See, for example, A. Kaledina, “Kak v Transnefti 120 milliardov rubley ukrali” [Transneft: How 120 billion rubles were stolen], *Komsomolskaya Pravda*, 16 November 2010, <<http://kp.ru/daily/24591/760437/>> or <<http://navalny.livejournal.com/526563.html>>.

source of positive change if aligned with the interests of the company. The growing demand for the rule of law among entrepreneurs suggests that in certain sectors, at least, there is a desire for behavior and standards that diverge from previous norms. Long-term efforts are required to introduce standards of professionalism and management that can supplant the informal order. Training programs for managers of different levels are essential to maintain such efforts.

Fourth, “modernizing” social networks can reverse their negative impact on the company’s operations. Instead of diverting the company’s dominant functions and processes, social networks can help organize and facilitate them, once their subversive role is restricted. These “modernizing” measures should be aimed not only at creating and developing new networks, but also at transforming existing networks into healthier, more open and inclusive ones. Times and spaces, conducive to the reproduction of informal practices—office spaces, cigarette breaks, tea breaks, informal drinks, birthday celebrations—can be reorganized.

Finally, external influences and organizations can play a substantial role in transforming the setting for unwritten rules. On a company level, investors, lawyers and consultants can act as “role models” by introducing new practices and norms into the Russian economy. Monitoring, articulating and publicizing the “role model” behavior are the essential drivers of change.