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Can Russia's state-managed, network capitalism be competitive? Institutional pull versus institutional push

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Abstract

In the fall of 2005, former chairman of Yukos Oil, Mikhail Khodorkovsky, was sentenced to prison, after being found guilty of fraud and tax evasion. Many viewed the trial as the government's attempt to gain control of the energy sector which Putin had declared as strategically crucial to the country. This article examines the role of the state and the type of capitalism that is evolving in Russia. We view this system as consisting of three forms of network capitalism that coexist in this transition economy – market, oligarchic, and siloviki – and the relationships among them, all existing within the pervasive environment of the Russian state. We argue that the Russian economy will continue to be based for some time on the cognitive institutional pillar rather than the regulative pillar. The article concludes with implications of government policy decisions for the various forms of capitalism, for the country's competitiveness and attractiveness for foreign investment, and for Russian managers.

1. The Yukos trial: a watershed for the Russian economy

Yukos, Russia's largest and most successful oil company, originated during the country's privatization program of the early and mid-1990s. In 2005, its chairman and major shareholder, Mikhail Khodorkovsky, and his partner, Platon Lebedev, were found guilty of defrauding the state during the 1995 privatizations of an insecticide research institute and a fertilizer factory. The court also concluded that the company owed $28 billion in back taxes. Khodorkovsky and Lebedev were given long prison sentences, and the company's major assets were broken up and sold at auction. The assets formed the basis for the newly created state-owned petroleum company, Rosneft.

Some saw the Yukos trial as the government's retribution for the excesses of the 1990s privatization program that resulted in the country's major industries ending up in the hands of a small number of powerful businessmen who used highly questionable methods to accumulate these industrial gems at a fraction of their true market value. But the Putin administration also seemed to have another motive for going after Yukos and Khodorkovsky – to squelch his political ambitions. In any case, the trial created great uncertainty about the future of the Russian economy and the state's role in it.

2. Assessing Russia's economic system

The Yukos-Khodorkovsky case called into question the role of the Russian government in business and the economy, the type of economic system that was emerging, and the implications for Russia's global competitiveness. We examine these issues in the context of institutional theory, and develop the concepts of institutional pull and push. We also draw upon the work

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of Boisot and Child (1996) who examined the government's role in the transitioning Chinese economy and the type of capitalism that has been emerging there.

3. Institutional pull versus institutional push

The dissolution of the centrally planned economy also saw the dismantling of institutions, including the state central planning system with its ministries that had controlled virtually all economic information, causing chaos throughout the entire economic system. New institutions needed for a successful transition (Peng, 2003) have not developed enough to support a codified market-oriented system of information, such as laws, regulations, and their enforcement, as well as business practices and values. The lack of institutional development was a major cause of the country's unstable environment and the resulting reliance on informal relationships and traditional values that existed before the tenuous attempts at transition to a market economy. Additionally, the government's efforts to diffuse important economic and business information have been limited and confusing, and enterprise managers thus have traditionally provided low transparency of company information.

Institutions have been defined as ''the humanly devised constraints that structure human interaction'' (North, 1990: 3), and include formal rules and laws as well as informal influences like cultural norms. Scott (1995) classified North's formal and informal aspects of institutions into three pillars: regulative, cognitive, and normative. The regulative pillar consists of formal rule systems like laws and regulations as well as enforcement mechanisms that are sanctioned by the state (North, 1990; Scott, 1995). The cognitive pillar includes accepted beliefs and values, and the normative pillar refers to legitimate means to pursue valued ends. We focus on the regulative and cognitive pillars since they comprise the institutional dichotomy we observe in Russia. Peng (2003) noted that most attention in the market transition literature concentrates on state-level policies rather than firm-level strategies. He added that international organizations, like the World Bank and United Nations, hope that firms themselves behave as reformers. We conclude that they have not done so in Russia until recently, and what has emerged is primarily the cognitive pillar of beliefs and customs that supports clans and networks.

All of these circumstances in Russia set the stage for the recent phenomenon that we call institutional pull, whereby companies, in pursuing their own self-interest, are imposing pressure on authorities to create formal institutions. These moves strengthen the regulative pillar. This is in contrast to the more commonly studied approach that Peng (2003) noted, which we refer to as institutional push, where authorities first initiate formal institutions to support and regulate the business environment. We view institutional pull and institutional push as being analogous to the marketing concepts of pull and push. Demand for a company's products and services can be created or pulled by customers' actions, or by a company's pushing its products and services through advertising and marketing. We believe that more such institutional pull is required in Russia to help strengthen regulative institutions and alleviate the current heavy dependence upon the cognitive institutional pillar of accepted beliefs and values.

The absence of a push orientation to develop institutions, after some years of sporadic development, is due primarily to the federal government's insufficient and inconsistent efforts, particularly in developing the judicial system. This situation, as well as the growing institutional pull phenomenon in Russia, is consistent with the nature of institutional change, which North (1990) noted is overwhelmingly incremental. We see this incremental evolution as being the typical form of change. Yet the transition has at times been characterized by discontinuous change or punctuated equilibrium (Gersick, 1991), such as the government's promulgation in 2002 of the Code of Corporate Conduct for companies having more than 1000 shareholders. We also view the emergence of institutional pull as being consistent with the notion of institutional relatedness. That concept is defined as ''the degree of informal embeddedness or interconnectedness with dominant institutions'' (Peng, Lee, & Wang, 2005: 623) that provides resources to a firm and increases its legitimacy (Granovetter, 1985).

These conditions have created a situation of companies pulling institutions into the setting by putting pressure on the government to develop them. Some positive initiatives are occurring in the areas of capital markets, regulation, and laws, all of which are beginning to strengthen the normative pillar. One result is to support an increasing level of transparency and interest in corporate governance that has developed not out of altruism, but from business owners' quest to increase personal wealth. A major impetus for the pull phenomenon of companies creating pressure for authorities to build institutions has been the vastly increasing number of initial public offerings planned for 2006 and 2007. Compared to the 13 initial public offerings in the entire period from 1992 to 2004, 2006 was expected to see nearly 30 such offerings raising $25