Andrei Yakovlev
Institute for Industrial and Market Studies
at State University – Higher School of Economics
ayakovlev@hse.ru

# State-business relations and improvement of corporate governance in Russia*

Abstract: In this paper we analyze the influence of the state on changes in the quality of corporate governance in Russia of the early 2000s, using a database on 822 joint-stock companies. We found that quality of corporate governance is higher at the companies closely connected to the government. These finding are in strong contradiction to the recent economic literature but they are robust in different specifications of our basic model. We provide explanation of this phenomenon for specific conditions of Russian economy in 2001-2004.

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## 1. Introduction

Government intervention in the economy by way of establishment of state-owned enterprises (SOE) has been generally met with criticism in the economic literature. Many empirical studies prove that the SOE, as a rule, are inferior to private firms in terms of efficiency (see a review of these studies in Megginson & Netter (2001), section 3). As noted by Perotti (2004), this is related to lack of sufficient accountability of the SOE, or to "soft budget constraints" as termed by Y. Kornai. In effect, the SOE managers and employees lose incentives to upgrade their efficiency, the SOE are used in political objectives, and the responsible government agencies get more and more corrupt. Besides even disregarding the corruption, the inefficiency of SOE can arise from a conflict between public interests and the interests of state officials who, following the standard bureaucratic logic, try to maximize the budgets under their control rather than to improve efficiency. The SOE may also restrict the activities of private firms and therefore, undermine competitive environment (Vining & Boardman, 1992).

Logically responding to of such skeptical view of the SOE by economists, governments focused on improvement of enterprise efficiency and economic performance in general by means of privatization policy. According to the estimates cited by Megginson & Netter (2001), the SOE share of "global GDP" has declined from more than ten percent in 1979 to six percent by 1996.

However, the experience of economies in transition in this context is far from unambiguous (Nellis, 1999). In Central and Eastern Europe, privatization usually has actually improved the performance of firms (Pohl et al, 1997). However, Poland in the early 1990s and especially China in the 1980s – early 1990s gave empirical evidence that SOE can show much better performance without any privatization. Pinto et al (1993) and Li (1997) explained this effect by the results of such measures as toughening of budget constraints and bank lending policy, stronger competition of imports, introduction of a system of incentives for SOE managers.

Russia is a special case in this context. On the one hand, a detailed study by Brown, Earle and Telegdy (2006) based ob the data from 24,000 enterprises over the period of 1985-2002 established that while the Ukraine, Romania and Hungary enjoyed productivity rise, on the average, as soon as in a year after privatization, in Russia the effect of privatization was indeterminate even five years after. At the same time, Russia was noted by extremely weak corporate governance throughout the 1990s, when Russian companies treated foreign investors with hostility and grossly violated shareholders' rights (Kraakman et al, 2000). In comparison with the countries of Central and Eastern Europe, Russian population expresses more criticisms against the outcome of privatization and is widely supportive of revision of its results (Denisova et al, 2007). The negative experience in Russia gave many reasons for new conclusions about the importance of institutional environment and about possibility of inefficient privatization under a weak government exposed to group interests (Stiglitz, 1999; Perotti, 2004).

Russia was mentioned also as a country with high share of 'politically connected firms' – where top officials or politicians act as shareholders or members of board or good friends of main owners (Faccio, 2006). Analyzing huge sample of 16,000 public companies in 47 countries for 1997 Mara Faccio concludes that even though political connections provide significant benefits connected firms under–perform their peers on an ex–ante basis. Last relevant studies for France (Bertrand et al, 2006) and China (Choi, Thum, 2007) support these findings.

On the other hand, two parallel trends became apparent in Russia during the 2000s: corporate governance got obviously better, and the government increased its presence in the economy. The first trend was expressed in terms of introduction of international standards of financial statements, in the IPO of Russian companies on international stock exchanges, in the more widespread practice of invitation of independent directors (Puffer and McCarthy, 2003; Yakovlev, 2004). This was followed by substantial growth in capitalization of the Russian stock market and since 2006, by a strong inflow of foreign investment.

The second trend was expressed in virtual nationalization of a number of large companies either with filing tax claims against them or with acquiring controlling stakes in private companies by the government or by the SOE (see OECD, 2006, section 1 for the economy in whole; Vernikov, 2007 for the banking sector). At the same time, the government was keen to exert informal pressure on business enterprises (Yakovlev, 2006). The years 2006-2007 were marked by establishment of state corporations, which were endowed with several billion dollars from the federal budget.

Since the beginning of the 2000s, the government took measures to streamline the activities of the SOE along with general improvement in the institutions of corporate governance (the Joint-stock company law was passed in a new version; the Bankruptcy law was revised; the Code of corporate behavior was designed; dissemination of best practice of corporate governance was promoted; a reform of the judicial system was launches and the system of law enforcement was upgraded). In particular, monitoring of SOE performance was introduced, corporatization of Federal state enterprises (FGUP) accelerated, standard instructions for state representatives in SOE boards with government stakes were developed, competitive procedures for appointment of SOE managers were introduced and contacts with them were formalized (HSE, (2003)). In the course of upgrading corporate governance in the public sector, the government launched initial public offerings of large state-owned companies in order to increase their capitalization and to get market appraisals of their performance. As a result, Rosneft, Sberbank and VTB-Bank had their "people's" IPO and managed to raise more than $27 billion in the market.

It is interesting to investigate in this connection how much the government initiatives have affected the behavior of joint-tock companies not only in the public but also in the private sector. Or, in other words, how much the government is helping disseminate the best practice of corporate governance with its policies in the public sector and its support of certain companies in the private sector.

In this paper we are going to answer this question relying on the results of a survey of 822 joint-stock companies, which was conducted by the SU-HSE and the Hitotsubashi University in 2005. The rest of paper is organized as follows. Section 2 gives a description of the data we use. Section 3 describes the methodology of our study. Section 4 includes the results of our regression analysis and their discussion. Section 5 presents our main findings and a conclusion.

## 2. Questionnaire and data.

As stated in Dolgopyatova & Iwasaki (2006) the basic purpose of our enterprise survey was to understand the evolutionary processes of ownership relations and the governance mechanism of Russian corporations with an underdeveloped market economy and incomplete social and economic institutions. Our questionnaire included about 150 questions about the influence of shareholders and managers on decision-making process in companies, the scale, progress and effects of business integration processes, relations between the business sector and the state and other issues.

Our enterprise survey was conducted in the first half of 2005. Local branches of the Levada Center sent interviewers to a total of 859 companies, among which 822 firms gave valid answers. The focus of survey was on the industrial and communications (except for postal services) sectors. This is because, in these two sectors, joint-stock companies account for the largest share of sales and because most of the corporations that have issued stocks or bonds in the capital market belong to these two sectors. The surveyed firms were selected from among joint-stock companies with more than 100 employees. This criterion was set to exclude small businesses, for which the issue of corporate governance is largely a secondary matter.

The samples were selected by the method of stratified sampling. The surveyed firms were randomly selected from sampling books of industrial and communications companies by taking

into account three attributes: the sector they belonged to; their scale (total number of employees); and their form of incorporation (open or closed joint-stock company). The proportion of surveyed firms in the various parts of Russia and the relative proportion of independent firms and member firms of business groups are a consequence of the random sampling. As there were only about 160 Russian companies in the surveyed sectors that had issued stocks or bonds in domestic or foreign securities markets, we asked the executives of all of these companies to answer our questionnaire and interviewed all who agreed to our request.

The questionnaires were answered by 277 CEO (33.7%), 85 first deputy CEO (10.3%), 417 deputy CEO (50.7%) in charge of economy, finance, sales, or corporate governance, 13 chairpersons of the board of directors (1.6%), and 30 heads of corporate governance departments (3.6%). The average length of service of the respondents was 13.5 years (median: 9), and that of service in their current position was 6.2 years (median: 4).

The 822 firms surveyed were situated in 64 regions of the 89 constituent entities of the Russian Federation. Classified into federal districts, 265 companies (32.2%) were located in the Central Federal District, 97 firms (11.8%) in the Northwest Federal District, 71 (8.6%) in the South Federal District, 197 (24.0%) in the Privolzhsky (Volga) Federal District, 83 (10.1%) in the Ural Federal District, 85 (10.3%) in the Siberian Federal District, and 24 (2.9%) in the Far East Federal District. Regional proportion of the samples of this survey was very close to that of the actual proportional distribution of Russian companies, except for the fact that the number of surveyed firms based in the Privolzhsky (Volga) Federal District was relatively higher.

Table 1 shows the proportional composition of the surveyed firms according to their sector and business category. Industrial companies accounted for 91.4% (751 firms) of all the samples, and communications businesses made up the rest, 8.6% (71 firms). Among the industrial companies, 255 machinery and metal working businesses made up the largest share (31%), followed by 169 food industry companies, which accounted for 20.6%. The proportional shares for the other six sectors ranged from 4.0% to 9.5%.

According to the responses to the questionnaires, the average number of workers of the surveyed firms was 1,884 (standard deviation: 5,570; median: 465). Table 2 shows the proportional composition of the surveyed firms according to the number of workers for both the industrial and communications businesses. We have estimated that, according to official statistics, the average number of workers per company in the industrial and communications sectors was 31.4 and 49.6, respectively, as of 2004. This clearly shows that the average scale of the surveyed firms is much larger than that of most Russian companies in the two sectors. The 822 surveyed firms employed a total of 1,549,008 people. This represents 10.3% of a total of 15 Mio workers, which is the estimated total of those who were employed in the year 2004 by the industrial and communications sectors.

Respondents were also asked to provide a figure for the total sales for their companies in 2004. The results showed that the average total sales of 720 companies that gave valid answers were 3890 Mio rubles (standard deviation: 34092 Mio; median: 200 Mio). The figure for the total sales of all the 720 companies that gave valid answers amounted to 2,800 billion rubles. It represents 23.9% of the 2004 total sales for the industrial and communications sectors.

Classified into the types of organizations (forms of incorporation) 553 samples (67.3%) were open joint-stock companies (OAO), and 269 firms (32.7%) were closed joint-stock companies (ZAO), including workers' joint-stock companies (people's enterprises), which are a special type of closed joint-stock company.

The majority of firms surveyed (570 companies or 69.3%), were founded through the privatization process that started after the collapse of the Soviet Union, 124 firms (15.1%) were newly formed in and after 1992, 79 businesses (9.6%) were newly established by a division divested from another privatized or state-owned firm, and 24 enterprises (2.9%) were established by firms that had merged.

499 corporations (60.7%) were “independent firms” that had no ownership relationship with any business group, and the rest, 323 enterprises (39.3%), were “member firms of business

groups." Among the latter firms, 278 companies (33.8%) were so-called "affiliated enterprises," and 44 (5.4%) were "core enterprises of their business groups."

Other details on the composition of the samples as well as full version of our questionnaire in Russian and English can be found in Dolgopyatova & Iwasaki (2006).

## 3. Methodology of the study

We used a set of probit-regressions for checking our hypothesis that connection of firm to the government can be positive for the quality of corporate governance in the Russian situation of the early 2000s.

For an independent variable, we took CG_Indicator - the integral indicator of quality of corporate governance, which was built on the base of a number of variables directly or indirectly describing relationships between join-stock companies and their shareholders, first of all the minority ones (the algorithm for construction of this independent variable is described below in the Section 3.1.).

In this aspect our approach differs from most previous studies which used various financial indicators of enterprise performance as dependent variables (Li, 1997; Tian & Estrin, 2008; etc). The explanation for our choice is that Russia has developed very high concentration of ownership and control under a narrow equity market and imperfect institutions of corporate governance. In this situation, if a company is showing strong financial performance, this by no means implies that minority shareholders of the company will be actually able to be given the share of the "corporate pie" they are formally due to.

We used two types of variables to measure the influence that the government can possibly exert on the quality of corporate performance in the surveyed joint-stock companies. Firstly, our questionnaire provided us with information about different forms of support that enterprises obtained from the government. This enabled us to form the StateSupport variable and its modifications. Secondly, we had the data on government shares in the capital of the surveyed joint-stock companies, as well as on other formal and informal relations between the government and the enterprises in question. Relying on this questionnaire data we built a variable of proximity of enterprises to the government NEAR_GOV (from this point of view our approach is close to Faccio (2006) and other studies of 'politically connected firms'). A detailed description of these two variables is given in Section 3.2. Later we used these variables in our regression analysis as main explaining factors.

To control our results we used the data on enterprise size by employment, and on their industrial and regional affiliation. In addition, we also used a number of other independent variables that could affect relationships of the surveyed joint-stock companies with their shareholders, and our aggregate indicator of quality of corporate governance. A description of all these variables is given in Section 3.3.

The regression analysis was conducted for two basic models, with the use of StateSupport and NEAR_GOV variables, respectively. A test for stability of the results was based on the inclusion of other explanatory variable into the regression, and also on a random elimination of 5% of the observations.

### 3.1. How we evaluated the quality of corporate governance

Traditionally, a variety of ratings is used for assessment of quality of corporate governance. However, they are applicable mostly to public companies that are traded on stock exchanges and disclose considerable volumes of information about their business. A small number of joint-stock companies can meet such criteria in Russia. For example, in 2007 Standard & Poors calculated its rating of informational transparency only for 80 companies (S&P, 2007). However, there are about 170,000 joint-stock companies in Russia, and most of them have minority shareholders. Our sample consists of such joint-stock companies to a large degree, and we tried to detect how their relationships with shareholders are changing.

To this effect, following conventional principles of corporate governance (OECD, 2004) we attempted to single out a group of firms in our sample that are oriented to best practice in corporate governance. In particular, we believed that this group should include the more transparent enterprises, which paid more attention to minority shareholder rights. In our questionnaire, this positive practice could be revealed with questions about listing of the company's securities on Russian and foreign stock exchanges, about representation of outside minority shareholders and/or independent directors in their boards, and also on dividend payments.

In addition, the questionnaire had questions whether the enterprise planned to go public on Russian and foreign stock markets. This issue was important for us because the share of publicly traded enterprises was established a priori at the time of sampling. But plans to go public (which involve fairly serious efforts to change the ways of information disclosure) were unknown to us. Therefore, we considered possible to unify the answers about the listing of the company's securities on stock exchanges and about plans to go public in a single variable. Distribution of companies in the framework of this variable is shown in Table 3. This table also gives the number of enterprises that paid dividends in 2001-2003 and had representatives of minority shareholders and/or independent directors in their boards.

We can believe that orientation towards the best practice of corporate governance is a combination of all three indications (listing on stock market or plans to go public, minority shareholders on the board and dividend payment). However, there can be situations in reality when an enterprise pays no dividends and invests all profits in expansion of its business. In our opinion, this policy doesn't infringe the rights of minority shareholders in case if their representatives sit in the board of directors and if the joint-stock company is publicly traded, because its value can go down on abuse of shareholder rights.

For this reason, while forming the binary CG_Indicator variable we considered possible to include the joint-stock companies that met no less than two out of three above mentioned criteria into the group of our interest. Such companies amounted to 18,6% of our sample.

To test the CG_Indicator variable, we made an additional examination of its relations with other characteristics of corporate governance at the surveyed enterprises. It was found that the firms oriented towards best practice of corporate governance had typically the organizational-legal form of open joint-stock company (OAO) and had foreign investors among their shareholders ($p < 0,01$ un both cases). In our opinion, these results prove that our choice of the CG_Indicator as the indicator of the level of corporate governance was well-founded. Open joint-stock companies differ from the closed ones by the right of a shareholder of the former to sell his stock freely (without consent of other shareholders). Thereby, the open joint-stock company is the legal form that provides the rights of minority shareholders with better protection. Foreign investors usually are better informed about their rights and defend their ownership more actively. Therefore, their presence among shareholders can be regarded as an indirect sign that quality of corporate governance is higher.

### 3.2. How we evaluated influence of the government on corporate behavior

Based on available information, we singled out two channels of influence on corporate behavior that were being used by the government:

- Various instruments of state support;
- Governmental shareholding and other ways of direct interaction of the state with managers/owners of enterprises.

The questionnaire of our survey included a number of questions that described receiving financial and organizational support from the government, as well as participation of the firms in government procurement on products and services for public needs.

The relevant questions were related to ways of receiving the support and participation in the system of government procurement and gave no means to directly measure the scale of support. Nevertheless, we believed that the number of concrete forms of support that a firm

obtained from the state could be an indirect indicator of intensity of the state support. This approach enabled us to form particular variables FinSupport, OrgSupport, StProcur and on their base, the aggregate StateSupport variable.

As can be seen from the data of Table 4 which gives the description of these variables, 51,4% of the firms obtained some kind of support. At the same time, the share of respondents that obtained financial and organizational support appeared to be much lower, and the share of firms that simultaneously received a number of different kinds of support through one channel was less than 10%.

To make a description of ways of direct interaction between the government and managers/owners of the firms, we used some other questions from our questionnaire: about interest of the government in corporate stock; about inclusion of government representatives in the boards of joint-stock companies; about participation of corporate managers in advisory councils that were acting under different levels of government.

At first glance, the three questions describe different aspects of interaction between the government and firms. Interest in corporate stock and inclusion in the boards enables the government to influence the activities of a firm. On the contrary, participation of corporate managers in advisory councils under different levels of government rather opens opportunities for lobbying their private interests. However, decisions to include corporate representatives in such councils are made by government bodies. Thereby, the government consciously makes some firms closer, at the same time giving them opportunities to influence the state policy.

In the present context, the matters of our interest were the questions about experience of top managers in public agencies, about former jobs of CEOs and chairmen of the boards and about agreement with the authorities on strategic decisions.

On the base of these questions we have formulated a new integral NEAR_GOV variable, which described the connection of firms to the government. In this case, we singled out three groups of enterprises: those with strong (close) connections, with weak connections and with no evident connections to the government.

The group of firms closely-connected to the government (Group One in Table 5) was formed by means of unification of all the firms where the government had controlling stakes and/or representatives on the board of directors, and/or where the managers took part in advisory councils under federal agencies.

The group of firms weakly-connected to the government (Group Two in Table 5) was formed by means of unification of all the firms that were not included in the Group One and where either the government was present as a shareholder (with no controlling right), or managers took part in advisory councils under regional authorities, or there was at least one out of the following indications:

- Top managers had experience in government bodies;
- The CEO/chairman of the board of directors formerly held a job in federal or regional bodies;
- Key decisions were coordinated with the authorities.

Finally, the group Three was formed as the residual. It included all the firms that had answered the relevant questions and were not included in the groups One and Two.

As a result, according to the data of Table 5, 20,9% of the firms are closely-connected to the government, and 32,4% of the respondents are weakly-connected to the government.

### 3.3 Controlling variable and other independent variables

Regional and industrial affiliation of the respondent enterprises and their size were assigned to controlling variables.

Taking into account that the survey had covered 64 regions, we used a REGION dummy in order to test the possible influence of this factor. This variable was formed on the base of the data on levels of economic development by region published by the Ministry for economic development and trade (MoEDT, 2005).

To monitor differentials by industry, we used a standard SECTOR variable. At the same time, the goals of our study required consideration of the scope of possible influence of the government on corporate behavior. Therefore, in some modifications of our basic model we also used a SECTOR_reg dummy, which designated affiliation of the surveyed enterprises to the regulated and non-regulated industrial sectors.

To take the size factor into consideration, we used group data on employment at the surveyed enterprises (the SIZE variable with division into four size groups - 100-299, 300-499, 500-999 and 1000 and more employees). The reason for this approach was that the rest of independent variables in the regression were categorical or ordinal and the use of numerical data (in the form of logarithm of employment) in their presence gave too much significance to the size factor. Moreover, we had grounds to believe, considering our previous studies, that the influence of firm size on the quality of corporate governance was not proportional.

We also used a range of other independent variables.

General assessment of financial condition of a firm - FINANCE. We recognized that the fact of dividend payment (which was significant in the formation of CG_Indicator variable) depended, inter alia, on the financial condition of a firm. Consequently, we could expect that the connection between these variable was positive. Furthermore, inclusion of FINANCE onto our regression could possibly lower the influence of other factors.

Presence of a controlling stake in a company in the hands of a single shareholder or a united group of shareholders - DOMINANT_OWNER. The results of a number of previous studies (Dolgopyatova, 2003; Guriev et al, 2004; Yakovlev, 2004) allowed understanding that under the Russian conditions, concentration of ownership rights could make positive influence on the quality of corporate governance. In particular, in a case when the shares were diffused among several owners, even relatively large shareholders that kept the enterprise under control at the given moment may have had no motivation to pursue its development in a long range because such a large shareholder had no guarantee that his position in the firm would remain unchanged in the future. This uncertainty about future ownership rights may give incentives to withdrawal of assets and to other measures that violate the rights of other shareholders. This is still truer for the behavior of managers, and the shareholders have no effective tools to stop this opportunistic behavior under dispersion of ownership and weak judicial institutions.

A tendency toward concentration of ownership and control was a logical outcome of such problems. The Russian experience demonstrated that a dominant shareholder, after having acquired a controlling stake, got incentives to restructure and develop the company business, and also found real means to be in command of its managerial team. In a number of cases, this was followed by improvement in the practice of corporate governance, with a focus on higher capitalization, introduction of international standards of financial reporting, launching an IPO, etc. This gave us reason to assume that there was a positive relation between the presence of a controlling shareholder or a group of controlling shareholders and the quality of corporate governance.

Membership of a firm in a business group – HOLDING. The firms that are members of holding company groups (the amounted about 40% of our respondents) can expect to get financial support of their projects from their parent company. Therefore, they can be less dependent on outside financing and can have fewer incentives to take into account the interests of small minority shareholders. At the same time, parent companies can more actively use the mechanisms of corporate governance for supervision of their subsidiaries.

Membership of a firm in a business association – BUSINESS_ASS. In the early 2000s, the government actively used national business associations (The Russian Union of Industrialists and Entrepreneurs /RSPP/, “OPORA” and “Delovaya Rossiya”) as channels for dialogue with the business community. This gave us grounds to believe that business associations could help disseminate the best practice of corporate governance on behalf of the interests of the business community.

Presence of top managers experienced in foreign companies in Russia or abroad – FOREIGN_EXP. To be proficient in using the mechanisms of corporate governance the managers must have certain expertise and skills. Multinational corporations usually have higher level of corporate governance. For this reason, we believed that presence of top managers experienced in multinational corporations in the respondent firms could help disseminate the best practice of corporate governance.

**4. Results of the regression analysis**

As follows from the data of the Table in Appendix A, three parameters appear to be most significant in different modifications of Model 1 (describing the effect of direct government support on the quality of corporate governance):

- Company size;
- Company's affiliation to the fuel and energy sector or to communications;
- Location in Moscow.

All the three conclusions have distinct logical explanations and are in good agreement with the practice. Large companies have much more incentives for introduction of good corporate governance than the smaller ones, because they can have substantially higher gains at comparable costs. These days, companies in the fuel and energy sector and in communications have the strongest presence in stock market, which implies that they abide by the principles of corporate governance in fuller measure. Finally, Moscow is the leading business center in Russia with well-developed financial infrastructure. And if the companies that are located in Moscow take into account the interests of minority shareholders and comply with other requirements of corporate governance, they can have faster access to cheaper sources of external financing.

At the same time, the variables of state support that we were interested in from the beginning have no statistical significance in any modification of Model 1. To confirm this result, we made an additional computation of regressions using enlarged versions of StateSupport, FinSupport, OrgSupport и StateProcur variables (which took into account not only the fact of state support given to a firm, but also variety of kinds of support received by the firm in question). However, all coefficients of these variables again turned out to be insignificant. All this gives us grounds to assume that rendering of financial or organizational support by the government, as well as selection of suppliers for the program of government procurement on products has nothing to do with the quality of corporate governance in the relevant companies.

Appendix B describes the results of a test of our second hypothesis that under the present conditions in Russia, connections of firms to the government (a formal and/or informal one) can have positive influence on the quality of corporate governance in these firms.

Model 2.0 supports this hypothesis (if the effects of size, industrial and regional affiliation that were found in the Model 1 are maintained). For instance, the companies closely-connected to the government have considerably higher quality of corporate governance than the non-connected companies ($p < 0.05$). For the companies weakly-connected to the government, the coefficient is also positive but statistically insignificant.

Model 2.1 was used for testing the robustness of our results. In particular, we added a number of additional variables to the regression, which in our opinion could affect the quality of corporate governance: belonging of the firm to the business groups; a controlling stake in the hands of a single shareholder; financial condition of the firm, and membership in business associations.

Insertion of these variables rather improved the general parameters of our model (McFadden pseudo R-Square rose from 0.200 до 0.231). However, only once we found a new meaningful correlation that corresponded to our initial assumptions: the firms in good financial condition abide by standards of corporate governance more regularly ($p < 0.10$). The coefficient of the variable of our interest, NEAR_GOV, rose a little (which could be interpreted as growing influence of this variable in this specification of the model) and kept its significance on the same level ($p < 0.05$).

Model 2.2 also confirmed our results. At the same time, this model gave additional evidence that the state can affect the quality of corporate governance not just in the capacity of a proprietor. In particular, the firms in regulated industries show to a great extent better quality of corporate governance ($p < 0.01$).

We used Model 2.3 to test whether there are differences in the relations, which we had found for the variable NEAR_GOV, in enterprise groups classified by size of employment. For this end, we introduced an interaction term [NEAR_GOV*SIZE] into our regression. As seen from the data in Appendix B, a different type of correlation is observed in a single case, for the firms with employment of 300-499 ($p < 0.05$). Differences by industry remain highly significant. Differences by size remain, but their statistical significance is lower. Influence of financial condition becomes insignificant. Finally, the coefficient of NEAR_GOV variable becomes even higher, but with a lower level of significance ($p < 0.10$).

Robustness of the results obtained with Model 2.0 was also confirmed with multiple random eliminations of 5% of the observations (the author can provide the results of computation of these regressions on request). Therefore, our analysis gives us grounds to assert that in Russia, in the period of 2001-2004, close connections of a company to the government made positive effect on the quality of corporate governance.

## 5. Conclusion

In this paper we made an attempt to evaluate influence of the state on changes in the quality of corporate governance in Russia of the early 2000s, using a database on 822 joint-stock companies. Owing to the quality of our questionnaire that had included a wide range of questions related to interaction between enterprises and public agencies, we were able to assess the influence of the state on the practice of corporate governance in different ways, from the most rigorous ones when the government acted as a shareholder to the mild ones when the matter was various types of support and stimulation of the firms.

Our regression analysis has showed that quality of corporate governance differs by enterprise size, location and sector affiliation. At the same time, rendering of financial or organizational support to the firms by the government, as well as selection of suppliers procurement on products and services for public needs has nothing to do with the quality of corporate government in the relevant firms.

On the contrary, the total of formal and informal connections between enterprises and the government is a matter of importance. In particular, quality of corporate governance is higher at the companies closely-connected to the government (including those where the government has controlling stakes and/or representatives on the board of directors, and/or where the managers take part in advisory councils under federal agencies). This result proved to be robust in different specifications of our basic model.

This conclusion is generally inconsistent with the conventional, in economic literature, attitude to the role of the state, and particularly on the role of the SOE (Megginson, Netter, 2001; Perotti, 2004 etc) and the role of political connections (Faccio, 2006). Even the recent studies on China, which Russia is coming closer to in terms of models of interaction between firms and the state, show that government stakes in corporations and/or other ways of influence have negative effects on enterprise performance (Nee, Opper, Wong, 2007; Choi, Thum, 2007; Tian, Estrin, 2008).

However, in our opinion, what is to be considered here is the stage of development of a concrete economy in a concrete point of time. The early 2000s in Russia were the time when some sort of proper order was introduced after disorganization and chaos of the preceding decade. This holds true, above all, for relations of the government with the SOE, which were put back under control with strong reliance on procedures of corporate governance. In particular, the government introduced monitoring of the SOE performance, required that joint-stock companies with its stakes should pay dividends, etc. In a sense, we can assert that the state as a proprietor used standard mechanisms and procedures of corporate governance for defense of its interests.

In the 2000s, channels and mode of enterprise influence on economic policies also began to change. In the 1990s, chances to come into contact with high officials and politicians were mostly a privilege of people representing Soviet industrial giants and of oligarchs. Such contacts were individual and as a rule, served for lobbying private interests of certain companies. Under President Putin, the state authorities turned to maintaining public contacts with the businesses through business associations (such as The Russian Union of Industrialists and Entrepreneurs /RSPP/, "OPORA" and "Delovaya Rossiya") and through a variety of advisory councils that were established under public agencies (The Council on National Competitiveness under the Prime Minister of the RF, etc.). This approach did not rule out chances for individual lobbying, but gave opportunities for formation and representation of collective interests of the business community. These collective forms of interaction with the state gave opportunities for influence on economic policies to the firms that demonstrated success in their business, more openness and more consideration for the interests of their shareholders.

The fact that these positive changes took place after a period of chaos and uncertainty of the 1990s allow us to draw a parallel between Russia and the China of the 1980s rather than contemporary China. It is noteworthy that empirical studies based on the data of that time give evidence of improvement in performance of the SOE (Li, 1997).

However, we have to emphasize that our conclusions about positive influence of the state on the quality of corporate governance refer exclusively to the period of 2001-2004 and cannot be extrapolated further. In this context, another comparison may be interesting – a comparison with the postwar Italy. Critical analysis of state ownership and the evolution of Italian corporate governance since the World War II was provided in the paper Barca & Trento (1997). They conclude that full scale or majority state ownership of corporations can be effective in separating ownership and control during stages of accelerated growth, and also when shifts in the sectoral balance are needed. But this system is bound to degenerate over time in the absence a functioning political market and in the case when state-owned enterprises are burdened with 'special social objectives'.

These judgments can be timely in contemporary Russia because consolidation of the state and economic success in the early 2000s gave leading politicians and top officials a sort of euphoria about the role and capabilities of the state. This resulted in further extension of the state presence in the economy, bringing a growing number of large companies under direct or indirect control of the government and to creation of giant, practically non-transparent state corporations, etc. In our opinion, if these trends go on they can change the character of state influence on behavior and performance of enterprises from the positive to the negative one in the nearest future.

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**Table 1. Distribution of surveyed firms by sector**

| | Number | Share (%) |
|---|---|---|
| Surveyed firms, total | 822 | 100.0 |
| Industry | 751 | 91.4 |
| Fuel and energy | 66 | 8.0 |
| Iron and steel and non-ferrous metals | 36 | 4.4 |
| Chemicals and petrochemicals | 33 | 4.0 |
| Machinery and metalworking | 255 | 31.0 |
| Timber, woodworking and pulp-and-paper industry | 63 | 7.7 |
| Construction materials | 78 | 9.5 |
| Light industry | 51 | 6.2 |
| Food industry | 169 | 20.6 |
| Telecommunications | 71 | 8.6 |

**Table 2. Distribution of surveyed firms by number of workers**

| | Industry | | Communications | |
|---|---|---|---|---|
| | Number | Share (%) | Number | Share (%) |
| Surveyed firms, total | 751 | 100.0 | 71 | 100.0 |
| 100-299 persons | 221 | 29.4 | 27 | 38.0 |
| 300-499 persons | 173 | 23.0 | 7 | 9.9 |
| 500-999 persons | 147 | 19.6 | 9 | 12.7 |
| 1000-4999 persons | 161 | 21.4 | 11 | 15.5 |
| 5000-9999 persons | 26 | 3.5 | 7 | 9.9 |
| More than 10000 persons | 23 | 3.1 | 10 | 14.1 |

**Table 3. Indicators of good corporate governance in the sample**

| | Number of firms | Share in total sample (%) |
|---|---|---|
| The corporate governance is good (according to CG_Indicator) | 153 | 18,6% |
| Company's securities (shares, bonds, Eurobonds) are listed on stock exchanges in Russia and abroad or company is making practical preparations to float its securities on stock exchanges | 138 | 16,8% |
| Independent directors and/or representatives of minority outside shareholders not working at the company are members of board of directors | 224 | 27,2% |
| Company paid annual common share dividends for 2001-2003 (at least one time) | 315 | 38,3% |
| Surveyed firms, total | 822 | 100% |

**Table 4. State support of surveyed firms in 2001-2004**

| | Number of firms | Share in total sample (%) |
|---|---|---|
| Firms received any state support | 423 | 51,4% |
| Firms received financial support from regional and local authorities | 187 | 22,7% |
| Including two and more types of support | 48 | 5,8% |
| Firms received organizational support from regional and local authorities | 228 | 27,8% |
| Including two and more types of support | 77 | 9,4% |

| | | |
|---|---|---|
| Firms participated in state procurement | 192 | 23,3% |
| Surveyed firms, total | 822 | 100% |

**Table 5. Connections of firm to the government (NEAR_GOV variable frequency)**

| | Number of firms | Share in total sample (%) |
|---|---|---|
| Group 1. Closely-connected firms | 172 | 20,9% |
| Group 2. Weakly-connected firms | 266 | 32,4% |
| Group 3. Non-connected firms | 384 | 46,7% |
| Surveyed firms, total | 822 | 100% |

Appendix A.

**Direct state support' influence on corporate governance of surveyed firms**

| Parameter Estimates | | Model 1.0 | | Model 1.1 | | Model 1.2 | | Model 1.3 | |
|---|---|---|---|---|---|---|---|---|---|
| | | Estimate | Std. Error | Estimate | Std. Error | Estimate | Std. Error | Estimate | Std. Error |
| Threshold | [CG_Indicator = 0] | 0,7052*** | 0,1730 | 0,6769*** | 0,1589 | 0,6679*** | 0,1645 | 0,6554*** | 0,162 |
| Location | [StateSupport=yes] | 0,0199 | 0,1169 | | | | | | |
| | [StateSupport=no] | 0 | . | | | | | | |
| | [FinSupport=yes] | | | 0,0304 | 0,1355 | | | | |
| | [FinSupport=no] | | | 0 | . | | | | |
| | [OrgSupport=yes] | | | | | -0,0247 | 0,1272 | | |
| | [OrgSupport=no] | | | | | 0 | . | | |
| | [StateProcur=yes] | | | | | | | -0,0133 | 0,137 |
| | [StateProcur=no] | | | | | | | 0 | . |
| Size (number of workers) | [1= 100-299] | -0,8934*** | 0,1544 | -0,9323*** | 0,1552 | -0,9311*** | 0,1576 | -0,9062*** | 0,1546 |
| | [2= 300-499] | -0,8089*** | 0,1663 | -0,8141*** | 0,1671 | -0,8198*** | 0,1684 | -0,8373*** | 0,1701 |
| | [3= 500-999] | -0,5726*** | 0,1608 | -0,5788*** | 0,1620 | -0,5577*** | 0,1636 | -0,5750*** | 0,1616 |
| | [4= 1000 and more] | 0 | . | 0 | . | 0 | . | 0 | . |
| Sectors | [1= fuel and energy] | 1,0474*** | 0,1923 | 1,0337*** | 0,1940 | 1,0645*** | 0,1940 | 1,0084*** | 0,1954 |
| | [2= iron and steel and non-ferrous metals ] | 0,3293 | 0,2552 | 0,3200 | 0,2550 | 0,3143 | 0,2553 | 0,2498 | 0,2624 |
| | [9= telecommunications] | 1,2134*** | 0,1901 | 1,2560*** | 0,1914 | 1,2066*** | 0,1900 | 1,1777*** | 0,1917 |
| | [4= chemicals and petrochemicals] | -0,2110 | 0,3287 | -0,1958 | 0,3309 | -0,3496 | 0,3636 | -0,2202 | 0,3313 |
| | [5= timber, woodworking and pulp-and-paper industry] | 0,1370 | 0,2273 | 0,1706 | 0,2289 | 0,1409 | 0,2289 | 0,0468 | 0,2358 |
| | [6= light industry] | -0,0568 | 0,2829 | -0,0509 | 0,2840 | -0,0315 | 0,2865 | -0,0638 | 0,2843 |
| | [7= food industry] | -0,0860 | 0,1796 | -0,1085 | 0,1838 | -0,0878 | 0,1857 | -0,0740 | 0,1814 |
| | [8= construction materials] | 0,1094 | 0,2283 | 0,1269 | 0,2287 | 0,1237 | 0,2295 | 0,1071 | 0,2296 |
| | [3= machinery and metalworking] | 0 | . | 0 | . | 0 | . | 0 | . |
| Groups of regions according to their level of economic development (MoEDT classification for 2004) | [0= Moscow] | 0,4527* | 0,2663 | 0,4276 | 0,2681 | 0,4994* | 0,2700 | 0,4482* | 0,2659 |
| | [1= high level] | -0,1211 | 0,2392 | -0,1429 | 0,2399 | -0,1364 | 0,2407 | -0,1583 | 0,2438 |
| | [2= upper-middle level] | 0,1165 | 0,1513 | 0,1127 | 0,1528 | 0,1131 | 0,1540 | 0,1030 | 0,1533 |
| | [4= lower-middle level] | -0,0160 | 0,1568 | -0,0792 | 0,1601 | -0,0355 | 0,1592 | -0,0133 | 0,1577 |
| | [5= low level] | -0,1538 | 0,2538 | -0,1744 | 0,2545 | -0,1477 | 0,2557 | -0,1665 | 0,2533 |
| | [6= very low level] | -0,7632 | 0,6331 | -0,7936 | 0,6378 | -0,7880 | 0,6341 | -0,7867 | 0,6323 |
| | [3= middle level] | 0 | . | 0 | . | 0 | . | 0 | . |
| Number of observation | | 822 | | 809 | | 795 | | 802 | |
| -2 Log Likelihood | | 397,8 | | 376,3 | | 370,6 | | 367,6 | |
| McFadden pseudo R-Square | | 0,195 | | 0,200 | | 0,201 | | 0,191 | |

Appendix B.

**State-business connections' influence on corporate governance of surveyed firms**

| Parameter Estimates | | Model 2.0 | | Model 2.1 | | Model 2.2 | | Model 2.3 | |
|---|---|---|---|---|---|---|---|---|---|
| | | Estimate | Std. Error | Estimate | Std. Error | Estimate | Std. Error | Estimate | Std. Error |
| Threshold | [CG_Indicator = 0] | 0,8333*** | 0,1724 | 1,0196*** | 0,2760 | 1,0101*** | 0,2614 | 1,1134*** | 0,2886 |
| Location | [NEAR_GOV=yes, strong] | 0,2954** | 0,1471 | 0,3262** | 0,1595 | 0,3229** | 0,1575 | 0,4510* | 0,2385 |
| | [NEAR_GOV=yes, week] | 0,1260 | 0,1330 | 0,1636 | 0,1452 | 0,1753 | 0,1441 | 0,2251 | 0,2435 |
| | [NEAR_GOV=no] | 0 | . | 0 | . | 0 | . | 0 | . |
| Size (number of workers) | [1= 100-299] | -0,8227*** | 0,1569 | -0,8794*** | 0,1768 | -0,8990*** | 0,1689 | -0,8405*** | 0,2526 |
| | [2= 300-499] | -0,7634*** | 0,1677 | -0,8129*** | 0,1896 | -0,8410*** | 0,1837 | -0,6702** | 0,2843 |
| | [3= 500-999] | -0,5414*** | 0,1617 | -0,5636*** | 0,1746 | -0,5872*** | 0,1685 | -0,5201* | 0,2753 |
| | [4= 1000 and more] | 0 | . | 0 | . | 0 | . | 0 | . |
| Sectors | [1= fuel and energy] | 1,0265*** | 0,1933 | 1,0116*** | 0,2104 | | | | |
| | [2= iron and steel and non-ferrous metals ] | 0,3370 | 0,2551 | 0,2578 | 0,2771 | | | | |
| | [9= telecommunications] | 1,1761*** | 0,1908 | 1,2125*** | 0,2212 | | | | |
| | [4= chemicals and petrochemicals] | -0,1710 | 0,3281 | -0,1245 | 0,3393 | | | | |
| | [5= timber, woodworking and pulp-and-paper industry] | 0,1651 | 0,2279 | 0,0050 | 0,2522 | | | | |
| | [6= light industry] | -0,0344 | 0,2853 | 0,0568 | 0,2974 | | | | |
| | [7= food industry] | -0,0733 | 0,1798 | -0,2442 | 0,2022 | | | | |
| | [8= construction materials] | 0,1187 | 0,2286 | 0,0875 | 0,2451 | | | | |
| | [3= machinery and metalworking] | 0 | . | 0 | . | | | | |
| | [SECTOR_reg = yes] | | | | | 1,1359*** | 0,1544 | 1,1486*** | 0,1574 |
| | [SECTOR_reg = no] | | | | | 0 | . | 0 | . |
| Groups of regions according to their level of economic development (MoEDT classification for 2004) | [0= Moscow] | 0,4557* | 0,2677 | 0,5410* | 0,2874 | 0,5486* | 0,2828 | 0,5278* | 0,2850 |
| | [1= high level] | -0,1413 | 0,2395 | -0,2812 | 0,2579 | -0,2869 | 0,2545 | -0,2837 | 0,2561 |
| | [2= upper-middle level] | 0,1037 | 0,1517 | -0,0317 | 0,1644 | -0,0151 | 0,1610 | 0,0062 | 0,1623 |
| | [4= lower-middle level] | -0,0217 | 0,1574 | -0,1225 | 0,1671 | -0,1262 | 0,1660 | -0,1207 | 0,1679 |
| | [5= low level] | -0,1682 | 0,2534 | -0,1885 | 0,2604 | -0,1820 | 0,2594 | -0,1826 | 0,2625 |
| | [6= very low level] | -0,7604 | 0,6515 | -0,8731 | 0,6924 | -0,8349 | 0,6768 | -0,8525 | 0,6862 |
| | [3= middle level] | 0 | . | 0 | . | 0 | . | 0 | . |
| | [HOLDING=no] | | | 0,0494 | 0,1381 | 0,0469 | 0,1346 | 0,0534 | 0,1361 |
| | [HOLDING=yes] | | | 0 | . | 0 | . | 0 | . |
| | [DOMINANT_OWNER=yes] | | | 0,0925 | 0,1871 | 0,0803 | 0,1865 | 0,1126 | 0,1890 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | [DOMINANT_OWNER=no] | | | 0 | . | 0 | . | 0 | . |
| | [FINANCE= good] | | | 0,2422* | 0,1320 | 0,2232* | 0,1301 | 0,2159 | 0,1314 |
| | [FINANCE= bad] | | | 0,0586 | 0,2167 | 0,0552 | 0,2149 | 0,0201 | 0,2172 |
| | [FINANCE= satisfactory] | | | 0 | . | 0 | . | 0 | . |
| | [BUSINESS_ASS= no] | | | 0,1373 | 0,1287 | 0,1264 | 0,1267 | 0,1381 | 0,1285 |
| | [BUSINESS_ASS= yes] | | | 0 | . | 0 | . | 0 | . |
| | [NEAR_GOV=1] * [SIZE=1] | | | | | | | 0,0902 | 0,4392 |
| | [NEAR_GOV=1] * [SIZE=2] | | | | | | | -1,1954** | 0,6043 |
| | [NEAR_GOV=1] * [SIZE=3] | | | | | | | -0,0206 | 0,4148 |
| | [NEAR_GOV=1] * [SIZE=4] | | | | | | | 0 | . |
| | [NEAR_GOV=2] * [SIZE=1] | | | | | | | -0,1341 | 0,3746 |
| | [NEAR_GOV=2] * [SIZE=2] | | | | | | | 0,0661 | 0,4037 |
| | [NEAR_GOV=2] * [SIZE=3] | | | | | | | -0,1349 | 0,4002 |
| | [NEAR_GOV=2] * [SIZE=4] | | | | | | | 0 | . |
| | [NEAR_GOV=3] * [SIZE=1] | | | | | | | 0 | . |
| | [NEAR_GOV=3] * [SIZE=2] | | | | | | | 0 | . |
| | [NEAR_GOV=3] * [SIZE=3] | | | | | | | 0 | . |
| | [NEAR_GOV=3] * [SIZE=4] | | | | | | | 0 | . |
| Number of observation | | 822 | | 746 | | 746 | | 746 | |
| -2 Log Likelihood | | 428,3 | | 510,1 | | 457,3 | | 450,1 | |
| McFadden pseudo R-Square | | 0,200 | | 0,231 | | 0,225 | | 0,236 | |