

# DEVELOPMENT STRATEGY

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## The influence of ferrous metallurgy corporations' interests on the regional development\*

*In the Russian scientific literature there are many papers published in which special attention is paid to the discrepancy between the economic interests of the metallurgical companies owners and enterprises controlled by them, and the tasks of national development and addressing the problems of social and economic growth in the regions and cities where the facilities of ferrous metallurgy industry operate. However, the global crisis that broke out in the second half of 2008 has brought the new plots in this respect.*

*In this article, the crisis period is seen as the time of the most vivid manifestation of the business owners' interests in the case of metallurgical holding "Severstal". Particular attention is paid to the influence of these interests on the socio-economic development of the Vologda oblast – a region where the powers of the parent company of the holding OJSC "Cherepovets metallurgical plant" OJSC "Severstal", one of the leaders of the domestic ferrous industry are located.*

*To identify common trends of metallurgical companies' influence on the regional economy, in the study there were used the comparative data on the Sverdlovsk, Chelyabinsk, Belgorod, Lipetsk, and Kemerovo oblasts, where ferrous metallurgy manufactures play a crucial role in shaping the outcomes of the regional economy.*

*We should also note that the statements reflecting the key indicators of financial activities of OJSC "Severstal" are presented in two versions on the official site of the company: according to Russian Accounting Standards (RAS) and in accordance with International Financial Reporting Standards (IFRS).*

*In the present paper we mainly used in statements prepared in accordance with international standards and presented in open electronic and other information resources.*

*Ferrous metallurgy corporations in Russia, owners' interests, social and economic development of the regions.*

### **1. The role of metallurgical corporations in shaping the performance of the Russian economy in crisis**

Ferrous metallurgy complex is a leader in the industry of modern Russia. It generates about 10% of Russian export resources. The most important feature of the complex is a high concentration of production in the form of holding companies and business groups.

Nearly two-thirds of the iron, steel and rolled steel produced in the country account for 8 major metallurgical works, which are parent companies of corporations and are able to conduct an independent structural and technological, economic and financial policies, including the world market, which received more than half of the rolled metal produced in the country in the pre-crisis period.

\* The article presents the results of research carried out in ISEDT RAS under the supervision of Doctor of Economics, Prof. V.A. Ilyin. The research involved Doctor of Economics T.V. Uskova, Ph.D. in Economics M.F. Sychev and researcher A.I. Povarova.

Table 1. Tax revenues received from the metallurgical industry in 2007 – 2009\*

Regions	2007		2008		2009		
	mill. rub.	share in the total amount of taxes,%	mill. rub.	share in the total amount of taxes,%	mill. rub.	share in the total amount of taxes,%	% to 2008
Belgorod Oblast	2835.1	16.2	3899.1	20.2	680.4	10.5	17.5
Lipetsk Oblast	12244.6	74.5	15799.1	81.4	1310.1	34.9	8.3
<b>Vologda Oblast</b>	<b>14710.9</b>	<b>74.5</b>	<b>14833.6</b>	<b>58.4</b>	<b>1963.9</b>	<b>25.0</b>	<b>13.2</b>
Sverdlovsk Oblast	23362.2	49.0	17808.1	41.7	5541.9	26.3	31.1
Chelyabinsk Oblast	19944.3	63.7	14305.2	53.1	1816.1	22.4	12.7
Kemerovo Oblast	8083.1	36.0	9286.5	26.3	550.6	4.6	5.9
RF (bill. rub.)	180.7	11.0	132.0	7.5	49.6	4.1	37.6

\* Income tax and tax on personal income.  
Sources: data of the Federal State Statistics Service, calculations of ISED T RAS.

Metallurgical complex is also one of the main budget sectors in the country. Before the crisis, metallurgy formed 8-11% of tax revenues of the consolidated budget of Russia. In several regions metallurgical production plays a dominant role in raising revenues of their regional budgets (*tab. 1*).

In 2007 – 2008 metallurgy accounted for 80% of tax revenues in the Lipetsk Oblast, 60-75% in the Vologda Oblast, more than half in the Chelyabinsk Oblast and 42-50% in the Sverdlovsk Oblast. In Belgorod and Kemerovo Oblasts metallurgical production is the second source of tax revenue after the industry of “Mining operations”.

The main component of tax revenues from the metallurgical industry is an income tax related to the most volatile source of income of any territorial budget. The worsening economic situation caused by the manifestations of the global financial crisis in late 2008 and in 2009 led to a dramatic reduction of income tax at all centers of metallurgical industry of the country (*tab. 2*).

Already in 2008 the profit of metallurgical enterprises (before taxation) in the whole of Russia decreased by 55%. The sharpest decline in profits – nearly 4 times – occurred at the enterprises of the Chelyabinsk Oblast. However, due to significant amount of profit for 9 months of 2008, a significant reduction in income tax was not observed.

Thus, in the Vologda Oblast it was managed to maintain a positive trend of income tax growth rate, in Sverdlovsk and Chelyabinsk Oblasts, the growth rate reduced by 21.5% and 15% respectively.

In 2009, the situation with tax payments from the metallurgical industry has deteriorated. According to the results of the year, the enterprises of the Sverdlovsk and Kemerovo Oblasts incurred a loss.

In other regions, except in the Chelyabinsk Oblast, there was a sharp decline in profits: in the Vologda Oblast by 91% compared to 2008, in the Belgorod and Lipetsk Oblasts – by 70-80%. In 2009, the Belgorod, Chelyabinsk and Kemerovo Oblasts failed to supply income tax from metallurgical companies neither in the territorial nor in the federal budget. Throughout the country, income tax from metallurgical production amounted to 7% from 2008 level, in the Vologda Oblast – 3.7%, the Sverdlovsk Oblast – 7% and the Lipetsk Oblast – 11%.

One of the most important factors of such a significant change in the income tax mobilization has been a significant deterioration in the financial position of steel companies.

Before the crisis, the profitability of sales in the steel industry reached very high quantities by world standards (more than 30% in the Russian Federation, 36% in the Vologda Oblast, 44-60% in the Lipetsk Oblast).

Table 2. Profit before taxation and profit tax, received by the consolidated budgets of the RF subjects from metallurgical industry

Oblast	2007		2008		2009		2010	
	mill. rub.	% to 2006	mill. rub.	% to 2007	mill. rub.	% to 2008	mill. rub.	% to 2008
<i>Profit (+), loss (-) before taxation *</i>								
Belgorod	11303.3	150.3	15337.2	135.7	3188.5	20.8	10156.3	66.2
Lipetsk	53492.8	78.8	90060.1	168.4	24877.2	27.6	39101.1	43.4
<b>Vologda</b>	<b>59814.2</b>	<b>120.6</b>	<b>55872.4</b>	<b>93.4</b>	<b>5184.4</b>	<b>9.3</b>	<b>22348.0</b>	<b>40.0</b>
Sverdlovsk	93258.3	109.4	67535.8	72.4	-7737.9		51385.0	76.1
Chelyabinsk	98073.6	145.4	26767.2	27.3	31332.6	117.1	46444.9	173.5
Kemerovo	31279.1	130.0	41669.3	133.3	-2329.5		11635.7	27.9
RF (bill. rub.)	726.3	128.3	323.6	44.6	208.5	64.4	469.0	144.9
<i>Income tax **</i>								
Belgorod	1992.4	140.9	4380.0	219.8	0		683.8	15.6
Lipetsk	9077.4	76.0	12077.6	133.0	1313.1	10.8	4530.7	37.5
<b>Vologda</b>	<b>10289.6</b>	<b>126.8</b>	<b>11676.0</b>	<b>113.5</b>	<b>433.6</b>	<b>3.7</b>	<b>4510.4</b>	<b>38.6</b>
Sverdlovsk	6967.0	93.3	5470.0	78.5	382.4	7.0	5551.9	101.5
Chelyabinsk	15452.7	122.0	13163.1	85.2	0		3231.1	24.5
Kemerovo	5857.0	109.0	8605.0	146.9	0		1435.8	16.7
RF (bill. rub.)	134.3	132.3	125.0	93.1	8.5	6.8	71.6	57.3
* Data of the Federal State Statistics Service.								
** Data of RF FTSO and its territorial bodies.								

With the onset of the crisis the profit margin fell for the whole industry by 14%. At the same time the most profound decrease was noted in the Kemerovo (2.2%) and the Sverdlovsk (9.6%) Oblasts. In the Vologda Oblast, the figure was higher compared with other regions and the Russian average (*tab. 3*).

Table 3. The level of profitability of goods sold, metallurgical production in 2006 – 2009, %

Regions	2006	2007	2008	2009
Belgorod Oblast	22.8	28.6	39.3	13.2
Lipetsk Oblast	60.7	43.8	50.4	14.4
<b>Vologda Oblast</b>	<b>38.1</b>	<b>34.6</b>	<b>37.3</b>	<b>19</b>
Sverdlovsk Oblast	28.3	27.2	21	9.6
Chelyabinsk Oblast	26.3	23.9	20.5	13.4
Kemerovo Oblast	22.2	26.6	26.2	2.2
RF	32.3	31.7	24	14
Source: data of the Federal State Statistics Service.				

Favorable conditions in domestic and international markets contributed to the capacity of net profit of steel companies, most of which was used by them to pay dividends. According to the Federal State Statistics

Service in 2007 – 2009 more than 33% of net profit was referred to the whole of the country's steel industry for these purposes (*tab. 4*).

In terms of “regions of metallurgists” there is significant differentiation in the level of income spent on paying dividends. For example, if the metallurgical enterprises of the Chelyabinsk and Lipetsk Oblasts allocated at least one third of net profit for these purposes, the enterprises of the Kemerovo, Belgorod and Sverdlovsk Oblasts – 60%. In 2008 – 2009 the metallurgists of the Vologda Oblast sent more than half of the remaining income available for dividends to their shareholders.

A significant deterioration in the financial position of steel companies was due primarily to a drop in revenue and gross profit as a result of intense curtailing of production and reducing the number of employees (*tab. 5*).

So, as a result of personnel optimization measures, the average number of employees of the Vologda Oblast's metallurgical enterprises decreased by 5.1 thousand people or 20% by

Table 4. Cash resources to pay dividends in the steel production in 2007 – 2009

Regions	2007		2008		2009		Total of 2007 – 2009	
	Mill. rub.	% of net profit	Mill. rub.	% of net profit	Mill. rub.	% of net profit	Mill. rub.	% of net profit
Kemerovo Oblast	19804.6	63.4	23072.2	55.0	2712.8	313.0	45589.6	61.5
Belgorod Oblast	882.2	7.8	16598.7	104.1	937.9	29.2	18418.9	60.5
Sverdlovsk Oblast	28021.4	29.7	51623.4	66.6	35961.2	159.7	115606	59.5
<b>Vologda Oblast</b>	<b>19503.1</b>	<b>32.6</b>	<b>34813.2</b>	<b>58.6</b>	<b>12457.9</b>	<b>57.1</b>	<b>66774.2</b>	<b>47.3</b>
Chelyabinsk Oblast	17822.9	21.5	16452.1	41.3	10818.2	26.9	45093.2	27.7
Lipetsk Oblast	17427.5	32.6	24305.3	23.4	2575.8	6.9	44308.6	22.7
RF	146952	22.9	240674	41.5	123871	59.4	511497	33.6

Source: data of the Federal State Statistics Service, calculations of ISED T RAS.

Table 5. The dynamics of performance indicators of metallurgical production enterprises in 2007 – 2009

Regions	Production, bill. rub.			The number of employed, pers.			Output, thousand rub./pers.		
	2007	2008	2009	2007	2008	2009	2007	2008	2009
Belgorod Oblast	68.6	104.8	67.3	11336	11466	10967	6050.1	9141.4	6134.5
<i>to the previous year, %</i>	<i>133.7</i>	<i>152.8</i>	<i>64.2</i>	<i>97.3</i>	<i>101.1</i>	<i>95.6</i>	<i>137.5</i>	<i>151.1</i>	<i>67.1</i>
Lipetsk Oblast	161.1	208.4	133.4	37286	37127	34436	4322.9	5611.9	3873.6
<i>to the previous year, %</i>	<i>111.3</i>	<i>129.3</i>	<i>64.0</i>	<i>97.5</i>	<i>99.5</i>	<i>92.7</i>	<i>114.1</i>	<i>129.8</i>	<i>69.0</i>
<b>Vologda Oblast</b>	<b>204.2</b>	<b>247.0</b>	<b>140.7</b>	<b>29082</b>	<b>27101</b>	<b>21989</b>	<b>7020.5</b>	<b>9114.4</b>	<b>6401.4</b>
<i>to the previous year, %</i>	<i>120.6</i>	<i>121.0</i>	<i>57.0</i>	<i>90.4</i>	<i>93.2</i>	<i>81.1</i>	<i>133.3</i>	<i>129.8</i>	<i>70.2</i>
Sverdlovsk Oblast	468.6	498.6	361.4	129811	115214	99240	3610.1	4324.9	3641.5
<i>to the previous year, %</i>	<i>122.0</i>	<i>106.3</i>	<i>72.5</i>	<i>94.6</i>	<i>88.8</i>	<i>86.1</i>	<i>129.0</i>	<i>119.8</i>	<i>84.2</i>
Chelyabinsk Oblast	416.0	472.6	307.0	79433	78266	68734	5236.5	6037.8	4465.9
<i>to the previous year, %</i>	<i>128.4</i>	<i>113.6</i>	<i>65.0</i>	<i>99.9</i>	<i>98.5</i>	<i>87.8</i>	<i>128.6</i>	<i>115.3</i>	<i>74.0</i>
Kemerovo Oblast	147.6	186.8	115.5	35307	29408	25309	4181.1	6352.7	4562.9
<i>to the previous year, %</i>	<i>111</i>	<i>126.5</i>	<i>61.8</i>	<i>89.4</i>	<i>88.8</i>	<i>86.0</i>	<i>124.2</i>	<i>151.9</i>	<i>71.8</i>

Source: data of the Federal State Statistics Service, calculations of ISED T RAS.

the end in 2009, in the Sverdlovsk Oblast – by 16 thousand people (14%), in the Chelyabinsk Oblast – by 9.5 thousand people (12%). Labour productivity in the whole steel industry in these regions decreased by 30% in 2009 compared with 2008, and the reduction in the level of output was from 27% in the Sverdlovsk Oblast to 43% in the Vologda Oblast. Such a sharp decline has not been observed since 1995. The result was a significant reduction in financial performance – the revenue from product sales and gross margin (*tab. 6*).

The most notable revenue decrease was recorded in the Vologda Oblast – 42%. In the Kemerovo, Lipetsk, and Chelyabinsk Oblasts the sales revenue fell by more than 35% compared to 2008. Thus, in all the regions the gross margins falling has been observed. It was most significant in the Belgorod Oblast – 87%, mainly due to a moderate decrease in cost of

sales compared to other regions. Gross margin of metallurgical enterprises in the Kemerovo Oblast has fallen by almost 80% in other regions – by 50–60%.

Depressive dynamics was also observed for other indicators of the metallurgical enterprises' financial position. The sharp deterioration in the balance of payments and the slowdown of real sector crediting has worsened the situation with the calculations and the growth of non-payments in 2008 already (*tab. 7*). In the Vologda Oblast there was observed the most significant build-up of debt liabilities both to the banks and the payment of taxes.

Significant reduction in income taxes and other fees from metallurgical industry to the budget system of the Vologda Oblast is associated with a change in the financial and economic situation in the region's main budget enterprise OJSC "Severstal".

Table 6. The dynamics of financial performance of metallurgical production enterprises in 2007 – 2009

Regions	Proceeds from sales, billion rubles			Cost of sales, billion rubles			Gross profit, billion rubles		
	2007	2008	2009	2007	2008	2009	2007	2008	2009
Belgorod Oblast	62.2	81.2	59.4	42.8	51.5	46.6	19.4	29.7	12.8
<i>to the previous year, %</i>	<i>131.5</i>	<i>130.5</i>	<i>73.1</i>	<i>126.6</i>	<i>120.9</i>	<i>89.9</i>	<i>143.7</i>	<i>153.1</i>	<i>43.1</i>
Lipetsk Oblast	165.8	218.1	138.4	103.0	130.1	103.6	62.8	88.0	34.8
<i>to the previous year, %</i>	<i>111.3</i>	<i>131.6</i>	<i>63.4</i>	<i>124.0</i>	<i>126.4</i>	<i>79.6</i>	<i>95.2</i>	<i>140.1</i>	<i>39.5</i>
<b>Vologda Oblast</b>	<b>233.5</b>	<b>284.9</b>	<b>164.9</b>	<b>159.2</b>	<b>190.7</b>	<b>121.8</b>	<b>74.3</b>	<b>94.2</b>	<b>43.1</b>
<i>to the previous year, %</i>	<i>121.3</i>	<i>122.0</i>	<i>57.9</i>	<i>120.2</i>	<i>119.8</i>	<i>63.9</i>	<i>123.8</i>	<i>126.8</i>	<i>45.7</i>
Sverdlovsk Oblast	480.7	595.3	423.6	343.2	452.8	354.3	137.5	142.5	69.3
<i>to the previous year, %</i>	<i>116.8</i>	<i>123.8</i>	<i>71.2</i>	<i>117.1</i>	<i>131.9</i>	<i>78.3</i>	<i>115.9</i>	<i>103.6</i>	<i>48.6</i>
Chelyabinsk Oblast	440.0	496.5	320.4	329.6	385.2	259.8	110.4	111.3	60.6
<i>to the previous year, %</i>	<i>128.9</i>	<i>112.8</i>	<i>64.5</i>	<i>131.6</i>	<i>116.8</i>	<i>67.5</i>	<i>121.3</i>	<i>100.8</i>	<i>54.4</i>
Kemerovo Oblast	158.6	200.6	123.5	116.1	148.6	112.7	42.5	52.0	10.8
<i>to the previous year, %</i>	<i>110.9</i>	<i>126.5</i>	<i>61.6</i>	<i>105.0</i>	<i>127.9</i>	<i>75.9</i>	<i>131.2</i>	<i>122.3</i>	<i>20.8</i>

Source: data of the Federal State Statistics Service, calculations of ISEDT RAS.

Table 7. Metallurgical production's accounts payable in 2007 – 2009, billion rubles

Subjects	The total outstanding debt			Obligations on credit and loan			Arrears payments to the budget		
	2007	2008	2009	2007	2008	2009	2007	2008	2009
Belgorod Oblast	41.3	64.5	71.2	34.8	52.8	63.2	0.2	0.4	0.6
<i>to the previous year, %</i>	<i>122.1</i>	<i>155.9</i>	<i>110.4</i>	<i>116.5</i>	<i>152.0</i>	<i>119.6</i>	<i>144.3</i>	<i>170.0</i>	<i>141.8</i>
Lipetsk Oblast	34.1	99.5	87.3	24.5	70.1	69.3	1.6	0.6	0.8
<i>to the previous year, %</i>	<i>178.2</i>	<i>2.9 p.</i>	<i>87.7</i>	<i>3.4 times</i>	<i>2.9 times</i>	<i>98.8</i>	<i>101.2</i>	<i>36.4</i>	<i>137.4</i>
<b>Vologda Oblast</b>	<b>52.3</b>	<b>157.9</b>	<b>169.9</b>	<b>30.1</b>	<b>132.3</b>	<b>145.1</b>	<b>0.54</b>	<b>0.7</b>	<b>1.3</b>
<i>to the previous year, %</i>	<i>95.1</i>	<i>3 times</i>	<i>107.6</i>	<i>76.6</i>	<i>4.4 times</i>	<i>107.0</i>	<i>75.6</i>	<i>122.6</i>	<i>195.0</i>
Sverdlovsk Oblast	190.6	325.4	351.2	117.6	246.4	279.7	2.6	2.6	3.2
<i>to the previous year, %</i>	<i>131.4</i>	<i>170.7</i>	<i>107.9</i>	<i>128.9</i>	<i>2.1 times</i>	<i>113.5</i>	<i>109.3</i>	<i>100.0</i>	<i>125.0</i>
Chelyabinsk Oblast	145.7	208.9	225.1	102.2	141.3	169.7	1.2	1.6	2.0
<i>to the previous year, %</i>	<i>141.9</i>	<i>143.4</i>	<i>107.7</i>	<i>178.0</i>	<i>138.2</i>	<i>120.1</i>	<i>61.7</i>	<i>132.2</i>	<i>124.4</i>
Kemerovo Oblast	33.0	50.4	51.1	13.3	24.7	28.0	0.9	1.3	0.6
<i>to the previous year, %</i>	<i>132.4</i>	<i>152.7</i>	<i>101.4</i>	<i>192.9</i>	<i>186.0</i>	<i>113.1</i>	<i>168.8</i>	<i>143.8</i>	<i>47.0</i>
RF	1004	1521	1602	553.4	1014	1136	13.8	17.0	21.0
<i>to the previous year, %</i>	<i>145.4</i>	<i>151.5</i>	<i>105.4</i>	<i>139.3</i>	<i>183.3</i>	<i>112.0</i>	<i>93.3</i>	<i>123.0</i>	<i>123.8</i>

Source: data of the Federal State Statistics Service, calculations of ISEDT RAS.

## 2. Factors affecting the financial results of the metallurgical enterprises (on the materials of OJSC “Severstal”)

### 2.1. General assessment of the corporations' financial results in 2007 – 2009

“Severstal” holding is one of the world's largest vertically integrated mining and smelting companies, specializing in the production of flat and long products of ferrous metals of a wide assortment. In 2008, “Severstal” became part of the 20 largest world producers of steel, having taken the 14th place in terms of the volume of production.

Since 2008, the company is divided into three main business divisions: “The Russian Steel”, “Severstal Recourse” and “Severstal International”, including European and North American segments (*tab. 8*).

The division “The Russian Steel” is the third company in Russia in terms of steel production. In the Russian market OJSC “Severstal” competes with OJSC “Novolipetsk metallurgical plant” (NLMP) and OJSC “Magnitogorsk metallurgical plant” (MMP).

Table 8. Aggregate structure of OJSC “Severstal”

Segment	Enterprises
The Russian Steel	The steel and galvanizing production in Cherepovets, a rolling mill in Kolpino, Izhora Pipe Plant, hardware companies in Russia, Ukraine, UK, Italy, the scrap metal recycling companies in Russia and various international support trade, service and transportation companies. 51 companies, including 15 abroad.
Severstal Resource	OJSC “Karelian rolled briquette”, OJSC “Olkon”, OJSC “Vorkutaugol”, PBS Coals Ltd. (USA), gold-mining enterprises in the east of Russia, Africa and Kazakhstan. 27 enterprises, including 16 abroad.
Severstal International	<u>Severstal North America (SNA):</u> 5 steel companies, coal companies, tin production. 13 companies in the U.S.A.
	<u>Lucchini (Lucchini Group):</u> Two steel production companies in Italy, four factories in France, commercial facilities in Western Europe, an engineering research center in France. Total 17 companies.

Table 9. The role of the OJSC “Severstal” in the formation of income tax in the budget system of the Vologda Oblast\*

Indices	2003	2004	2005	2006	2007	2008
Profit before taxation, bill. rub.	24.6	52.7	46.0	47.4	57.2	52.8
The share of total taxable income, %	85.4	86.8	86.3	78.2	76.3	53.1
Current income tax, bill. rub.	4.2	9.3	8.4	8.4	10.3	10.2
The share in of total income tax, %	68.8	76.1	80.6	71.0	66.0	46.7

\* The indices for 2009 – 2010 are not given as because of the sharp decline in profits the holding produced estimates of income tax untimely (according to Vologda Oblast FTSO, in 2009, income tax on profits from the region's steel production totaled 0.4 billion rubles. According to the report of OJSC “Severstal” in RAS, the current income tax for 2009 is estimated to total 3.85 billion rubles). In 2010, OJSC “Severstal” has received a loss of 34 billion rubles.

Sources: Form № 2 “Report on Profits and Losses of OJSC “Severstal” in 2004 – 2008; the data of the Russian Treasury; Federal State Statistics Service, calculations of ISDET RAS.

At the beginning of 2011 OJSC “Severstal” united 108 companies and 51 subsidiaries and associated companies which are not essential for the holding.

The main owner of “Severstal” is the CEO A.A. Mordashov who controls its four Cypriot offshore companies, which hold 70.85% of shares. OJSC “Severstal” is the only founder of Ltd. “Holding mining company”, acting as a 100% owner of OJSC “Karelian rolled briquette and” OJSC “Olkon”. Totally in 2010, A.A. Mordashov had 82.93% of the share capital of “Severstal” under his direct or indirect control.

“Severstal” holding is essential in the formation of revenues of the budget system of the Vologda Oblast; in the pre-crisis period (2003 – 2007) it provides 66-80% of income tax expense in the consolidated budget of the region (*tab. 9*).

According to the accounting policy of OJSC “Severstal”, the amount of income tax payable is calculated by each company from pre-tax profits determined in accordance with the tax laws of the country in which the company is based.

The bulk of the profits of “Severstal” is generated in Russia and is taxed at a flat rate fixed by the law at 24% in 2007 – 2008 and 20% in 2009 – 2010. The segment of Severstal North America is subject to income tax in the U.S., which usually reflects the current tax rate of 35-36% of profit before tax. Most of the profits derived by the segment Lucchini is subject to income tax in Italy and France. In 2008, the tax rate for Lucchini amounted to 35.5%. Other foreign subsidiaries pay taxed determined by the legislation of the countries concerned.

Here are the data describing the formation of the companies’ taxable profits (*tab. 10*).

Table 10. The calculation of the taxable profit of OJSC "Severstal" in 2007 – 2010, million dollars

Indices	2007	2008	2009	2010
Revenues	4895.7	7369.9	1813.5	4648.5
Including: Gross profit	4681.8	5892.8	1698.2	4463
Other incomes	213.9	1477.1	115.3	185.5
Expenditure	2319.5	4790.5	2914.7	2734.5
Including: general and administrative	766.9	1026.8	735.5	638.4
commercial	942.5	1117.8	864.2	990.7
interest	325.6	508.4	601.2	630.8
Other expenses	284.5	2137.5	713.8	474.6
<b>Profit (+),loss (-) before tax</b>	<b>2576.2</b>	<b>2579.4</b>	<b>-1101.2</b>	<b>1914.0</b>
To the previous year, %	122.0	100.1		
<b>Income tax</b>	<b>700.2</b>	<b>517.5</b>	<b>17.9</b>	<b>487.2</b>
To the previous year, %	110.2	73.9	3.5	
Sources: consolidated statements of OJSC "Severstal" for 2007 – 2010, calculations of ISEDT RAS.				

As can be seen, the analysis of the consolidated financial statements shows that the fall in profits and, accordingly, in income tax, has begun in 2008 already, and in 2009 Severstal holding has finished with a loss of \$1.1 billion dollars. Income tax expense has decreased by 96.5%.

The main factors worsening the financial performance of OJSC "Severstal" in late 2008 and in 2009 were:

1. Reduced production due to lower demand for steel products.

2. The high level of production costs, reducing the amount of taxable income.

3. Reducing corporate capitalization and depreciation of different types of assets.

#### *2.2. The impact of damping of market demand for ferrous metallurgy products in the global financial crisis*

In 2002 – 2007 steel production in Russia was growing rapidly from 2.3% per year, the production of OJSC "Severstal" was growing annually by 3%. In 2007 the volumes of steel products consumption increased by 11%. An important factor of growth of metallurgical production was strong demand from the construction and pipe companies, which are major consumers of "Severstal" (*tab. 11*).

Despite the priority of the domestic market in sales policy, OJSC "Severstal" exports 40% of its products. The main consumers in foreign markets are the European countries (*tab. 12*). In 2009, sales increased in the countries of Central and South-East Asia (primarily China) due to the sharp decline in domestic demand.

Since the 4th quarter of 2008, the decline in both global and Russian steel production has begun. Compared to 2007, global production fell by 1.3%. In Russia in 2008 it was produced 68.7 million tons of steel, which is 5% less than in 2007 (*tab. 13*). According to the data of the corporation Chermet the consumption of steel products dropped by 14% – from 40 million tons in 2007 to 34.4 million tons in 2008. In 2009, world steel consumption dropped by another 6.5%. Exports from Russia decreased by 9.2% – from 29.5 million tons to 26.8 million tons.

In 2010, the production in Russia has not reached the level of 2007, but approached to the indices of 2008.

In OJSC "Severstal" there also was a decline in production in 2008–2009. However, in the context of the holding divisions it was in differently directed.

Table 11. The distribution of revenue from domestic sales by consuming industries

Name	2007		2008		2009	
	bill. rub.	share, %	bill. rub.	share, %	bill. rub.	share, %
Pipe enterprises	46,4	24	60,9	25	31,8	22
Automobile production	17,4	9	26,8	11	10,0	7
Mechanical engineering	34,8	18	41,4	17	25,8	18
Construction and metal processing	89,0	46	109,6	45	70,3	49

Source: annual report of OJSC "Severstal" on RAS for 2007 – 2009.

Table 12. The distribution of export sales by geographic region

Name	2007		2008		2009	
	bill. rub.	share, %	bill. rub.	share, %	bill. rub.	share, %
Europe	60.0	31	80.4	33	33.0	23
CIS + Baltic States	65.8	34	80.4	33	30.2	21
North America	5.8	3	12.2	5	1.4	1
Middle East	29.0	15	26.8	11	24.4	17
Central and South America	11.6	6	12.2	5	8.6	6
Central and South-East Asia	17.4	9	21.9	9	37.3	26
Africa	3.9	2	9.7	4	8.6	6

Source: annual report of OJSC "Severstal" on RAS for 2007 – 2009.

Table 13. Steel production in 2006 – 2010

Index	2006	2007		2008		2009		2010		
		mill. tons	% to 2006	mill. tons	% to 2007	mill. tons	% to 2008	mill. tons	% to 2009	% to 2007
World	1247	1346	107.9	1329	98.7	1229	92.5	1413	115.0	105.0
Russia	70.6	72.2	102.3	68.7	95.1	59.2	86.2	67.0	113.2	92.8

Release of iron and steel in the division The Russian Steel in 2008 decreased by 7%, rolled metal – by 18%, in the European division Lucchini – by 14 and 7% respectively (*tab. 14*).

The overall growth of major products was achieved through acquisitions of new assets in North America. Decline in production continued in 2009: Russian enterprises have reduced production of the most significant products by 10-13%, and European ("Lucchini") – by 35-42%. In 2009, the total production of rolled metal, cast iron and steel decreased by 8%, 10.5% and 13% respectively.

Reduction in coal production by 20.5% in 2008 is due, in addition to macroeconomic factors, to the sale of "Kuzbassugol" to the American company ArcelorMittal. The holding management acknowledged that with the acquisition of "Vorkutaugol" Kuzbass assets lost strategic importance for the Cherepovets

Metallurgical Plant (the revenue of the enterprise "Kuzbassugol" for 2007 amounted to 12% in total sales revenue).

Overall, the year of 2008 recorded a growth of prices for steel and coal, although the selling price for hardware products at the enterprises of "Lucchini" fell by 53% (*tab. 15*). In 2009, the most significant decline in prices affected the division "The Russian Steel". Thus, the weighted average sales prices for rolled metal fell almost by 50%, for hardware and pipe products – by 28%.

Reduced demand for steel and a collapse in prices appeared under the influence of the following factors:

- first, the decline in production in the steel consuming sectors of economy – construction, automotive and machine building, contributing to a real decline in demand for steel consumption. Thus, in the 4th quarter



Table 14. Production of major products at OJSC "Severstal" in 2007 – 2010\*

Divisions	2007	2008		2009		2010		
	thous. tons	thous. tons	% to 2007	thous. tons	% to 2008	thous. tons	% to 2009	% to 2008
CAST IRON								
Russian Steel	8758.5	8125.1	92.8	7223.4	88.9	8689.3	120.3	106.9
Severstal North America	1656.3	3200.8	193.2	3456.4	108.0	3878.1	112.2	121.2
Lucchini	2534.4	2189.5	86.4	1418.8	64.8	1896.2	133.6	86.6
Consolidated	12949.2	13515.4	104.4	12098.6	89.5	14463.6	119.5	107.0
STEEL								
Russian Steel	11898.6	11096.9	93.3	9547.8	86.0	11085.2	116.1	99.9
Severstal North America	1979.7	5099.9	+2.6 times	5455.2	107.0	5955.6	109.2	116.8
Lucchini	3585	3020.6	84.3	1746.4	57.8	2451.5	140.4	81.2
Consolidated	17463.3	19217.4	110.0	16749.4	87.2	19492.3	116.4	101.4
ROLLED METAL								
Russian Steel	9426.1	7747	82.2	6743.5	87.0	7660.6	113.6	98.9
Severstal North America	2386	4417.3	185.1	5143.7	116.4	5698.7	110.8	129.0
Lucchini	2329.7	2151.3	92.3	1254.9	58.3	1761.1	140.3	81.8
Consolidated	14141.8	14315.6	101.2	13142	91.8	15120.4	115.0	105.6
COAL								
Severstal Resource:	9463.1	7519	79.5	9148	121.7	11733	128.3	156.0
«Vorkutaugol»				6679	88.8	8508.7	127.4	
PBS Coals (USA)	0	0		2469		3224.3	130.6	

\* Including internal sales between the segments.  
Source: annual reports of OJSC "Severstal" for 2007 – 2009.

Table 15. The weighted average prices for basic products of OJSC "Severstal" in 2007 – 2010\*

Divisions	2007		2008		2009		2010	
	doll./tons	% to 2006	doll./tons	% to 2007	doll./tons	% to 2008	doll./tons	% to 2009
ROLLED METAL								
Russian Steel	666	118.2	939	141.0	496	52.8	641	129.2
Severstal North America	707	102.2	965	136.5	709	73.5	773	109.0
Lucchini	996	no data	1334	134.0	944	70.7	949	100.5
Consolidated	727	н.д.	996	137.0	588	59.0	711	120.9
PRODUCTS of FINAL REDISTRIBUTION (hardware, pipes)								
Russian Steel	791	113.5	1517	191.8	1091	71.9	1200	110.0
Severstal North America	-	-	1823		1488	81.6	1411	94.8
Lucchini	2671	н.д.	1249	46.7	1017	81.4	1025	100.8
Consolidated	1072	н.д.	1507	140.6	1121	74.4	1207	107.7
COAL								
Russian enterprises	84	113.2	147	175.0	84	57.1	140	166.7
PBS Coals (USA)	-	-	110	-	106	96.4	147	138.7

\* Excluding sales within the company.  
Sources: annual reports of OJSC "Severstal" in 2007 – 2009.

of 2008, the demand in the automotive industry decreased by 6.3%. As a result of the construction industry crisis the demand began to decline from the first quarter of 2008 already;

- second, reduction of the level of population's income as a result of massive layoffs and rising unemployment;

- third, a strong dependence of the level of metal prices on the level of energy prices (energy costs in the production of metals are up to 30% of the cost price);

- fourth, the introduction of new production capacity. High profitability due to increases in world metal prices in 2005 – 2007 prompted manufacturers to overproduction and to launching the projects inefficient before. Thus, as a result of production growth China turned from the largest steel importer into a major exporter, increasing its share in world production from 23 to 44%.

The drop in demand, prices and sales volumes inevitably resulted in reduction in the main financial results of OJSC “Severstal” – sales revenue and gross profit.

In 2009, revenues from sales in the whole of the holding made up 58% compared to the level of 2008; revenue from domestic sales was

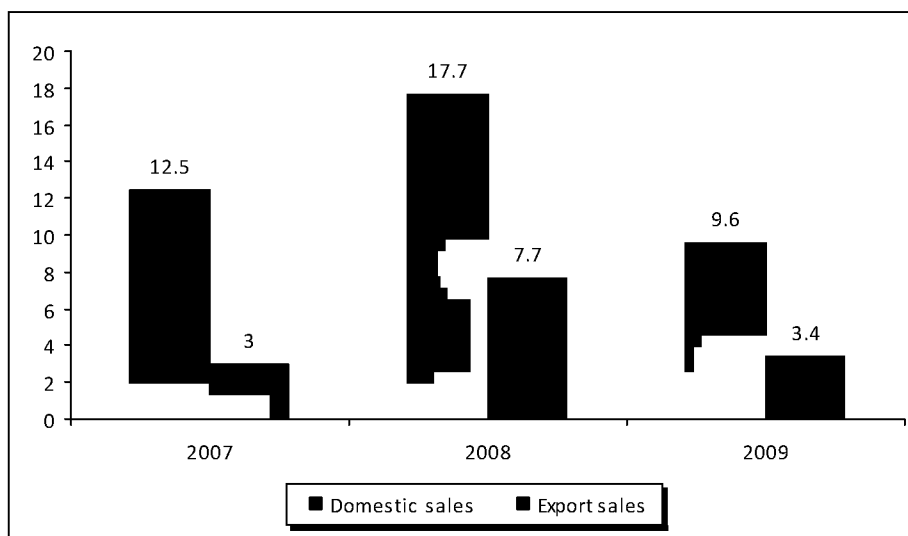
decreasing at a more great rate (almost twice). Export sales fell by a third (*figure*).

In 2009, the decrease in revenues occurred in virtually all types of goods sold. Particularly striking was the decreased sale of scrap, section rolled steel, semi-finished products and iron ore rolled briquettes (*tab. 16*).

More than half of the proceeds of OJSC “Severstal” were provided by the companies belonging to the division of “The Russian steel” (*tab. 17*).

The share of “Severstal Resource” in the formation of revenue, increased from 11% in 2008 to 25.7% in 2010. On the contrary, the participation of the European division has declined. As a result of lower demand for rolled products in Europe by 50% which followed the steep recession in the second half of 2008, “Lucchini’s” sales in 2009 have not reached even a half of the previous year volume. The share of North American enterprises accounted for one third of revenue in 2009, but in nominal terms its volume was annually reducing and at the end of 2010 the U.S. companies have brought little more than 20% of the total holding’s revenue. This was largely due to the stoppage of some metallurgical plants in response to falling demand.

Proceeds from sales of OJSC “Severstal” in domestic and foreign markets in 2007 – 2009, bill. doll.



Source: annual reports of OJSC “Severstal” in 2007 – 2009.

Table 16. Proceeds from sale by types of products of OJSC "Severstal" in 2008 – 2009

Name	2008, mill. doll.			2009, mill. doll.			2009 to 2008, %		
	Total	Including:		Total	Including:		Total	Including:	
		domestic market	foreign market		domestic market	foreign market		domestic market	foreign market
Hot-rolled sheet	5952.5	4542.7	1409.8	3003.8	1912.7	1091.1	50.5	42.1	77.4
section rolled steel	3794	3310	484	1301.2	1117.6	183.6	34.3	33.8	37.9
Galvanized sheet	2350.3	2219.9	130.4	1920	1809.3	110.7	81.7	81.5	84.9
Cold-rolled sheet	2314.4	1919.6	394.8	1606.3	1270.6	335.7	69.4	66.2	85.0
Semi-finished products	1667.3	1051.1	616.2	582.1	297.4	284.7	34.9	28.3	46.2
Hardware products	1384.6	952.4	432.2	853.8	575.5	278.3	61.7	60.4	64.4
Iron ore rolled briquettes	453.1	252.1	201	217.2	82.1	135.1	47.9	32.6	67.2
Scrap	321.3	26	295.3	58.3	19.4	38.9	18.1	74.6	13.2
Gold	190.4	96.2	94.2	512.3	299.4	212.9	269.0	311.2	226.0
Other	3971.1	3346	625.1	3000	2258	742	75.5	67.5	118.7
Total	22393	17716	4677	13055	9642	3413	58.3	54.4	73.0

Sources: annual report of OJSC "Severstal" in 2008 – 2009.

Table 17. Revenues from sales in the context of OJSC "Severstal" divisions in 2008 – 2010\*

Divisions	2008		2009		2010	
	mill. doll.	share in the total volume, %	mill. doll.	share in the total volume, %	mill. doll.	share in the total volume, %
Russian Steel	12063.8	53.9	6179.1	47.3	8814.8	64.9
Severstal North America	2452.7	11.0	1870.8	14.3	3484.3	25.7
Lucchini	5319.4	23.8	4023.1	30.8	2911.5	21.5
Consolidated	3989.5	17.8	1757.1	13.5	-	-
Russian Steel	22392.7	100.0	13054.5	100.0	13573.3	100.0

\* The data for 2007 are not given, since the bulk of the assets of the division "Severstal North America" was consolidated in 2008.  
Sources: consolidated statements of OJSC "Severstal" for 2009 – 2010, calculations of ISED T RAS.

Table 18. Product cost in the context of the divisions of OJSC "Severstal" in 2007 – 2010

Divisions	2007		2008		2009		2010	
	mill. doll.	% to 2006	mill. doll.	% to 2007	mill. doll.	% to 2008	mill. doll.	% to 2009
Russian Steel	5781.5	119.5	7388.0	127.8	4081.4	55.2	6003.2	147.1
Severstal Resource	1182.1	124.9	1376.4	116.4	1405.6	102.1	1781.5	126.7
Severstal North America	1348.3	78.7	5841.4	+3.2 times	4687	80.4	2911.6	62.1
Lucchini	3194.4	113.1	3372.4	105.6	1948.0	57.8	-	-
Consolidated	10821.6	122.0	16499.9	152.5	11356.3	68.8	9110.2	80.2

Sources: Consolidated statements of OJSC "Severstal" in 2007 – 2010, calculations of ISED T RAS

The decrease in production volumes, reduction in prices for basic raw materials, as well as the weakening of the ruble in 2009 helped to reduce the cost of sales by one-third as compared to 2008 (*tab. 18*).

It should be noted that in the pre-crisis period of the holding's products cost has been growing rapidly. Thus, in 2008 it increased by 52.5%, while in the U.S. division the cost increased 3.2 times.

Of course, such an increase in costs was largely due to Severstal's new purchases in the U.S. market. Also an important factor was the rise in prices for raw materials, fuel and electricity which are the main components of cost. Considering the lack of consolidated data on the cost structure of the holding's marketable products, let us provide it on the basis of the reporting performance of the division "The Russian Steel" (*tab. 19*).

Table 19. Cost structure of marketable products of OJSC “Severstal” in 2007 – 2009, %

Name	2007	2008	2009
Materials	67.6	69.9	58.9
Fuel and energy	7.9	7.3	9.1
Payroll and deductions	8.3	7.4	9.0
Depreciation	4.7	3.9	5.9
Other expenses	11.5	11.5	17.1
Total	100.0	100.0	100.0

Table 20. Gross profit of OJSC “Severstal” in 2007 – 2010

Divisions	2007		2008		2009		2010	
	mill. doll.	% to 2006	mill. doll.	% to 2007	mill. doll.	% to 2008	mill. doll.	% to 2009
Russian Steel	3563.1	133.8	4675.7	131.2	2097.7	44.8	2811.6	134.0
Severstal Resource	667.0	128.8	1076.3	161.4	465.2	43.2	1702.8	3.7 times
Severstal North America	-42.8	-	-522.1	12.2 times	-674.4	129.2	-96.0	-14.2
Lucchini	562.1	98.9	617.0	109.8	-190.9		-	
Consolidated	4681.8	121.6	5892.8	125.9	1698.2	28.8	4463.0	+2,6 times

Sources: consolidated statements of OJSC “Severstal” in 2007 – 2010, calculations of ISERT RAS.

As you can see, the cost of raw materials and energy resources account for two thirds of the cost of marketable products.

Proceeding to the dynamics of gross profit, we should note that it includes only the cost of production and sales. Other expenses (profit, interest and management) that have a significant effect on the rate of taxable profit are not counted in determining the gross results.

The sharp decline in sales revenue in 2009 led to a reduction in gross profit of OJSC “Severstal” 3.5 times (*tab. 20*).

In 2009, the main role in the gross margin indices deterioration, on which the tax base depends directly, was played by the foreign divisions which had received a gross loss – “Lucchini” and “Severstal North America”. At the same time by the end of 2008 the loss of U.S. companies increased by more than 12 times compared to 2007, and in 2009 it increased by another third. In 2010, the company data also showed a decrease in revenues and gross loss. Thus, the bulk of the holding’s gross profit is provided by Russian companies. European enterprises of “Lucchini” division showed an improvement

of gross financial results only in 2008, but their growth rates significantly lagged behind the growth rates in the Russian structures.

The deterioration of financial performance in 2009 was typical for all the steel companies, including Novolipetsk and Magnitogorsk metallurgical complexes.

The volume of gross profit in these companies has significantly decreased compared to 2008 – by 63 and 58% respectively. However, the rate of profit decline was slightly lower than at OJSC “Severstal”. This is due to a marked decline in cost of sales as the volume of sales revenues at “NLMC” and “MMC” declined faster than at “Severstal” (*tab. 21*).

### 2.3. Destructive effect of the owners’ interests on costs, profitability and capitalization of corporations

Management, business and interest expenses are the main share of the costs taken into account when forming the pre-tax profit. If we do not take into account the year 2008, which was the peak of holding losses on derecognition of assets, the mentioned costs were 70-90% in the cost structure of all the divisions of “Severstal” (*tab. 22*).

Table 21. The main financial results of OJSC "NLMC" and "MMC" for 2007 – 2010

Indicators	year 2007	year 2008		year 2009		year 2010	
	million dol- lars	million dol- lars	in % to the year 2007	million dollars	in % to the year 2008	million dollars	in % to the year 2009
OJSC "NLMC"							
Revenues	7719.1	11698.7	151.6	6139.9	52.5	8350.7	136.0
Costs	3977	6307.8	158.6	4150.4	65.8	5402.6	130.2
Gross profit	3742	5390.9	144.1	1989.5	36.9	2948.1	148.2
OJSC "MMC"							
Revenues	8197	10550	128.7	5081	48.2	7719	151.9
Costs	5710	7835	137.2	3940	50.3	5952	151.1
Gross profit	2487	2715	109.2	1141	42.0	1767	154.8

Sources: Consolidated statements of OJSC "NLMK" and OJSC "MMK" for 2008 – 2010, calculations of ISED T RAS.

Table 22. The share of commercial, administrative and interest expenses in total costs taken into account when determining the pre-tax profit of OJSC "Severstal" for 2007 – 2010, %

Divisions	2007	2008	2009	2010
Russian Steel	90.3	70.7	81.0	85.4
Severstal Resources	76.9	43.1	67.0	74.3
Severstal North America	72.9	23.5	80.8	82.2
Lucchini	85.0	84.2	68.0	-
Consolidated	87.7	55.4	75.5	82.6

Sources: Consolidated statements of OJSC "Severstal" for 2008 – 2010, calculations of ISED T RAS.

Table 23. Selling expenses of OJSC "Severstal" for 2007 – 2010

Divisions	2007	2008		2009		2010	
	million dollars	million dollars	in % to the year 2007	million dollars	in % to the year 2008	million dollars	in % to the year 2009
Russian Steel	662.2	798.6	120.6	638.7	80.0	780.9	122.3
<i>share in expenses, %</i>	<i>49.8</i>	<i>35.6</i>		<i>39.0</i>		<i>39.8</i>	
Severstal Resources	163.7	180.9	110.5	141.9	78.4	210.6	148.4
<i>share in expenses, %</i>	<i>34.0</i>	<i>16.9</i>		<i>20.0</i>		<i>30.1</i>	
Severstal North America	2.2	16.4	+7.5 p.	13.5	82.3	-	-
<i>share in expenses, %</i>	<i>1.5</i>	<i>1.2</i>		<i>3.1</i>		<i>-</i>	
Lucchini	118.0	122.0	103.4	72.7	59.6	-	-
<i>share in expenses, %</i>	<i>26.5</i>	<i>27.6</i>		<i>18.5</i>		<i>-</i>	
Consolidated	942.5	1117.8	118.6	864.2	77.3	990.7	114.6
<i>share in expenses, %</i>	<i>40.6</i>	<i>23.3</i>		<i>29.7</i>		<i>36.2</i>	

Sources: Consolidated statements of OJSC "Severstal" for 2008 – 2010, calculations of ISED T RAS.

Let us consider in detail the dynamics of these expenses of OJSC "Severstal". The main types of business costs are transportation costs. They are up to one third of the total cost on average, taken into account when forming the pre-tax profit. Business expenses occupy the largest share (40%) at enterprises of "Russian Steel". In 2009, in whole of the holding costs decreased by 23%, but in 2010 its growth trend resumed (*tab. 23*).

General logistic and administrative (executive) expenses are usually salaries and bonuses of management personnel, travel expenses, transportation costs, maintenance of offices, fees for audit, insurance and legal firms, as well as hospitality. In the cost structure of OJSC "Severstal" administrative expenses make up 25% (*tab. 24*).

The volume of administrative expenses amounted to 50% to the wage fund. However,

Table 24. Administrative expenses of OJSC “Severstal” for 2007 – 2010

Divisions	2007	2008		2009		2010	
	million dollars	million dollars	in % to the year 2007	million dollars	in % to the year 2008	million dollars	in % to the year 2009
Russian Steel	373.6	506.2	135.5	340.9	67.3	423.9	124.3
<i>share in expenses, %</i>	<i>28.1</i>		<i>22.6</i>		<i>20.8</i>		<i>21.6</i>
Severstal Resources	136.8	173.9	127.1	107.5	61.8	138.1	128.5
<i>share in expenses, %</i>	<i>28.5</i>		<i>16.3</i>		<i>15.2</i>		<i>19.8</i>
Severstal North America	70.8	173.8	+2.5 p.	162.1	93.3	78.4	48.4
<i>share in expenses, %</i>	<i>46.7</i>		<i>13.1</i>		<i>37.1</i>		<i>28.1</i>
Lucchini	188.0	176.5	93.9	128.2	72.6	-	-
<i>share in expenses, %</i>	<i>42.2</i>		<i>40.0</i>		<i>32.6</i>		<i>-</i>
Consolidated	766.9	1026.8	133.9	735.5	71.6	638.4	86.8
<i>share in expenses, %</i>	<i>33.0</i>		<i>21.4</i>		<i>25.2</i>		<i>23.3</i>
To wage fund, %	50.0		49.4		40.8		47.5
Remuneration of key management	57.2		43.9		20.8		52.8

Sources: Consolidated statements of OJSC “Severstal” for 2008 – 2010, calculations of ISED T RAS.

Table 25. Loans involved by OJSC “Severstal” in 2007 – 2010

Divisions	2007	2008		2009		2010	
	million dollars	million dollars	in % to the year 2007	million dollars	in % to the year 2008	million dollars	in % to the year 2009
<i>The amount of borrowed loans</i>							
Consolidated	3677.5	7542.1	+2.0 p.	4354.8	57.7	3481.6	80.0
<i>Loans and borrowings (long-term debt financing)</i>							
Consolidated	2813.2	6227.2	+2.2 p.	5748.6	92.3	4719.8	82.1
Russian Steel	1139.6	3900.3	+3.4 p.	4198.2	107.6	3731.2	88.9
Severstal Resources	391.9	801.2	+2.0 p.	674.4	84.2	291.8	43.3
Severstal North America	843.5	1452.4	172.2	1097.7	75.6	1370.4	124.8
Lucchini	650.1	1069.5	164.5	1009.3	94.4	-	-

Sources: Consolidated statements of OJSC “Severstal” for 2008 – 2010, calculations of ISED T RAS.

it should be recognized that significant reduction in general and administrative expenses in 2009 helped reduce the overall expenses of operations by almost 50%<sup>1</sup>.

In 2008, the increase in administrative expenses amounted to 34%, while in the North American division administrative expenses increased by 2.5 times. In 2010 the enterprises of “Russian Steel” and “Severstal Resources” these expenses again show significant growth.

The greatest increase in production costs and decrease in profits was observed due to the

<sup>1</sup> Operating expenses of the holding in 2009 dropped by 612 million dollars, including administrative expenses – by 291.2 million dollars.

increase of interest payments produced by the involvement of a significant amount of loan resources in 2008 and, accordingly, increase in debt (*tab. 25*).

As a result of increased borrowing interest payments at the end of 2008 increased 56% (*tab. 26*).

Judging by the data in *table 27*, the main increase in interest costs in the consolidated expenses of the holding in 2008 was provided by North American companies. In 2008, their spending on these projects has increased 3.3 times, and in 2009 – 1.4 times. The significant increase in interest payments was showed by all the holding structures, except “Lucchini”.

Table 26. Interest expenses of OJSC "Severstal" in 2007 – 2010

Divisions	2007	2008		2009		2010	
	million dollars	million dollars	in % to the year 2007	million dollars	in % to the year 2008	million dollars	in % to the year 2009
Russian Steel	163.7	282.1	172.3	346.7	123.0	469.7	135.5
<i>share in expenses, %</i>	12.3	12.6		21.2		23.9	
Severstal Resources	69.0	105.1	152.3	226.5	+2.2 p.	170.4	75.2
<i>share in expenses, %</i>	14.4	9.8		31.9		24.4	
Severstal North America	37.5	122.9	+3.3 p.	177.6	144.5	151.0	85.0
<i>share in expenses, %</i>	24.7	9.2		40.7		54.1	
Lucchini	72.8	73.0	100.3	61.7	84.5	-	-
<i>share in expenses, %</i>	16.3	16.5		15.7		-	
Consolidated	325.6	508.4	156.0	601.2	118.3	630.8	104.9
<i>share in expenses, %</i>	14.0	10.6		20.6		23.1	

Sources: Consolidated statements of OJSC "Severstal" for 2007 – 2009, calculations of ISED T RAS.

Table 27. Expenses dynamics for interest payments on borrowings and loans in 2007 – 2009, % to previous year

Regions	2007	2008	2009 to 2007, times
Belgorod oblast	2.5 p.	129.6	2.1
Lipetsk oblast	179.5	4.4 p.	4.6
Vologda oblast	80.1	183.4	3.3
Sverdlovsk oblast	142.5	2.7 p.	4.7
Chelyabinsk oblast	114.1	166.0	2.8
Kemerovo oblast	112.3	176.5	3.2
Russian Federation	135.3	173.0	2.5

Sources: Federal State Statistics Service, calculations of ISED T RAS.

Rising interest payments were common to all the "regions-metallurgists" considered by us. During 2007 – 2009, the expenses on interest payments on loans increased by 2.5 times in whole in iron and steel industry of the country. At the same time their most significant increase was observed in the Sverdlovsk, Lipetsk, Volgograd and Kemerovo oblasts (*tab. 27*).

Cost structure of the Novolipetsk and Magnitogorsk metallurgical complexes also demonstrates a high proportion of commercial, administrative and interest costs (60-80% for "NLMC" and 70-90% – at "MMC"). At the same time on administrative expenses are directed more than 20% of the costs at "NLMC" and more than a third – at "MMC" (*tab. 28*).

As a result of the fall in metal prices and demand the "Severstal" holding in October 2008 began to reduce power. At the beginning of 2009 workload in Russia amounted to 50%, in the U.S. – 40% in Europe – 60%.

The financial and economic crisis in 2008 led to a significant reduction in capitalization and depreciation of different types of assets. For quite a long period the world has seen a marked increase in the stock market, accompanied by an increase in value of tangible and intangible assets on the balance of organizations. Especially strong growth occurred since 2006 and until mid-2008. During this period the value of the assets of OJSC "Severstal" has increased by 1.5 times (from 15.3 billion dollars to 22.5 billion dollars.)

Table 28. Selling, administrative and interest expenses of OJSC  
“NLMC” and “MMC” in 2007 – 2010, million dollars

Expense name	OJSC “NLMC”				OJSC “MMC”			
	year 2007	year 2008	year 2009	year 2010	year 2007	year 2008	year 2009	year 2010
Selling	442.7	734.5	654.6	708.9	551	650	429	565
<i>share in expenses, %*</i>	<i>52.2</i>	<i>31.1</i>	<i>45.0</i>	<i>55.8</i>	<i>44.9</i>	<i>35.6</i>	<i>38.1</i>	<i>37.6</i>
Administrative	214.8	366.7	297.2	263.1	452	513	349	495
<i>share in expenses, %</i>	<i>25.3</i>	<i>15.5</i>	<i>20.4</i>	<i>20.7</i>	<i>36.9</i>	<i>28.1</i>	<i>31.0</i>	<i>32.9</i>
Interest	31.4	247.3	1709	15.9	87	110	87.3	140
<i>share in expenses, %</i>	<i>3.7</i>	<i>9.2</i>	<i>11.7</i>	<i>1.2</i>	<i>7.1</i>	<i>6.0</i>	<i>8.5</i>	<i>9.3</i>
Total	688.9	1318.5	1122.7	987.9	1090	1273	874	1200
<i>share in expenses, %</i>	<i>81.2</i>	<i>55.9</i>	<i>77.2</i>	<i>77.7</i>	<i>88.9</i>	<i>69.7</i>	<i>77.6</i>	<i>79.8</i>

Sources: consolidated statements of OJSC “NLMC” and OJSC “MMC” for 2008 – 2010, calculations of ISEDT RAS.

Table 29. Depreciation of assets of OJSC “Severstal” in 2007 – 2010

Divisions	year 2007		year 2008		year 2009		year 2010	
	million dollars	in % to profit	million dollars	in % to profit	million dollars	in % to profit	million dollars	in % to profit
Russian Steel	9.9	0.4	42.1	1.6	39.4	5.1	21.1	1.8
Severstal Resources	3.1	1.5	489.9	98.4	48.7	-20.0	15.8	1.5
Severstal North America	0	0	1004.4	-131.6	26.5	-2.4	44.2	-17.2
Lucchini	15.9	9.1	3.9	1.9	104.5	-20.0	-	-
Consolidated	28.9	1.1	1540.3	59.7	219.0	-20.0	81.1	4.2

Source: Consolidated statements of OJSC “Severstal” for 2007 – 2010.

However, the financial and economic crisis in 2008 led to a decline in business activity, downfall of stock market and depreciation of assets – fixed assets, goodwill and other assets<sup>3</sup>.

Depreciation of assets of OJSC “Severstal” in the crisis amounted to 1.8 billion rubles. The most significant allowances “Severstal” had to do in 2008 were 1.5 billion dollars (*tab. 29*).

Judging by the data in table 30, the basic part from the depreciation of assets in 2008 – 2010 took place at the overseas units of “Severstal”. For example, North American Division has provided 65% of losses from allowances in 2008 and 55% in 2010.

<sup>3</sup> Depreciation of assets can be explained based on the concept of an asset as a resource that can generate income in the future. Obviously, with a decrease in business activity and macroeconomic indicators it may be a situation where future incomes from the assets will be insufficient to recover their cost. In the case of such an assumption the company is obliged to conduct a depreciation test of its long-term assets. If the hypothesis is confirmed, the balance-sheet asset value should be reduced. In this case there is the assessment of recoverable amount. If the balance-sheet asset value exceeds its recoverable amount, depreciation loss is reflected.

The contribution of European companies in 2007 and 2009 was half of the losses of the holding.

The result of acknowledgement of losses from assets in 2008 was the reduction in taxable income by 40%. In 2009, the allowances of assets in 0.2 billion rubles increased the loss of the holding by 20%. In the division “Severstal” North America, depreciation of assets was a key factor in losses in 2008. But for the allowances, earnings of the US companies would have amounted to 241.2 million dollars. In the mining segment of the holding losses from allowances in 2008 amounted to 489.9 million dollars, which is almost comparable to the amount of profit (497.8 million dollars).

In two other steel companies – “NLMC” and “MMC” – losses from allowances of impaired assets have not had such a significant impact on the amount of taxable income. Thus, at the Magnitogorsk Complex depreciation procedures were held only in 2008 and



Table 30. Depreciation of assets of OJSC "NLMC" and OJSC "MMC" in 2008 – 2010

Name	year 2008		year 2009		year 2010	
	million dollars	in % to profit	million dollars	in % to profit	million dollars	in % to profit
"NLMC"	128.4	4.1	43.7	7.3	58.2	3.4
"MMC"	56.0	5.0	0	0	0	0

Source: consolidated financial statements of OJSC "NLMC" and OJSC "MMC" for 2008 – 2010, calculations of ISED T RAS.

Table 31. Financial results of OJSC "NLMC" and OJSC "MMC" for 2007 – 2010, million dollars

Segments	year 2007	year 2008	year 2009	year 2010
<i>Profit (+), losses (-) before taxing</i>				
NLMC	3156.8	3131.7	594.7	1722.3
MMC	1626	1106	257	290
<i>Net profit (+), losses (-)</i>				
NLMC	2247.3	2278.7	215.1	1255
MMC	1306	1081	219	232

Source: consolidated financial statements of OJSC "NLMC" and OJSC "MMC" for 2008 – 2010.

amounted to only 5% of taxable income. At the Novolipetsk Complex in 2008 – 2010 allowances resulted in decrease of profits by 3-7% (tab. 30).

Slight losses from depreciation of assets allowed competitors of "Severstal" to end 2009 – 2010 profitably, despite a sharp decline in revenues and gross profit. However, net profit at "NLMC" in 2009 decreased by 90.6%, in "MMC" – 80% (tab. 31).

We have examined the basic indicators of OJSC "Severstal", serving a basis for determining the taxable profits and the factors of significant changes during the crisis. What holding structures played a crucial role in the deterioration of the final financial results of its activities in 2009 – 2010? To answer this question we must analyze the data of segment reporting of profits and losses of "Severstal" (tab. 32).

Judging by the data from Table 32, losses of OJSC "Severstal" in 2009 – 2010 were provided by foreign subsidiaries. In 2009, the share of the US companies accounted to 60% of losses, nearly a third of the losses was given by the European companies. But for the losses of foreign divisions, the holding would have got profit by the end of 2009 amounting to 0.5 billion rubles.

In 2010, the bulk of the loss was formed by the division "Lucchini". In general, losses of foreign assets exceeded the profit of the other two divisions by 1.3 times. As a result, up to 2010 the holding got a negative net profit indicator of 0.5 billion rubles (but for the foreign companies the net profit in 2010 would have amounted to 1.8 billion rubles).

Note that in the pre-crisis period, the US companies were unprofitable. Nevertheless, "Severstal" increased its presence in foreign markets by buying up assets. In 2007 – 2010 5.3 billion dollars were used for these purposes. In 2008 capital expenditures of Severstal in mergers and acquisitions in the USA reached \$3.2 billion dollars and accounted for 94% of the total expenses of the company to acquisitions in 2008. One-third of the acquired assets fell for the 4th quarter, when began the falling of price for steel products and profits. Virtually all the US companies were unprofitable at the time of the transaction and up to 2008 had a negative financial result, which was included in the consolidated financial statements of the holding.

According to the audit report, the earnings of the majority of the acquired companies from the dates of their acquisition are insignificant in relation to the profits of the holding in 2007 – 2008.

Table 32. Financial results of segments of OJSC "Severstal" for 2007 – 2010, million dollars

Segments	2007	2008	2009	2010
<i>Profit (+), losses (-) before taxing</i>				
Russian Steel	2448.3	2621.7	774.3	1183.6
Severstal Resources	200.9	497.8	-242.8	1066.9
Severstal North America	-144.1	-763.2	-1099.8	-256.4
Lucchini	174.0	204.4	-523.1	-
Consolidated	2576.2	2579.4	-1101.2	1914
<i>Profit tax ("Russian Steel" and "Severstal Resources")</i>				
Total	657.5	825.7	143.8	440.5
Including in the budget of the oblast	480.0	602.8	129.4	396.5
<i>Net profit (+), losses (-)</i>				
Russian Steel	1837.9	1979.6	604.6	947.8
Severstal Resources	153.8	314.2	-217	862.3
Severstal North America	-134.6	-373	-1084.3	-1072.8
Lucchini	93.5	136.5	-411.5	-1210.1
Consolidated	1876.5	2061.9	-1119.1	-515.0
* Income tax is calculated by ISED T RAS according to the Russian tax rate (in 2007 – 2008. – 17.5%, in 2009 – 2010 – 18%).				
Source: consolidated statements of OJSC "Severstal" for 2008 – 2010.				

Table 33. Outstanding obligations of the companies purchased by OJSC "Severstal" in 2007 – 2010, million dollars

Types of obligations	2007	2008	2009	2010
Credit debts	16.2	585.6	0	17.3
Tax liabilities	128.0	387.1	0	93.7
Pension payments	0	410.5	0	0
Debt financing	63.2	579.8	0	107.4
Other short-term obligations	41.9	296.8	0	38.7
Other long-term obligations	16.7	271.6	0	11.3
In total	266.0	2531.4	0	268.4
Source: consolidated statement of OJSC "Severstal" in 2007 – 2010.				

In addition, the unliquidated obligations of the purchased enterprises were in 2007 – \$266 million dollars, in 2008 – \$2.5 billion dollars, in 2010 – 268.4 million dollars (*tab. 33*).

After all the purchases made by "Severstal" the share of its foreign assets in the capacity of steel production has reached 60%. Consequently, it is possible to speak about the real transnationalization of the company's business.

However, according to the reporting data for 2007 – 2009, the main income source of "Severstal" was the Russian business, as for three years the division "Severstal North America" has been having losses, as it has already been mentioned. The data given in *table 34* can demonstrate the low efficiency of foreign assets purchased by "Severstal".

According to these data, naturally there is a question: for what purpose is it necessary to buy plants with the debt burden in amount of hundred millions USD and almost total lack of net profit? In addition, prospects for such companies are minimal in the highly competitive U.S. market. It is obvious, that the new purchases accelerate capitalization of the holding. Outwardly, this activity in the U.S. market looks like export of hundreds millions and billions USD, but increase in capitalization is used to finance transactions in the foreign market, rather than the new investment projects in Russia. This conclusion is confirmed by the data that characterize the direction and amount of investments into associated companies and joint ventures (*tab. 35*).

Table 34. The purchasing costs and financial result of foreign business by OJSC "Severstal" in 2007 – 2009, billion dollars

Item	Severstal North America	Lucchini
Purchasing costs in 2007 – 2008	4.4	0.9
Capital investments in 2007 – 2009	2.0	0.67
Net profit (+), losses (-) in 2007 – 2009	-1.6	0.23 (in 2007-2008); -0.4 (2009)

Source: annual financial statement of OJSC "Severstal" in 2007 – 2009.

Table 35. Investments into associated companies and joint ventures of OJSC "Severstal" in 2007 – 2010, million dollars

Company	2007	2008	2009	2010
Air Liquide Severstal (Russia)	7.5	10.1	13.8	17.9
Intex Resources ASA (Norway)				14.6
Iron Mineral Beneficiation Services (Africa)				7.2
Spartan Steel Coating LLC (the USA)	54.0	51.6	49.1	47.5
Ohio Coatings Company (the USA)		16.6	17.8	
LLC "Gestamp-Severstal-Kaluga" (Russia)			16.3	18.0
Double Eagle Steel Coating Company (the USA)	22.9	19.4	15.6	18.5
LLC "Gestamp-Severstal-Vsevolzhsk" (Russia)			15.9	14.9
LLC "Severstal-Gonvarri-Kaluga" (Russia)				10.0
LLC "Prognoz-Serebro" (Russia)		6.8	6.6	5.5
Bethlehem Roll Technologies (the USA)		4.3	3.9	
Todlem S.L. (Spain)			2.8	3.7
Others	1.3	2.2	2.2	0.7
In total	203.0	110.9	143.9	158.5
<b>Including into foreign companies</b>	<b>195.5</b>	<b>94.0</b>	<b>95.0</b>	<b>92.2</b>

Source: consolidated statement of OJSC "Severstal" in 2007 – 2010, estimation by ISED T RAS.

Against the background of the Vologda Oblast other "regions-metallurgists" spend more less its funds on the buying new assets.

The data given by Rosstat (the Federal Service of State Statistics) about buying subsidiaries according to the type of economic activity "Steel production" were used for making a comparative analysis (*tab. 36*).

As you can see, even in the Chelyabinsk and Sverdlovsk oblasts, where production and profit from metallurgical enterprises are higher than in the Vologda Oblast, the amount of money spent on buying assets, was in 7-15 times lower.

At the same time years of 2007 and 2008 were characterized by global consolidation of steel industry. Many leading companies have declared that the increase of self-sufficiency in raw materials is a key strategic priority for them.

Especially, a lot of mergers and acquisitions by one firm of another were in the USA, where many middle-sized companies were bought by some international steel producers from other regions, including from Russia. According to the journal "Finance", in 2004 – 2008 the largest Russian metallurgical holding companies spent 20 billion USD on the buying assets abroad (*tab. 37*).

The most active buyers are companies Evraz Group and Severstal that made 50 and 30% of all transactions. The most actively buying assets by all Russian holdings was carried out in 2008, when the indicators of industrial and financial activity began to decrease.

Steel companies spent the available resources not only on purchasing new structures, but also on paying dividends.

Table 36. Funds for buying subsidiaries in 2006 – 2009, million rubles

Oblasts	2006	2007	2008	2009	In total in 2006 – 2009	In % according to expenses in the Vologda Oblast
Vologda oblast	31 742.3	25 242.4	50 304.2	31 473.3	138 762	100.0
Chelyabinsk oblast	5 390.3	1 781.4	12 008	177.1	19 356.8	13.9
Sverdlovsk oblast	3 460.4	197.9	1 991.6	3 388.7	9 038.6	6.5
Kemerovo oblast	0.04	1 732.1	0	9.9	1 742	1.3
Belgorod oblast	0	0	162.6	0	162.2	0.1

Table 37. Profile purchases by the steel plants abroad in 2004 – 2008, million dollars

Company	2004	2005	2006	2007	2008	Total in 2004 – 2008
Evrast Group	0	282	110	5800	3315.8	9507.8
Severstal	386	0	30.5	800.9	4502.3	5719.7
Mechel	0	0	0	0	2157	2157
NLMIC	0	0	909	211.6	430	1550.6
MMIC	0	0	0	104	1000	1104
Total	386	282	1049.5	6916.5	11405.1	20039

Table 38. The accrued dividends in the steel plants in 2003 – 2009, million rubles

Plant	2003	2004	2005	2006	2007	2008	2009
Severstal	9425.7	9867	8222.6	10250.9	19247	30956.5	0
<i>In % to net profit</i>	<i>50.1</i>	<i>25.0</i>	<i>24.0</i>	<i>29.2</i>	<i>45.7</i>	<i>80.2</i>	<i>0</i>
NLMIC	36229	10787.8	17979.7	17979.7	17979.7	11986.5	1318.5
<i>In % to net profit</i>	<i>16.0</i>	<i>21.6</i>	<i>51.1</i>	<i>35.6</i>	<i>44.4</i>	<i>16.7</i>	<i>20.8</i>
MMIC	430.5	14244.5	19708.4	34112.4	10488.8	4268.6	4134.5
<i>In % to net profit</i>	<i>2.1</i>	<i>42.6</i>	<i>74.0</i>	<i>90.0</i>	<i>24.0</i>	<i>16.0</i>	<i>56.0</i>

Source: financial statement of OJSC Severstal, OJSC "NLMIC, OJSC "MMIC" in 2003 – 2009, according to RAS (Russian Accounting Standards) and calculations of ISED T RAS.

The analysis of dividend policy has shown that the considerable part of the net profits was spent on these purposes. For example, if in 2004 – 2006 the dividend shares of "Severstal" was 24-29% of net profit, then in 2007 it was 45.7%, and in 2008 – 80%. At the same time the remaining part of its net profit remained unallocated according to the decision of general meeting of shareholders.

At the Novolipetsk steel plant in the period of 2003-2009 the accrued dividends amounted 16-50% of net profit, and at the Magnitogorsk steel plant – 16 – 90% (*tab. 38*).

The most significant dividend payments on the Severstal were in 2008. Considering the company's dividend policy in this year, it is possibly to find out the following feature: the extraordinary general meetings of shareholders,

where it was declared about dividend payments according to the results of 6 and 9 months of 2008, were held on September 30 and December 26, in other words in the first case, when it was clear that the crisis is unavoidable, and in the second case – when the losses were estimated according to results of the 4th quarter.

On November 13, 2008 the general meeting of shareholders at OJSC Karelian rolled briquette, the subsidiary of "Severstal", decided to set flat dividends, once for 2005 – 2007 in amount of 20.5 bill. rub., although the net profit of the company in 2008 was in 2 times less – only 10.1 bill. rub.

All these facts show that before the crisis the dividends reduced circulating funds of OJSC "Severstal", that is necessary timely to carry out production, financial and social obligations.

Table 39. Dynamics of financial indicators in Severstal, Novolipetsk and Magnitogorsk metallurgical industrial complexes in 2008 – 2010, billion rubles

	OJSC "Severstal"			OJSC "NLMIC"			OJSC "MMIC"		
	2008	2009	2010	2008	2009	2010	2008	2009	2010
Own circulating funds*	-38.0	-52.9	-64.4	41.0	43.1	65.1	18.1	11.2	-11.4
Long-term financial investments	274.6	291.8	252.5	109.1	112.3	96.6	28.3	45.6	66.5
Short-term debts	41.4	39.5	79.1	45.3	28.7	36.2	44.2	27.3	26.4
Net profit (+), losses (-)	38.6	1.4	-39.6	71.7	24.0	32.4	10.1	27.4	24.4
Accrued dividends	35.0	0	0	12.0	1.9	7.7	4.3	4.1	4.1
Unallocated profit**	148.8	150.1	106.2	221.9	246.6	274.0	105.7	129.5	149.8

\* Own circulating funds according to ISED T RAS is the difference between capital of the company and its non-circulating funds.

\*\* According to the letter from the Ministry of Finance, from 23.08.2002 № 04-02-06/3/60 unallocated profit is the rest of net profit remaining at the disposal of the organization as a result of the activity in the last fiscal year and decisions on its use (in the direction of reserves to cover losses, dividends and capitalization, etc.). The index of unallocated profit in the balance sheet reflects the net profit accrued during the time of existence of the organization. The decision to use unallocated profit is made by the general meeting of shareholders.

Source: annual statements of metallurgical industrial complexes in 2008 – 2010, according to RAS (Russian Accounting Standards) and estimations by ISED T RAS.

Since 2008, the indicator of own circulating capital of OJSC "Severstal" is in the negative zone and is tending to further reduction. Long-term investments at the end of 2008 have increased in 1.4 times according to their amount at the beginning of the year. Two-thirds of long-term investments were used as investments into subsidiaries. As in 2008 about 80.2% of net profit was directed to pay dividends, the amount of unallocated profit in the 4th quarter decreased in 13.2 bill. rub. according to the amount of profit at the end of the 3rd quarter (*tab. 39*).

Thus, sending capital and reserves of OJSC "Severstal" to dividends and long-term financial investments was the key factors to reduce its own circulating funds before the crisis.

Steady decline in the financial responsibility of the corporation and the synchronous increase in short-term debts continued until 2011. According to the result of 2010 more than 64 billion rubles to finance non-circulating assets by means of own funds of "Severstal" are missing. As a result of its own funds deficit the corporation had to borrow non-circulating funds that inevitably led to increase in short-term debts in 2 times at the end of 2010

compared with the debt at the beginning of the year.

In the 4th quarter of 2010 in connection with loss in amount of 58.8 billion rubles the amount of accumulated unallocated net profit decreased in 63.2 billion rubles against the amount of profit in the 3rd quarter. At the beginning of 2011 unallocated profit as a redundant capital according to the balance sheet of the OJSC "Severstal" is 106.2 billion rubles.

Unlike the "Severstal" the financial responsibility of the Novolipetsk metallurgical industrial complex was increasing during 2008 – 2010. At the beginning of 2011 the plant could send more than 65 billion rubles of its circulating funds to finance non-circulating assets. At the same time debt financing was reducing. In addition, much less net profit (on average 20% against 50-80% in "Severstal") was sent for paying dividends.

In the Magnitogorsk metallurgical industrial complex, on the contrary, the share of its own sources of funding decreased annually, and at the end of 2010 its own circulating capital had a negative value. The lack of own circulating funds was caused by a significant increase in long-term financial investments, costs of fixed assets and incomplete construction.

Table 40. Accrued dividends to the general directors of steel plants in 2003 – 2008

Enterprise	2003	2004	2005	2006	2007	2008
<i>Mordashov A.A. ("Severstal")</i>						
Share fraction, %	82.7	82.7	82.7	82.37	82.37	82.37
Accrued dividends, bln. rub.	7.8	8.2	6.8	8.4	15.85	25.5
<i>Lisin V.S. ("NLMC")</i>						
Share fraction, %	95.5	95.5	89.95	83.16	84.61	86.76
Accrued dividends, bln. rub.	3.5	10.3	16.2	15.0	15.2	10.4
<i>Rashnikov V.F. ("MMC")</i>						
Share fraction, %	No data	No data	97.14	96.98	87.3	86.6
Accrued dividends, bln. rub.	No data	No data	19.1	33.1	9.2	3.7

The major shareholders (the general directors of metallurgical holdings) received the great share of accrued dividends (*tab. 40*).

Results of the analyzing dividend policy in the largest metallurgical holdings of the country allow to conclude that this policy is based on the principle of maximizing owners' profit and then – stimulating future development. Huge amounts of dividends paid to the major shareholders of steel companies show that in recent years in all of these companies was formed the mechanism of transferring assets from corporate to individual property when their profit is derived abroad according to the dividend scheme.

The newspaper "Trud", the Agency of Political and Economic Communications have been ranking social responsibility of Russian companies since 2009. In August 2009, the social responsibility of the Novolipetsk Metallurgical Plant has been estimated by experts at 6.65 points (on a ten point scale), and "Severstal" – at 5.85. As a result of 2010 Novolipetsk Steel was rated at 5.61 points, and "Severstal" – 4.83. The owners of metallurgical corporations mainly solve business objectives. The objectives of national economic and social development in the logic of their actions are still in the background.

### Conclusion

The research of the influence of corporate interests in the steel industry on the regional development allows making some fundamental conclusions:

1. In the Russian regions, where the dominant role in the industry belongs to steel industry, steel production provides more than half of tax revenues to the budgetary system. At the same time income tax is the leading one.

2. The global financial and economic crisis occurred in the Russian economy in the second half of 2008, negatively affected the production and financial activity results of Russian companies operating in steel production. As a result, budget revenues in the federal, regional and municipal levels, as well as the budgetary provision decreased deeply.

3. Social responsibility of Russian companies remains very low. During the crisis, profit of "Severstal" company was used primarily for buying loss-making U.S. companies, for maximizing owners' income and only then for investing profit into the future development.

4. Federal and regional state authorities cannot realize interests of Russian society and territorial communities, and also observe moral norms of behavior which are typical for socially-oriented state. And it is impossible to restrain the desire of private business for a permanent enrichment.

In order to overcome the oligarchic nature of Russian steel corporations, clearly manifested in their activities during the crisis, it is necessary, in our opinion, to correct the existing legislation and to adopt new standard acts. In particular, it should be:

- coming back to the problem of introducing progressive income tax rate. This measure will

reduce the tax burden of poor people and increase tax revenues from the taxation of excess profit, and it can ensure the social justice, as well as stimulation of consumer demand,

- considering the reasonability of establishing single tax rate on dividends in amount of 15%, that will ensure to limit the capital flight and to enrich the state budget,

- strengthening administrative measures according to large-sized business in order to collect debts on payments to the budget and extra-budgetary social funds,

- radically changing legislation that controls insurance payments to social funds. These payments must be paid from all kinds and from all income levels, as health care,

education and social security are a shared responsibility of all members of society,

- adopting standard acts that make investments of corporations in other industries through tax incentives more efficient and profitable,

- restricting right to set up offshore companies by major Russian corporations. In our opinion, it would be useful.

Of course, only the consolidation of all forces in the civil society according to large monopolistic structures will ensure their participation in the socio-economic development of the country and all subjects of the Federation and thus will ensure to increase the social responsibility of Russian business.