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CORPORATE GIANTS AND ECONOMIC GROWTH — A CASE FOR CHINA AND RUSSIA

SIEMS MONTHLY BRIEFING

SKOLKOVO Institute for Emerging Market Studies
Moscow School of Management
August 2010

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INTRODUCTION

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Historically economic growth depends crucially on profit creation and the appreciation of asset prices. Although the vibrant sector of small businesses in many countries is the workhorse for generating jobs and emancipating the poor from poverty, profit creation and wealth accumulation however, more or less take place mostly at large scale enterprises.

In this report, we study the largest 400 companies in China and Russia. Like in many countries in the world, corporate giants assume an increasingly prominent role in China, as the economy continues to undergo structural consolidations in various industry sectors. And this is particularly so since 2008, as the worldwide financial crisis started to have repercussions throughout the Chinese economy.

Developments of the corporate world largely reflect the changing dynamics of country level economic developments. Multinationals from corporate America used to play a dominant role in markets all over the world, and although they still do, large corporations in China and Russia are quickly starting to catch up in size, profitability and operational efficiency. Of particular interest is the development of private companies in China and Russia, as both economies continue to transition from previously planned economies to fully market oriented economies.

This report looks at the development of large corporations in China and Russia, especially private companies. We are interested in the role and the extent of the private sector in wealth creation and economic development, as well as the performance of the private sector in comparison with the state sector.

OVERVIEW OF CORPORATE CHINA AND CORPORATE RUSSIA

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Corporate China and corporate Russia are still relatively small compared with corporate America. They are largely constrained by the size of their respective economies. Although the Chinese and Russian economies have been growing rapidly in recent years, the US remains the world's largest economy, still requiring at least 30 more years for China to catch up. 2009 GDP in the US was $14.26 trillion. This is nearly three times the size of China's economy with a GDP just short of $5 trillion, and more than ten times the size of Russia, which has a GDP of $1.23 trillion. US dominance has been eroded in recent years by the enlargement of the European Union common market, which has an equivalent GDP of over $16 trillion, and by the rapid growth of the BRIC economies.

Although the Chinese and Russian economies have been growing rapidly in recent years, the US remains the world's largest economy

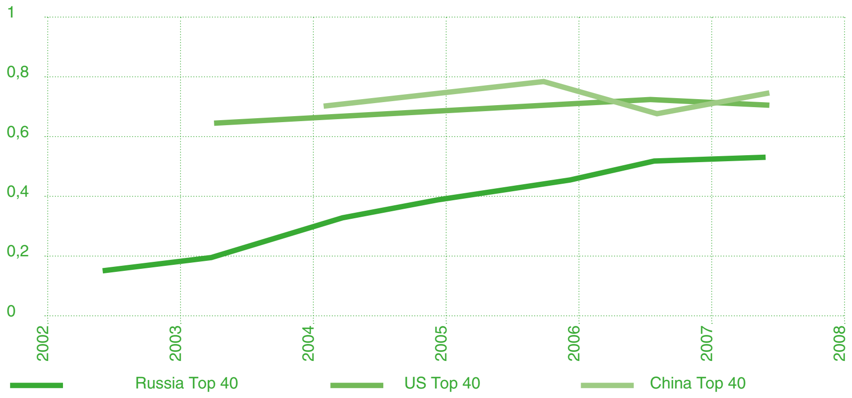
Let's first take a look at the size of the corporate sectors in China, Russia and the US in comparison to the overall economy as shown in the following figure. Our data comes from several sources. For American companies, we take the top 400 from the Fortune 500 list before 2003 and Global 2000 list after 2003. Data for China comes from the top 500 company list published by China Enterprise Association. For Russia we use data from Expert RA Rating Agency regarding the top 400 Russian companies, whose information is taken from a Federal service of the financial markets, Federal State Statistics Service and the Federal tax service, submitted in SPARK-Interfax.

Combined revenues of the largest 400 companies in China account for 70%-80% of the country's GDP between 2004 and 2008, with its peak occurring in 2006. But 2007 saw a noticeable drop just below 70%, followed by an immediate come-back in 2008. Some of the companies in the 400 list have gone global such as Huawei and Lenovo as the vanguards of a new breed of multinational corporations from China. Some are entrenched large state-owned enterprises active in domestic markets such as China Mobile and Sinopec. Others are private companies that are relatively obscure to the western world. By private companies, we mean those defined as opposed to the notion of state-owned enterprises. In our case, the equity structure of these companies is such that management decisions are not determined or heavily influenced by the state.[1]

Exhibiting a similar trend, Russia shows a consistent pattern of its top 400 companies taking an increasing share of GDP. While China and the US have a

[1] It should also be clearly stated that our notion of private companies is different from what is widely understood in the western world as those companies in the private sector that are not publicly listed on stock exchanges.

FIGURE 1/ Top companies aggregate sales as percentage of GDP

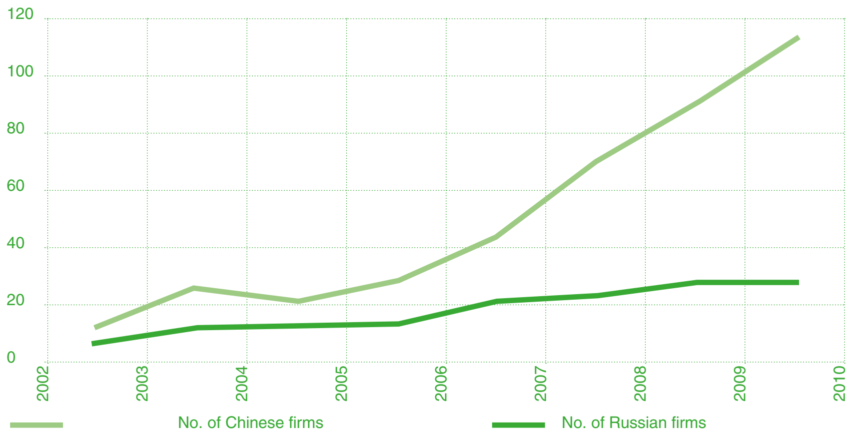


Data Source: SIEMS Calculations

comparable share of its top 400 companies aggregating to about 70% of GDP, Russia's top 400 companies jointly take 55% of GDP. All these trends seem to confirm the hypothesis that wealth creation of nations is indeed achieved mostly by corporate giants. Moreover, there seems to be a trend of convergence towards the total revenues of 400 companies settling somewhere between 70% and 80% of the nation's GDP.

Another measure of the increasing role of corporate China and Russia in economic development is the number of companies making into the Fortune Global 2000 list. The figure below shows the number of Chinese and Russian companies in the Fortune Global 2000 list from 2003 to 2010. Both countries display an upward trend of taking a larger share of the list.

FIGURE 2/ No. of Chinese and Russian companies in the Global 2000 list



Data source: SIEMS Calculations

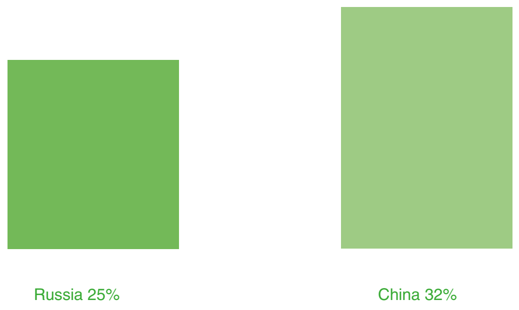
China has 113 companies on the list by 2010, while Russia has 28.

What is striking is the speed at which the number of Chinese companies has been making onto the list. Averaging about a 25% annual rate of increase, China shows by far the fastest rate of growth. At this rate, half of the Fortune Global 2000 list will be Chinese companies in 10 years.

> While China and the US have a comparable share of its top 400 companies aggregating to about 70% of GDP, Russia's top 400 companies jointly take 55% of GDP

One important attribute we examined was the number of companies in the 400 list that have international operations. By international operations, we mean companies having subsidiaries or holding stakes in companies that operate overseas, not just having exports of products or international trading activities. By this criterion, about one third of the largest 400 companies in China have international operations, while in Russia only a quarter of the 400 companies do.

FIGURE 3/ Percent of International Operations in Top 400 list for Russia and China



Data source: SIEMS Calculations

CHINA, RUSSIA, US TOP 400 COMPANIES

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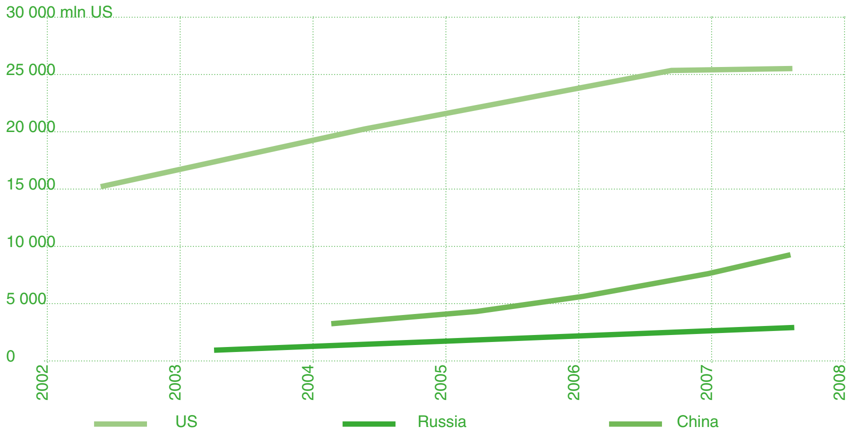
Here we provide a comparative analysis of the top 400 companies in the US, Russia and China at a firm level. First we look at the sheer size of the top companies in the three countries, as shown in the following figure. In terms of sales, American companies are still much larger than their Chinese and Russian counterparts. The average size of an American company in the top 400 list has sales revenues over $25 billion, about two and half times as much as the average size of Chinese companies in the top 400 list. Average size of Russian companies in the top 400 list is even smaller, less than half of the size of an average Chinese company on the list.

American companies are still much larger than their Chinese and Russian counterparts

FIGURE 4/ Large Companies Average Sales



Data source: SIEMS Calculations

Although Russian companies are still underdogs compared to corporate giants in the US and China, they are growing however, much faster, and much more profitably. The table below shows the growth rates and the profit margins averaged over the entire top 400 list from 2003 to 2008. On average Russian companies are growing very fast, four times as fast as American companies, and approximately 45% faster than Chinese companies. The profit margin also more than doubled that of American and Chinese companies.

One possible explanation of the excellent performance of Russian companies may be due to the increasing oil exports and high-flying

On average Russian companies are growing very fast, four times as fast as American companies, and approximately 45% faster than Chinese companies oil prices prior to the financial crisis, as the Russia's top 400 list is heavily weighed by companies in the energy sector. However, there are also Russian companies in other sectors that have been growing very fast and highly profitably.

Russian and Chinese companies also feel the pinch on the revenue side, while the impact on profitability is more severe in Russia than in China

Chinese companies, as expected, display the typical high-growth-low-margin phenomenon that has been well-known to the western world. The average growth rate is almost three times that of American companies, but the average profit margin is less than in the US. If not for the adverse impact of the 2008 financial crisis in the US, the profitability comparison would further favor American companies.

There have been several theories proposed by experts with respect to Chinese companies' low margin phenomenon. For example, Chinese companies, especially in manufacturing, have traditionally taken the middle role of the value chain that typically generates low margins. Chinese companies are also known to lack brand premium capability. On the positive side, it is argued that many Chinese companies have been expanding very fast by heavy capital outlays at aggressive depreciation schedules.

PROFIT MARGIN AND GROWTH RATE OF COMPANIES IN US, RUSSIA AND CHINA

	US		**Russia**		**China**	
Year	Profit Margin	Growth Rate	Profit Margin	Growth Rate	Profit Margin	Growth Rate
2003	5.21%	15.91%	8.90%	38.69%	3.52%	29.19%
2004	5.93%	10.39%	11.48%	50.70%	4.51%	30.61%
2005	6.48%	10.18%	11.55%	32.13%	4.46%	20.39%
2006	8.00%	8.98%	13.38%	28.00%	4.44%	23.67%
2007	6.56%	7.17%	11.28%	28.95%	5.21%	24.98%
2008	-2.04%	0.84%	6.41%	25.00%	4.63%	19.08%
Average	5.02%	8.91%	10.50%	35.76%	4.70%	24.65%

Source: SIEMS Calculations

The impact of the 2008 financial crisis is noticeable across all three groups, with the US being hit the hardest. Average profit margin for the first time in recent years is in negative territory, while growth is under 1%. Russian and Chinese companies also feel the pinch on the revenue side, while the impact on profitability is more severe in Russia than in China.

Aside from the hydrocarbon effect, the simple comparison above begs the question of why Russian companies have been doing much better than Chinese companies, as both emerging markets probably have the

similar competitive dynamic environment in many market sectors. Are Russian companies managed better, or is it because their competitive advantages may come from other factors related to market power, or government power in the case of state-owned enterprises?

Russian companies on average are more profitable than their Chinese counterparts.

We first rule out market power positions due to state ownership, as we will provide a detailed comparative analysis of the private sector between China and Russia. At an aggregate level, Russian private companies hold a much larger stake in the top 400 list in terms of the number of firms (314 out of 400) and the revenue percentage (59%). In the top 400 list in China on the other hand, only 72 out of 400 are private companies, and their revenue share stands at only 16%.

TOP 10 RUSSIAN AND CHINESE COMPANIES

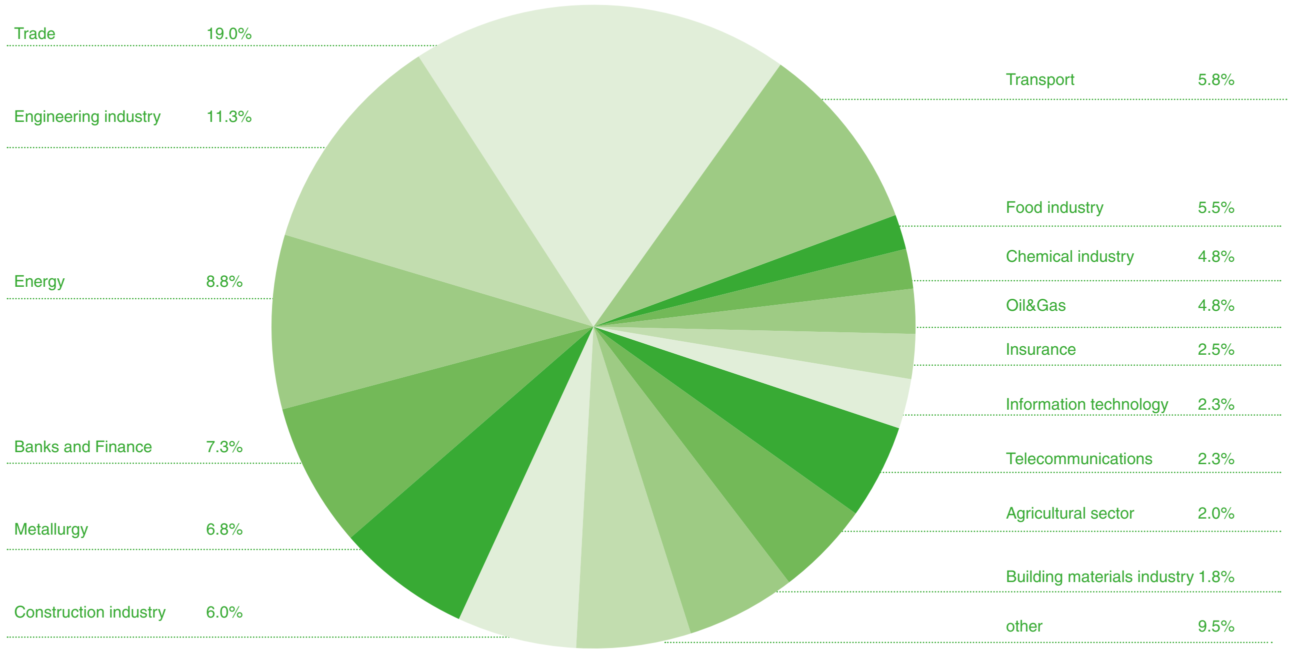
2008	**Company name**	**Sector**	**Sales (10000RMB)**	**Profit rate**
1	SINOPEC	Oil&Gas	122786322	2.58%
2	State Grid Corporation of China	Electric utility	101073254	3.33%
3	China National Petroleum Corporation	Oil&Gas	100067727	11.34%
4	ICBC	Banking	39003400	21.02%
5	China Mobile	Telecommunications	35790506	24.19%
6	China Life Insurance	Financial service	33040422	6.76%
7	China Construction Bank	Banking	31418300	22.01%
8	Bank of China	Banking	31004900	20.00%
9	Agricultural Bank of China	Banking	25905700	4.58%
10	China Southern Power Grid	Electric utility	25755016	4.61%
Average			54584554.7	12.04%
2009	**Company**	**Sector**	**2008 Sales (mln rouble)**	**Profit Rate**
1	Gazprom	Oil&Gas	3518960	29.32%
2	Lukoil	Oil&Gas	2146412.4	14.32%
3	RosNeft	Oil&Gas	1140203.9	28.60%
4	JSC Russian Railways	Transport	1101710.5	4.97%
5	TNK-BP Holding	Oil&Gas	763773.8	27.09%
6	Sberbank	Banking	696997	18.64%
7	Surgutneftegas	Oil&Gas	576571.6	33.94%
8	Severstal	Metallurgy	556682.9	11.56%
9	Evraz Group S.A	Metallurgy	506646.8	15.42%
10	Tatneft	Oil&Gas	444332	4.09%
Average			1145229.09	18.79%

Source: SIEMS Calculations

Although the question of managerial strategies partly explaining the differences in operations results between China and Russia is an intriguing one, and certainly waits to be further researched in the future, we hypothesize one possibility is the relatively higher market power by these large Russian companies in their respective markets. For example, the Russian top 400 list is populated by companies in oil and gas, metallurgical, and wholesale and retail industries, where higher market concentration is often observed. Revenues of the largest ten companies in Russia account for an astounding 40% of the revenues of all the companies combined in the top 400 list, while the largest companies in China account for only 25% of the total revenues in the 400 list. The top 10 list in Russia is, as expected, dominated by those companies in the lucrative oil and gas business, while the same list in China is a more balanced blend of companies in banking, electricity and telecommunication businesses besides oil and gas. The average profit level also exhibits a noticeable difference between the two groups as shown below. Russian companies on average are more profitable than their Chinese counterparts.

The difference in sector distribution is not just limited to the top 10 largest companies. It extends to the entire list of 400 companies in China

FIGURE 5: Sector Distribution in Russia



Source: SIEMS Calculations

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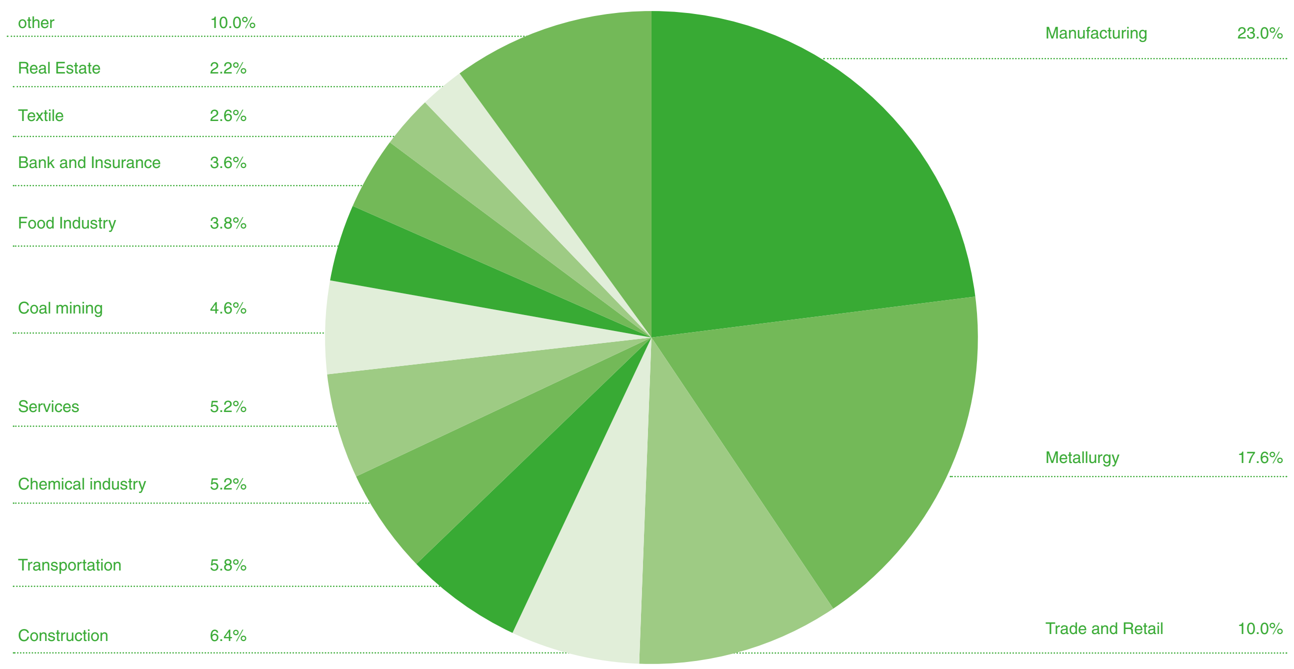
and Russia. The following two figures show the sector distribution of those companies respectively in the two countries. The top four sectors, trade and retail, engineering, energy, banks and finance account for nearly 50% of all companies in the 400 list in Russia. In China, manufacturing, metallurgy, trade and retail account for about 50% of all 400 companies in the list. This after all reflects the difference in compositions of the two countries' economy, where China is the world's manufacturing factory while Russia depends heavily on oil and gas exports revenues.

FIGURE 6: Sector Distribution in China



Source: SIEMS Calculations

COMPARISON OF CHINESE AND RUSSIAN PRIVATE COMPANIES

In the rest of the paper, we will focus on private companies. By private companies, we mean the majority equity share of the company is owned by individuals and parties other than the state, and corporate decision making is not controlled by the state. Note that our notion of private companies is defined as opposed to the notion of state-owned enterprises, and is different from what is widely understood in the western world as those companies in the private sector that are not publicly listed on stock exchanges. How Chinese private companies compare to SOEs vis- -vis their Russian counterparts is the central issue we will address in this section.

How the private sector came into being differs markedly in China and Russia, although they started more or less at the same time in the late 1980s and 1990s. The private sector in Russia is largely the result of a quick dismantling of the Soviet planned economy and a massive privatization program of state assets. In some cases, the government auctioned off packages of stock shares in state enterprises as collateral for bank loans. Later the government let these loans be converted to equity stakes. As a result, some of the largest private companies in Russia are deeply connected to banks and financial institutions.

> Some of the largest private companies in Russia are deeply connected to banks and financial institutions

Private companies in China however, face an adverse environment from the very beginning. In the early days in the late 1980s, the government opened up several what are called nonstrategic industry sectors for private companies to enter, which were typically less profitable and overly competitive. Therefore those private companies in China that have survived fierce competition and rose to prominence over the years typically have strong company leadership and management style.

We first provide an overall view of the largest 400 private companies in China, and particularly as a percentage of the GDP as shown in the following table. The data is from our research project on private companies in China, where we use a business census data in the manufacturing sector from China's National Statistics Bureau from 1998 to 2008. This table indicates an overall upward trend of the role private companies in China play, from only 2.98% in 1998 to the height of 12.96% in 2007. In 2008, the trend seems to begin to reverse with the largest 400 private companies holding 10.48% of the GDP. The phenomenon is sometimes referred to as "State-Progress-Private-Regress," which we will discuss in more detail in the next section.

Private companies in Russia hold a significantly larger share of the nation's GDP, as the country is more privatized than China, as the following

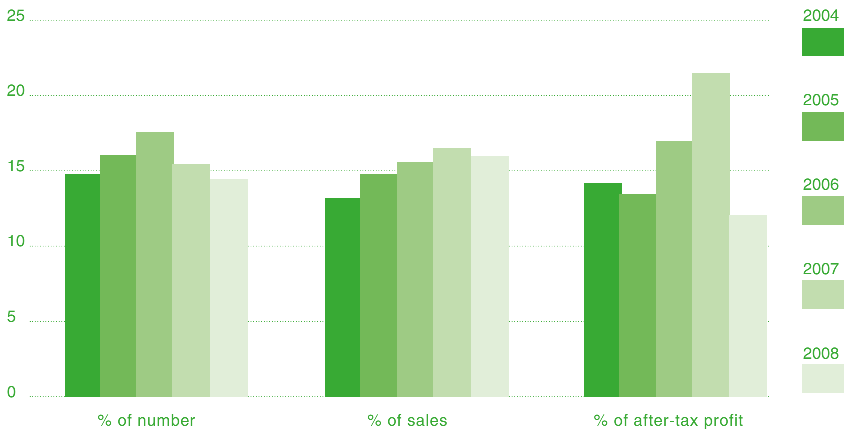
Russian table shows. Given that our data of 400 largest Russian companies shows 80% of the list consists of private companies, we pick the top 300 companies as a base for comparison. Even with 100 companies less, Russian private companies still holds a much larger share of the nation's GDP – about 40% overall. Also barring 2008, which is a year heavily affected by the worldwide financial crisis, Russian private companies generally enjoy higher profit levels than Chinese private companies.

LARGEST 400 PRIVATE COMPANIES IN CHINA (UNIT: THOUSAND RMB)					
year	average size	largest rev	smallest rev	profit level	% of GDP
1998	627843	6310832	221451	6.77%	2.98%
1999	695232	8209528	246878	7.02%	3.10%
2000	1126649	15222459	519148	7.44%	4.54%
2001	1409491	16228951	602956	6.92%	5.14%
2002	1706539	17214203	751630	7.05%	6.67%
2003	2503556	21317203	1107030	7.06%	8.32%
2004	3495898	32256392	1480542	6.02%	10.30%
2005	4579726	49547106	1939970	5.18%	11.46%
2006	5559876	65880528	2373801	5.82%	12.14%
2007	6867735	93013876	2875499	6.22%	12.96%
2008	7875471	122930693	3196168	5.77%	10.48%
Source: SIEMS Calculations					

LARGEST 300 PRIVATE COMPANIES IN RUSSIA (UNIT: MILLION RUBLE)					
year	average size	largest rev	smallest rev	profit level	% of GDP
2003	14134.9	593698.1	2783.2	6.53%	32.12%
2004	22034.9	830304.2	4169.6	8.42%	39.40%
2005	29094.9	1309374	5346.8	8.26%	40.36%
2006	35683.2	1482915	6887.3	9.90%	39.79%
2007	44289.2	1719104	9444.8	8.00%	40.13%
2008	55066.1	2146412	11330.1	4.18%	39.65%
Source: SIEMS Calculations					

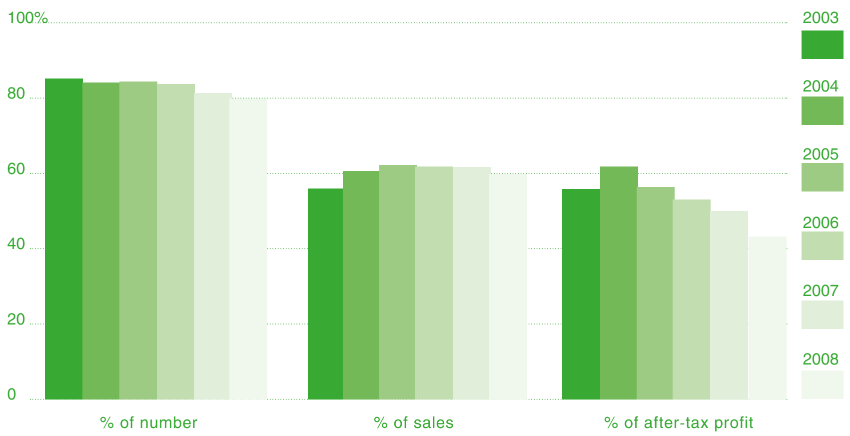
Next, we look at how private companies compare to the overall top 400 list in China and Russia. The two tables below show the percentage numbers in terms of the number of private companies, their sales revenues and their profits in the top list. Here is where Russian private companies shine overwhelmingly over the Chinese. About 80% of the companies making into the top list are private companies in Russia, while only 18% are private companies in China. On the revenue side, Russian private companies hold 59%, while Chinese private companies hold only 16%. And profit wise, the contrast is as stark.

FIGURE 7: Proportion of private companies in China's top 400



Source: SIEMS Calculations

FIGURE 8: Proportion of private companies in Russia's top 400



Source: SIEMS Calculations

The comparison above confirms the conventional wisdom that the private sector in Russia plays a more prominent role than in China. Both countries seem to see a slight erosion of the private sector in recent years.

However Chinese private companies tend to outperform SOEs by a large margin compared to their Russian counterparts. The table below shows the revenue growth rates for four groups of companies. The comparison between private companies and SOEs in China shows a clear pattern – private companies growing much faster than SOEs, except in 2008. In Russia, both groups tend to grow more or less at comparable average rates in recent years, although private companies still did better than non-private companies, especially in 2003 and 2004. And overall Russian companies grow much faster than Chinese companies.

The higher growth rate of Russian companies compared to Chinese companies brings about an important question – is such high growth due to overall sector growth and true productivity gain, or simply market consolidation at the cost of other smaller competitors? After all, macro economic data at the national level seems to suggest that China's higher growth rates overall should percolate down to various industry sectors, and large companies should be the first to benefit from overall increasing economic activities. But our analysis suggests that although Chinese companies' revenue growth rate is still impressive, it lags significantly behind Russian companies.

2008 is an interesting year in that all companies, both in Russia and China, see a noticeable setback as a result of the worldwide financial crisis. But the impact seems to be more severe on the private sector in China, as the top 400 private sector saw its average growth rate cut in half. Although Russia also saw a noticeable drop in its corporate growth rate, the impact is spread more evenly among private and SOEs.

REVENUE GROWTH COMPARISON IN CHINA AND RUSSIA

	2003	2004	2005	2006	2007	2008
Private companies in the Russian Top 400 list	41.6%	55.0%	37.2%	34.5%	40.0%	27.3%
Non-private companies in the Russian Top 400 list	23.2%	25.0%	39.4%	30.6%	33.0%	21.6%
Top 400 private Chinese companies	52.7%	42.9%	35.3%	29.8%	31.6%	15.7%
Non-private companies in the Chinese Top 400 list	29.2%	30.6%	20.4%	23.7%	22.4%	19.1%

Source: SIEMS Calculations

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CHINA'S RECENT TREND OF "STATE-PROGRESS-PRIVATE-REGRESS" PHENOMENON

Unlike Russia, the privatization and marketization of the national economy in China took place in a phased evolutionary manner. Since the early 1990s, private companies started to emerge all over the country, and a large number of previous state-owned enterprises turned private via MBO or other means, particularly in what are called non-strategic industries from the government's point of view. For example, the consumer electronics industry and highway-freight industry are dominated by private companies.

However, starting from early 2009, somewhat as a byproduct of the repercussions of the financial crisis in China, some economic observers have pointed out the "State-Progress-Private-Regress" (SPPR) phenomenon. In a narrow sense, SPPR refers to market share expansion of the state-owned economy in certain industries, and the market share shrinkage, or even entire elimination of private enterprises in certain industry sectors. In a broader sense, it is also manifested in the strengthening of government economic intervention in the private sector, also termed as " macro-control" in China.

Starting from early 2009, somewhat as a byproduct of the repercussions of the financial crisis in China, some economic observers have pointed out the "state-progress-private-regress" (sppr) phenomenon

According to official 2002 statistics from the Statistics Bureau, China's state-owned industrial output accounted for 40% of total GDP. But it dropped to 29.5% in 2007, down by nearly 10%, indicating that the overall economic development is still in a "State Regress, Private Progress" trend. But three sectors: oil and gas industry, tobacco industry and non-ferrous metal smelting and rolling processing industry, remained firmly in the hands of the state. Since the 2008 financial crisis however, the trend started to reverse, and we are starting to see "State Progress, Private Regress" taking media headlines. This phenomenon may be attributed to several reasons. First, as various industry sectors continue to consolidate to higher market concentrations, particularly after the financial crisis, state-owned enterprises' dominant position in key strategic industries gets further strengthened. Some of these companies, such as in banking and tobacco sectors, are extremely lucrative oligopolies. The second reason is that these mega state-owned enterprises are the primary beneficiaries of the Ten-industry Revitalization Plan and the 4-trillion Yuan stimulus package announced last year. State-owned enterprises have received almost all the important government procurement orders. The banking system in China also treats more favorably those state-owned enterprises when it comes to access to loans and in-

State-owned enterprises have received almost all the important government procurement orders vestment funding requests. All of these factors combined, contributed to the "State Progress, Private Regress" phenomenon.

The easy money available to SOEs has resulted in yet another unexpected twist in that those companies need to branch into opportunities in other fields, as their core businesses get mature with limited growth potentials. Real estate easily becomes the prime target. As land auctions are increasingly patronized by a large number of central government owned SOEs – a phenomenon called "Real Estate King," land price starts to skyrocket, leading to higher condo prices and contributing to real estate bubbles.

The defining characteristics of the recent SPPR trend may be summarized in three aspects: the state's monopolization of industries directly related to natural resources and basic infrastructures, the clear demarcation of the state and the private sectors, and the "glass ceiling" phenomenon.

In 2009, China's state-owned capital made small steps in many economic sectors, but certainly one giant leap in the natural resource and energy related fields. Iron and steel, coal mining, and airline industries are areas where the private sector suffered most. Shanxi province is currently in the process of nationalizing the entire private coal mine industry under the pretext of improving mining safety amid a barrage of coal mine accidents in recent years. In Shandong, the provincial government set out the goal that within two years all private steel mills in the province need to be consolidated under Shandong Steel, which is the flag-ship iron and steel SOE in Shandong province. Rizhao Steel, which is comparable to Shandong Iron and Steel in size but runs much more efficiently and profitably, became its latest subsidiary. In airline industry, most private airline companies have either become bankrupt or seen capital infusion from SOEs. For example, the private United Eagle Airlines is now partly owned by the state-owned Sichuan Airlines.

China's industrial sectors are clearly demarcated, with the state-owned enterprises clustering in a small number of upstream industries and gradually evolving into comfortable oligopolies

SPPR does not occur in all industries - for example, after 2001, state capital largely stayed out of the food and beverages, textiles and apparels, and household appliances industries. Today, China's industrial sectors are clearly demarcated, with the state-owned enterprises clustering in a small number of upstream industries and gradually evolving into comfortable oligopolies. The number of active players is gradually reduced due to consolidation and market exit of failing firms, but the survivors' profitability increases rapidly. In some cases, the formation of such high market powers is not so much achieved via market competition and product innovation, but through favorable policy treatment, state financial aid and other government micro-intervention forces. Private capital on the other hand, is mostly limited to downstream industries. When they started to expand upstream, they often run into all kinds of obstacles.

The common phrase of "glass ceiling" to describe women's difficulties in career advancement in corporate America is borrowed in Chinese press to describe the difficulties of private companies to break into the lucrative SOE strongholds. It refers particularly to the phenomenon that although there are no announced market entry restrictions in certain industries and sectors, the actual access is de facto limited by having to meet too many and too difficult ad hoc conditions and requirements. By setting too high a threshold for access eligibility, the nominal free market entry policy is rendered an effective "glass ceiling" – one can see through, but can never get through.

Examples abound of such phenomenon. For example, the "new 36" policy, which has been announced for some time, clearly states to encourage private capital into basic infrastructure industries, including traffic transportation, water conservancy, electricity grid and generation, oil and gas, telecommunications, and etc. However, these infrastructure fields, including electricity grid and generation, telecommunications, and TV broadcasting remain to be the bastion of the state-owned economy, having seen hardly any private entrant so far. As another example, the "new 36" policy also allows private capital into the financial sector, yet so far China is still to see the emergence of banks and financial institutions financed by private capital.

To a lesser degree, the SPPR phenomenon is also happening in Russia. In the last few years, the weight of state-owned firms in the Russian economy has expanded dramatically, leading some observers to speak of a reversal of market reforms. According to Alfa-bank, in the middle of 2003 the Russian state owned stock worth about 20 percent of the capitalization of Russia's stock market. By early 2007 the state's share had risen to 35 percent. Much of the growth represented a buying spree by SOEs, especially oil company Rosneft and the natural gas company Gazprom. Among the largest acquisitions were major assets confiscated from the private oil company Yukos in lieu of tax debts, purchased by Rosneft, which thus became the country's largest producer of crude oil. Gazprom, for its part, purchased the private oil company Sibneft for $13 billion in 2005. In 2006 it agreed to spend over $7 billion buying a share of the Sakhalin II oil project from Royal Dutch Shell. In the banking sector Vneshtorgbank has acquired private rivals. Defense firms in aviation and

In the last few years, the weight of state-owned firms in the Russian economy has expanded dramatically

shipbuilding are consolidating into large new conglomerates under state ownership. The state's arms-export firm Rosoboroneksport has taken control of assets in metallurgy and auto manufacturing.

Classic laissez faire economics predicts harm to a market economy of the SPPR phenomenon. Some economists have already pointed out the long term adverse impact of rolling back private enterprises, leading to less market efficiency and deterioration of China's overall corporate competitiveness. In Russia, such concerns may be overstated. Neither the behavior of Russian SOEs, nor the environment in which they operate, recalls the pre-reform era. Indeed, it is doubtful that both governments in China and Russia have a deliberate long-term policy of reversing back the economy to pre-reform era. Much of the SOEs' expansion may just reflect the commercial, profit-driven ambitions of their leaders rather than a coherent government policy rationale. Nevertheless, governments in both countries should still be mindful that the SPPR trend will bring detrimental effect to the long-term competitiveness of their corporate giants and the microeconomic efficiency of SOEs does not threaten its other economic priorities.

RESEARCH AUGUST, 2010

CONCLUSIONS

SKOLKOVO
Moscow School of Management
RESEARCH AUGUST, 2010

This report provides a comparative analysis of top companies in China, Russia and the US. Of particular interest is the status of the private sector in China and Russia. Using several datasets, we are able to draw some interesting conclusions.

Our analysis confirms the hypothesis that economic development and wealth creation are, by and large, centered around large corporations across China, Russia and the US. Total sales of the largest 400 companies combined converge to a bit over 70% of the GDP in both China and the US. In Russia, revenues of the top 400 companies currently account for about 55% of the GDP, and the trend seems to indicate these large companies' contribution to the GDP will continue to rise towards convergence to the American and Chinese level.

The pattern of corporate giants holding a large share of the GDP has a long history that can be traced back to the 1900s in Great Britain and later in the US. Contrary to populace belief that small and medium businesses are the engine of economic growth, our analysis indicates that bulk of the economic activities is accounted for by a few hundred largest corporate giants regardless of developed or emerging economies. And, as such, the nature of a country's growth pattern is also decidedly defined by these top companies. This brings about several important implications as far as long-term sustainable economic growth is concerned for China and Russia.

The nature of a country's growth pattern is also decidedly defined by these top companies

The top 400 list in China seems to be dominated by two sets of companies. On the one side, there are those SOE giants in resource-based industries or government strategic industries such as public utilities, telecommunications, banking and financial institutions. The market structure of many of these companies is comfortable oligopolies where competitive pressure is less and profitability prospects are good. The question for these companies is whether SOEs operating in such a comfortable environment will provide operations efficiency in the long run. Already we are seeing SOEs showing consistently lower growth rates than private companies in China. On the other side, there are many manufacturing companies in industries characterized by global competition, fast changing technologies, and meager industry wise profit margins. The question for these companies is whether the model of low-cost manufacturing factory of the world will survive the factor-price equalization prediction and still be sustainable over the long run. More importantly, Chinese manufacturing companies have been known for lack of R&D investment and innovation drives. Many corporate executives in China are recognizant of this issue and the Chinese government is keen on encouraging and cultivating indigenous innovations, as witnessed for example, by the recent government procurement policy that is heavily tilted towards products containing elements of indigenous innovations.

Chinese manufacturing companies have been known for lack of R&D investment and innovation drives

The top 400 list in Russia brings about the issue of national economic health, as it indicates Russia's heavy dependence on oil and gas industries. Russian companies' higher profit margins may also be related to the high-flying oil prices before the financial crisis. In fact, macro data also confirms Russia's GDP fluctuates tightly with world oil prices. Will this energy-driven growth model be sustainable over the long run, particularly when the world seems to be increasingly moving towards a new alternative energy era? Our analysis suggests that maybe it is time that corporate giants in Russia start to diversify into other growth areas such as alternative energy and high tech industries.

At a firm level, Chinese and Russian companies are still small by American standard. But we are starting to see more Chinese and Russian companies making the Fortune Global 2000 list. In 2010, there were 113 Chinese companies on the list, while Russia had 28. At the current rate at which Chinese companies have been making into the list, we are projecting half of the Fortune Global 2000 list will be Chinese companies in 10 years. Already one third of the 400 largest companies in China have international operations.

Russian companies are still underdogs compared to corporate giants in the US and China. However our analysis shows that they are growing much faster, and much more profitably. This phenomenon debunks the myth that there is little or no profit in emerging markets. While it is true that Chinese companies display the typical high-growth-low-margin pattern, the Russian companies in our study consistently show average profit margins of over 10% in recent years barring 2008 due to the worldwide financial crisis. Is Russia's high profitability due to its competitiveness and productivity improvement, or simply the hydrocarbon effect? We hypothesize it may be more related to market power positions and high market concentration ratios. However, we would not rule out the possibility that there indeed exist unique Russian strategic management styles and practices accounting for these companies' success.

Our analysis also confirms the conventional wisdom that the private sector in Russia plays a more prominent role than in China, as many as 80% of the top 400 list are private companies, while only 18% of the top 400 list in China are private companies. While Chinese private companies tend to outperform SOEs by a large margin, there is relative less noticeable difference in the growth rate between private companies and SOEs in Russia. The structural differences in profitability between private companies and SOEs in China begs the question whether such differences are due to industry or sector specific contextual characteristics or due to differences in managerial and operational models inherent in the ownership structure. The Russia experience however seems to indicate the former effect is fairly limited.

The private sector in Russia plays a more prominent role than in China

Our analysis points to another important issue – both China and Russia seem to see a slight erosion of the private sector in recent years. China is now witnessing the unfolding of what is called "State-Progress-Private-Regress" (SPPR) phenomenon, as many private companies are being nationalized or consolidated under the SOEs, especially in coal mining, iron and steel, and aviation industries. A similar pattern is also unfolding in Russia.

The SPPR phenomenon cures many of the short-term pains of the economy, but whether it will pose a long-term detrimental effect on the competitiveness of the Chinese economy as well as corporate China still remains to be seen. There is no doubt that the private sector in China has been booming since the economy started to move towards a market-oriented direction since the 1990s. However it is also true that some of the best SOEs in China have been growing larger and stronger. The model of paralleled growth of the private and state sector seems to have been working fine for the last thirty years in China. Now the question is if the country will sustain such a distinctively different growth model from the Russians in the next twenty years, where the private sector plays a dominant role after a massive privatization effort.

The model of paralleled growth of the private and state sector seems to have been working fine for the last thirty years in China

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