

Moscow, 20-21 June 2001

SESSION II: DEVELOPING EFFICIENT BOARD PRACTICES

BOARD OF DIRECTORS: ROLE, FUNCTIONS AND RESPONSIBILITIES

Presentation by

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¹ Dear ladies and gentlemen!

We are grateful to the Roundtable organizers for the opportunity to contribute to the discussion of issues related to Board of Directors' operation in Russian nowadays.

Board functioning raises a number of issues, related, in particular, to the fact that the Board of Directors fails to ensure efficient enough interaction of different parties in the system of relationships of a corporation, while the Board is the very entity supposed to coordinate this system so that it functions in the best interests of all shareholders.

In my presentation I would emphasize an important question: "What to do in this situation", in other words, to try and find ways to improve the efficiency of Boards of Directors in Russia. Here we face a variety of new problems, typical for the Russian business practice.

The Investor Protection Association (IPA) has some very unique features, which enable it to make a deep and comprehensive analysis of the real situation and to understand the moods of the business community to find the most effective solution of the Board functioning problem.

Having set up this objective, the Investor Protection Association, together with the Russian Managers Association and with the support of the Center for International Private Enterprise (CIPE) conducted the Survey in 2000-2001 «**The Role of Independent Directors in Russian Enterprises**».

The Survey had the following main directions:

- study of the main sources of financing of joint-stock companies and their interest in raising equity funding,
- clarification of Russian business community perception of the notion of "independent director",
- study of the specific understanding of independent directors role by managers and investors, and finally,
- evaluation of Russian business community's activity in nominating independent directors to BoDs of open joint-stock companies.

Obtained results evidence the following trends.

¹ The views expressed in this paper are those of the author and do not necessarily represent the opinions of the OECD or its member countries. This paper is subject to further revision.

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First. The main source of funding of virtually all surveyed companies is their own funds. Over one half of enterprises use debt financing. Only 14% of respondents use equity funding, while the demand for equity funding was demonstrated by over 80% companies.

Second. The Russian business community has the following perception of an "independent director". The below criteria were assigned the highest priority in the received answers. So, an independent member of the board is a member which:

- a) is not financially or otherwise dependent upon the controlling shareholder;
- b) is not financially or otherwise dependent upon the company's management;
- c) is not financially or otherwise dependent upon the company's counterparts;
- d) is not a representative of the State, even if the State is a minority shareholder. The latter criterion is obviously the result of Russian business practice specifics, where all the multiple attempts to pass the law about corruption of State officials, "successfully fail" for many years.
- e) a specific note should be taken about one more criterion, cited by 57% of issuers and 15% of shareholders: «An independent director should be a member of an investors' association». This is the evidence of how topical the establishment of such organizations is, so that directors, besides their legal responsibilities, would also be responsible before the company and investors.

We may add from our side that an independent director should be a high-level professional, well aware of all the most up-to-date business trends, to understand main shareholders' problems and should have good knowledge of the situation at the specific enterprise.

At the same time, and this is the **third**, and the most important conclusion of our survey, there is a general positive attitude of both investors and managers towards independent directors on the Boards. In particular, the Russian business community expects the following results of independent directors' activity:

- a) ensuring objectiveness of information about the company;
- b) strengthening investors' confidence towards the company;
- c) improvement of the overall company's image, including on the international markets;
- d) as the result of the above increasing the value of business.

The Survey data unambiguously say that investors, evaluating the perspectives of investing in a specific enterprise, give high score to independent experts' professional opinions and to the presence of at least one independent Board member. This is another proof of the conclusion that the presence of independent directors on Boards may become one of the efficient mechanisms for investors to influence and control the company's activities.

Therefore, independent directors are one of the levers for Russian companies to regain investors' confidence, to strengthen their market positions, to increase the value of their business and, in general, to contribute to the efficient development of the business in Russia.

The Investor Protection Association does its best to increase the number of independent directors in Russian companies. Last year 25 investor representatives were elected to Boards of Directors. This year we have elected our representatives to BoDs of 39 issuers.

IPA, jointly with leading experts in this area, developed a long-term research program «**Functions and decision-making practices of Boards of Directors in Russian companies**». The program includes five separate surveys, the results of which will be published regularly. More importantly, the surveys' basis will be the same companies and institutional investors, which participated in the first Survey. This would allow to track the dynamics of processes going on at enterprises. Our new investors' representatives in BoDs will also join the respondents.

Survey topics:

1. «Board of Directors' responsibilities and competence» (this Survey is already started).
2. «Board of Directors' decision making practices»
3. «Monitoring of the management actions and shareholders' relations»
4. «Board members' appointment and remuneration»
5. «Board members' professional skills».

So by year 2002 we will get, together with the Russian business community, the complete picture of formation and activities of Russian companies' Boards of Directors.

The Association will organize monthly seminars together with one of the leading global consulting firms, starting from September 2001. Seminars' objective will be to present Surveys' results and conclusions and their practical implementation, discussion of important issues of Board functioning, training for BoD members etc..

Seminars' participants will include Board members, enterprise managers, representatives of international and Russian business organizations, State officials.

Thank you for your attention.