The Implementation of Corporate Governance Standards in Large Russian Companies

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Abstract—The best corporate governance practices, summarized in the form of international standards, serve as a means to increase the effective management of major corporations. Presently, the Principles of Corporate Governance by the Organization for Economic Cooperation and Development (OECD Principles) are considered to be the universally accepted standard. The article analyzes the implementation of the OECD Principles in some major Russian companies. For analysis, the assessment methodology of the corporate governance quality proposed by the International Finance Corporation (IFC) is used. Such papers as companies’ charters, shareholders’ meeting conclusions, annual reports, and the reports of the media on corporate events have served as the initial information base about the compliance with recommendations for corporate management. The quality of implementing corporate governance standards was comparatively assessed in eight Russian companies. The first (primary) level for the OECD Principles implementation is characterized by the implementation of 15 standards. Almost every company has already complied with these standards. The implementation of 24 standards was also verified that characterize the achievement of the company’s second (advanced) corporate level. It turned out that only one company out of eight investigated fully implemented all standards of the first and second levels. Voluntary compliance with corporate governance standards makes the corporation more sustainable and investor-attractive that ultimately contributes to its development. Russian companies under study are still in the beginning of the international standards implementation in corporate governance practices. Only the primary level of standards implementation has been achieved that means that only mandatory requirements of applicable law are complied with. A lot of more advanced standards have already been used by companies. However, their complete implementation that allows to speak about the transition to a higher level of corporate governance has not been implemented yet.

Keywords—OECD principles of corporate governance; Russian corporation; International Finance Corporation; IFC; Sberbank; Gazprom; LUKOIL; VTB 24; Aeroflot

I. INTRODUCTION

Any owner is interested in building a simple, economical and efficient system for managing their enterprise. The investor also prefers investing in those companies that have the most transparent and efficient management structure, provide with disclosure about their activities and respect the rights of owners and creditors. The rational management system contributes to the company's performance of all assumed liabilities (including legal requirements), which allows to ensure the sustainability and profitability of the company's functioning.

Based on the theory of transaction costs, the concept of which was introduced by R. Coase [1-3] and developed by O. Williamson[4], we believe that one or the other form of ownership, a particular method of economic management is chosen (consciously or intuitively) on the basis of the necessity to achieve maximum production efficiency. In other words, the selected control method must ensure the minimization of transaction costs associated with the interaction of those who are involved in management (company owners, top managers, State regulatory and supervisory authorities and other stakeholders). From this point of view the used control method is not a mere formal-legal design of technological, financial, investment processes that constitute the production process, and is not generated only by the entrepreneur's personal preferences. On the contrary, the pursuit of production efficiency makes it necessary to introduce certain standards of control and compliance with certain ethical rules of engagement between all persons involved in the management.

In relation to the corporation management the maximum efficiency control will be achieved (at least theoretically) under the compliance with corporate management standards that are appropriate for this exact form of economic management. It is obvious that these standards must not be speculative, they appear from the generalization of the management practice in the most successful corporations.

The most famous standard of corporate governance is Corporate Governance Principles of the Organization for Economic Cooperation and Development (OECD Principles of Corporate Governance [5], unofficial Russian text of the OECD Principles [6] is available). First published in 1999, the OECD Principles have been repeatedly improved, and today are the main instrument in the field of international
corporate governance standards. The current version of OECD Principles was adopted in 2015.

The OECD principles are frequently used by public authorities of countries outside this organization, to improve national legislation as well as corporate executives for practical improvement of management. It concerns Russia as well, where the OECD Principles are the basis for the national Code of corporate governance [7].

A number of publications clarify and develop the generally accepted OECD Principles. Let us mention “The Statement of Principles for Global Corporate Governance” (ICGN Statement on Global Corporate Governance [8]) in that regard. International network of corporate governance (International Corporate Governance Network, ISGN) includes a significant number of participants, such as institutional investors, companies, professional participants of the securities market and individuals. ICGN participants select those companies for investment that are committed to the principles of transparent and responsible corporate management, and ensure the safety of the investment and the equity of income distribution. The latest version of the Statement refers to 2005.

Recommendations on corporate governance are presented in the “Guidelines for Corporate Conduct of the European shareholders’ Group” (Euroshareholders Corporate Governance Guidelines) [9]. The main objective of this organization is the representation of the interests of EU individual shareholders, the protection of small shareholders, the achievement of transparency in the capital markets, increase in the cost of equity of European companies and support of positive corporate governance practices.

There is some continuous work to improve corporate governance systems. In 2015-16, a group of influential U.S. managers made a number of corporate governance principles, the application of which should improve the quality of public companies management in the United States. “Reasonable principles of corporate governance” (Commonsense Principles of Corporate Governance [10]) were signed by the 13th of managers and shareholders of the major U.S. companies, among which should be mentioned Berkshire Hathaway, JPMorgan Chase, General Electric, General Motors and Verizon Communications. The largest asset management companies, such as BlackRock, Vanguard Group and State Street Global Advisors also participated in that work.

In the authors' joint statement that precedes the “Reasonable principles”, it is said that they protect the interests of all groups involved in the management- investors, senior and top managers. In the recommendations, considerable attention is given to relevant factors that can provoke conflicts of interest at the present time. In particular, there are some recommendations to refuse the issue of shares which limit the right to vote, as well as to develop procedures for replacing ineffective Directors.

II. THE PROBLEM

Many large Russian companies use the corporate method of management. They declare their adherence to international standards of corporate governance and are implementing them in their practical activity. However, the degree of implementing the recommended standards depends on the goodwill of owners and top managers of the company. The aim of the study is to evaluate quantitatively the degree of implementing the corporate governance standards in several major corporations in Russia.

III. THEORY

A. Current legislations

Under the Russian legislation [11, section 65.1], the Corporation is determined as a collective form of ownership, the highest management body being the General assembly of its members. The General Assembly appoints the Executive officers of the Corporation, makes decisions on establishment of other legal entities, collectively claims and changes articles of incorporation, etc. [11, article 65.3]. Collective management entails not only benefits in the form of combining forces and resources of the members of the Corporation that are necessary to achieve the statutory goals. It also implies the spread of interests of the Corporation members, not only consent, but also opposition in the process of developing management decisions. Some special legislative rules are introduced to resolve the controversy arising between various owners, between owners and managers, as well as to avoid corporate conflicts. For example, for joint-stock companies, which are the most striking example of the corporation, there exist the special law [12]. However, no matter how detailed these standards are, they are unable to describe the diversity of the corporation members' interests. This makes necessary to develop, introduce and comply with internal corporate standards which regulate the interaction of management participants. Therefore, corporate governance practice suggests not only the implementation of legal requirements but the obligations voluntarily assumed by participants of the management process.

B. Corporate governance standards

It is known that the Corporation must adhere to the following OECD Principles [5]:

- The corporate governance framework should promote transparent and fair markets, and the efficient allocation of resources. It should be consistent with the rule of law and support effective supervision and enforcement.

- The corporate governance framework should protect and facilitate the exercise of shareholders’ rights and ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

- The corporate governance framework should provide sound incentives throughout the investment chain and provide for stock markets to function in a way that contributes to good corporate governance.

- The corporate governance framework should recognize the rights of stakeholders established by law or through
mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

- The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

Each of the principles can be detailed to specific provisions and quantitative indicators that are desirable to achieve, or even surpass.

Corporation is free not to comply with the standards, or to implement them partially or completely. The implementation of corporate governance standards is not achieved instantly, and never finishes completely. Due to the fact that the standard recommendations are of a qualitative nature, there always remain possible improvements to achieve a new, more favorable status of the control system. The standards themselves are also improved. Figuratively speaking, this recalls the race for the horizon, while approaching to the imaginary line between the earth and the sky it moves away from the traveler.

C. Methods

To measure the progress of specific companies on the path to some more exact implementation of corporate standards there was used the methodology of the International Finance Corporation (IFC). In accordance with this methodology four levels of standard compliance can be achieved [13, p. 17].

First level - the company complies with the legislation requirements.

Second level – the company is taking initial steps to improve corporate governance.

Third level – the company has developed a system of corporate governance.

Fourth level – the company is a leader in the field of corporate governance.

To meet a certain standard the company must comply with certain corporate governance standards. For the first level 15 rules should be performed, for the second level – 24 standards, for the third level – 25 standards, for the fourth level – 24 corporate governance standards [14. p. 8].

The performance of each set of rules indicates the achievement of some new, higher-quality corporate governance. The attainment of the first level suggests that the company is simply fulfilling corporate rules contained in national legislation (there are mandatory, in fact). The last, fourth level, means that the company is a role model.

It is important to emphasize that according to OECD principles, any interested party must have the opportunity (if desired), to establish the fact of compliance with the specific demands, based on open data provided by the company on a permanent basis. In other words, if a company follows certain corporate guidelines, but does not report about it, it means (to the outside observer) some failure to comply with the standard requirements.

Thus, by analyzing the totality of the data provided by this or that Corporation, as well as open sources (websites, corporate disclosure, communications media, including the Internet, information about extrajudicial disputes, the decisions of the courts, etc.), it is possible to quantify the level of corporate governance in a particular company, and also to compare the quality of corporate governance in different companies.

An overview of the implementation of corporate norms is found in the annual reports of the Bank of Russia [15]. However, the execution results of those or other requirements are reported in a highly aggregated form, without isolation of the largest, large and/or medium sized companies, and only public joint stock companies (PJSC).

IV. RESEARCH RESULT

The current state assessment of the corporate governance in Russian companies is realized on the example of several largest companies in different sectors of the economy. As the object of study eight major Russian companies were chosen: PJSC “Sberbank”, “VTB 24” (joint-stock company), PJSC “LUKOIL”, PJSC “Gazprom”, PJSC “Aeroflot”, PJSC “Sibir Airlines”, PJSC “Magnit”, “IKS 5 Finance” Ltd.

To identify discrepancies between international standards and corporate governance practice the statutes of the companies were analyzed, as well as corporate governance codes adopted by them, other internal documents, owners’ assembly solutions, the annual companies' reports [16-23].

In the absence of information on implementing specific rules of corporate governance (including informal sources), it was considered that the company did not comply with this norm of corporate law.

For analysis, reports and other information for the period from 2015 to 2017 were taken into account. The degree dynamics of the compliance with corporate governance standards in previous years was not considered. Plans to change the corporate governance system in the future, which were declared by companies, were not taken into account.

At the initial stage of the study the following task was formulated - to analyze the compliance of the mentioned companies to the first level of corporate governance. The initial stage results are presented in [24, 25]. The next step was to analyze the achievement degree by the companies of the second level of corporate governance to obtain a more complete picture of the corporate governance state in the companies. The first and second phase results of the study are presented in Table I. It demonstrates that even large domestic corporations have not done all the initial steps yet to improve corporate governance corresponding to the second level.
TABLE I. CORPORATION STANDARDS IMPLEMENTATION IN THE FIELD OF CORPORATE GOVERNANCE

<table>
<thead>
<tr>
<th>Corporation</th>
<th>Implemented Standards, %</th>
<th>First level</th>
<th>Second level</th>
</tr>
</thead>
<tbody>
<tr>
<td>PJSC “Sberbank”</td>
<td></td>
<td>100</td>
<td>96</td>
</tr>
<tr>
<td>PJSC “VTB 24”</td>
<td></td>
<td>100</td>
<td>96</td>
</tr>
<tr>
<td>PJSC “Gazprom”</td>
<td></td>
<td>100</td>
<td>100</td>
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<tr>
<td>PJSC “LUKOIL”</td>
<td></td>
<td>100</td>
<td>96</td>
</tr>
<tr>
<td>PJSC “Aeroflot”</td>
<td></td>
<td>100</td>
<td>96</td>
</tr>
<tr>
<td>PJSC “Sibir Airlines”</td>
<td></td>
<td>100</td>
<td>79</td>
</tr>
<tr>
<td>PJSC “Magnit”</td>
<td></td>
<td>100</td>
<td>88</td>
</tr>
<tr>
<td>“IKS 5 Finance” Ltd</td>
<td></td>
<td>93</td>
<td>79</td>
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</table>

Let us give some specific examples of non-compliance of corporate governance norms.

It was revealed partial nonobservance of the rules to provide the society and other shareholders additional information about the candidate nominated to the Board of Directors (in companies of PJSC “LUKOIL”, PJSC “Sibir Airlines” and Ltd “IKS 5 Finance”). In the documents of PJSC “Airline Siberia” there is a clause providing additional information about the candidate to the Board of Directors, but the composition of this information is not specified. In other companies, the candidates’ information list is clearly identified in internal regulations.

The standard about the Corporation regulations the availability on the Board of Directors is not observed in the company of PJSC “Airline Siberia”.

We failed to find any information either in public sources or internal documents on training programs that deal with corporate governance for members of the Board of Directors and Executive bodies in such companies as PJSC “Sibir Airlines” and Ltd “IKS 5 Finance”.

The standard, concerning the function extension of Audit Commission is implemented only at PJSC “Gazprom”. In other companies, internal reports indicate that Audit Committee performs its functions set forth by law, but that is all (this can be applied to PJSC “Sberbank”, PJSC “VTB 24”, PJSC “LUKOIL” and PJSC “Aeroflot”). At the same time no regulations on the Audit Commission are available to public in PJSC “Airline Siberia”, PJSC “Magnit”, “IKS 5 Finance” Ltd.

There is not any standard which provides for the presence of representatives of minority shareholders in the Board of Directors, in the documents of companies PJSC “Airline Siberia”, PJSC “Magnit” and “IKS 5 Finance” Ltd.

The analysis shows that there was PJSC “Airline Siberia” and “IKS 5 Finance” Ltd which have reached the least degree of compliance with the corporate governance standards of the second level. However, only the company, PJSC “Gazprom”, has complied with all the standards of the first and second level of corporate governance.

V. CONCLUSION

The best corporate management practices, summarized in the form of international standards, serve as a means to increase the effective management of major corporations. Voluntary compliance with corporate management standards makes the corporation more sustainable and investor-attractive that ultimately contributes to its development.

Taken separately, the OECD principles are clear, and do not seem difficult to implement. However, some comprehensive implementation of the requirements, as well as the achievement of a certain standard level does not appear such an easy task. As it is evident from the study, the most companies adhere to the “almost all”, but cannot achieve higher level of performance standard. Only one company out of eight (12.5% of surveyed companies) overcome first two levels standards of corporate governance. Moreover, it all concerns the major domestic Russian companies that may not refer to the lack of financial resources, skilled management personnel, or the inability to attract external auditors and consultants.

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