The Fourth Meeting of the Russian Corporate Governance Roundtable
THE RESPONSIBILITIES OF THE BOARD AND THE ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE
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INTRODUCTORY SESSION: RECENT DEVELOPMENTS IN CORPORATE GOVERNANCE

RECENT DEVELOPMENTS IN CORPORATE GOVERNANCE

Presentation by

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[1]Good morning everyone. Special thanks to the organizers for the opportunity to attend this forum today. This is the fourth Roundtable and it is encouraging to see the number of participants growing from a meeting to meeting.

Now let me proceed to the topic of my brief speech. I was asked to speak about the latest developments in the corporate governance landscape in Russia. It is not easy to do so in the 10 minutes that I have, because things are changing rapidly in this country, and we, who live and work in Russia, see so many changes happening every day. I decided to go one step further and take you through the implications of these changes on the infrastructure and corporate level, as we at Troika see them. This will be the topic of my speech.

Let me start with citing Robert Hamilton from the University of Texas Law School, who describes the corporate governance in the US in the 1950s, - the description, which I *came across* in his research paper of "Corporate Governance in America"

"**In 1950 the executive officers of large publicly held corporations controlled corporate activities while the role of the board of directors was largely passive. Its composition was essentially determined by the Chief Executive Officer**. *"* [*]

In many respects, Russia's state of corporate governance 2001 mirrors that in America in the fifties:

Boards of directors are largely passive and have few outside shareholders, though this is now changing.

Executive officers do indeed exercise huge corporate powers, more than just control of day-to-day operations.

Few companies have a formal procedure to evaluate the CEO's performance: it is assessed by the one criterion of how well this officer serves the narrow interests of the controlling owner.

Therefore, out of the existing powers, (1) the general assembly, (2) the board and (3) the CEO, the first is deliberately left out of things, the second keeps a low profile, and control is wielded by the Chief Executive.

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[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.
[*] ROBERT W. HAMILTON Law Journal of Corporation Law, Vol. 25, No. 2 University of Texas Law, Public Law Research Paper No. 08 "Corporate Governance in America" (July 2000)

By 2000, America's corporate governance has undergone a revolutionary change: "In 2000, boards of directors of publicly held corporations are composed primarily of independent directors selected by an independent committee. These boards have assumed significant oversight roles in many areas of corporate governance and the role of the Chief Executive Officer has been correspondingly reduced." Robert Hamilton identifies four major factors that contributed to this transformation:

Growth of institutional investors and their willingness to become involved in issues of corporate governance,

Scandals of the Nixon administration,

Development of takeover bids and their subsequent decline

Development of recommendations for improved corporate governance by a variety of respected organizations.

Now, as we look at Russia, as of mid 2001, we find all these four factors tha contributed to the corporate governance reform in the US.

THE FIRST FACTOR. In Russia in 2000-2001 institutional investors may not have ***increased*** their presence but they certainly made their presence ***felt***, by standing up against corporate governance abuse. – the recent examples, the Sberbank, Gazprom, Norilsk Nikel cases. The indifference and non-interference of 97-1998 (TNK, Uralmash Zavody, Sibneft) gave way to a reactive attitude in 1999-2000 (Surgutneftegaz, YUKOS) and a proactive stance in 2000 (UES, Norilsk Nickel, Sberbank, Gazprom).

In early 2001 the Investor Protection Association (IPA) identified 72 companies in which it will seek Board representation. This will be the second consecutive year that small shareholders, led by the IPA, have consolidated their votes to nominate independent directors. Last year, the IPA put forward candidates in 34 companies, including such blue chips as Gazprom, UES, Rostelecom and Aeroflot. However, small shareholders are still underrepresented on the boards of such majors as Norilsk Nickel, Surgutneftegaz, Sibneft, Tatneft and YUKOS. This year, the IPA has decided to bid for directorships in those companies, too.

FACTOR NUMBER 2. The start up capital of the early years of privatization was attended by many loan-for-shares –related scandals. The crisis of 1998 saw a series of scandals involving property redistribution which trailed numerous corporate governance activities which were less than acceptable in any culture anywhere in the world.

FACTOR NUMBER 3. After the crisis the foreign capital fled the market and those Russian Financial Industrial Groups that weathered the crisis were well positioned to take over less successful competitors for half-nothing. Throughout 2000 we saw consolidations across the metal and heavy machinery sector, oil&gas and petrochemical industries, which has continued through the first half of 2001. The current spate of takeover activity has had and continues to have a major impact on corporate governance in Russia.

FACTOR NUMBER 4. Russia has climbed up the corporate governance bandwagon rather late in the day. But, by mid 2001 Corporate Governance has become a center of a public interest. **Reports of corporate governance related workshops and seminars, rating services and investor initiatives are mounting.**

An important stimulus for change in corporate governance was the development of recommendations by international organizations including and the OECD and WB. The present Corporate Governance Roundtable is another instance. Work started in 1998 and has gathered momentum throughout early 2001, with encouragement from the highest level. For instance, the WEF annual meeting in Davos devoted a special session to ailing corporate governance in Russia. The next meeting is scheduled for the first week of July, and to my knowledge there will be further discussions on this issue.

Now, the leading role in the setting of corporate governance standards is played by the regulators, which last January launched a vast educational campaign – promulgating ethos of good corporate governance via the drafting of tailored principles of the best corporate governance practices for Russia. There is no doubt however, **that greater involvement by corporations should be more evident.**

The corporate conduct and corporate culture of Russian Companies, can be briefly summarised, as follows:

In Russia in 2001 there are **no independent directors in the Western understanding of this word**. When it comes to the decision-making the approach “I will vote for you if you vote for me” is a common practice. There are few examples when directors would vote in the best interests of **ALL** shareholders. More often than not directors are lobbying the interests of certain groups that have elected them.

There is a lack of understanding of the fiduciary duties and corporate ethics by directors. Even in the companies where institutional investors have their representatives sitting on the Board – the accountability and information disclosure is inadequate. We very often hear about insider trading activities taking place.

There are still examples where **the management control at supervisory level is critically high**, although the law clearly sets up 50% cap on the presence of executive directors at supervisory level.

Lack of transparency remains the gravest problem, Election of directors, in many cases, is a wild guess. The link between the Board candidates and the group that nominates that candidate is not always clear. Few companies provide sufficient information about candidates and even fewer give any clear indication how various candidates come to be elected or indeed who may have proposed individual candidates.

The next challenge is to improve information disclosure, and as part of a bigger problem - I should mention **the low information value of annual reports, and or web sites** of Russian companies. Few companies dwell on the business growth plans. As a result, mergers and reorganizations often come as a big surprise to shareholders. It has yet to become a rule, that quoted companies advise investors of inherent business risks.

Yet, when we look at Russia of mid 2001, we can see developments which make us optimistic about the future fate of corporate governance in Russia.

Ladies and gentlemen, to close my short presentation I will mention **some really progressive changes on the corporate level**.

The long held practice of mid/late nineties, where the same individual would hold two posts, as a CEO and Chairman of the company, is gone. All companies now separate these two positions, in accordance with the Cadbury recommendations.

The major and encouraging change, which I would call " value enhancement " on a corporate level - is the changing perception of the role of the Board of Directors and acknowledgement of the importance of this role. An independent director has become an attribute of a progressive company.

We know some examples where candidates from a minority shareholders, or institutional investors from IPA members, were supported by a controlling owner.

Furthermore, we also know examples where companies, in search of skilled independent directors often turn to the market for references.

This is very much the stage that most Russian corporates are at in mid 2001.

And as a closing remark now let me go back to what we wrote on the developments on the corporate level in late 2000.

"Most of Russia's assets have been stolen and allocated into friendly hands. Many minority shareholders have had their rights violated. Now we are about enter the stage where those who have stolen will want their rights protected. They will not want other groups to steal from them, they will demand that the law is enforced. Another reason for this will be the fact that these companies will eventually want a proper market rating either because they want access to capital markets or simply for prestige."

As they succeed (and they will to some extent) their ratings will increase and investors will make money. This is inevitable. This is what is happening with Yukos now. And while some investors will hold a grudge against the company, others will be increasingly prepared to take risks and overlook past mistakes and not miss the inevitable bounce when it comes.

I started by comparing Russia with the US. The factors that brought changes around in the US are in place in Russia. More importantly, in Russia we see first series of changes akin to those which took place in America over the last half a century. We are now moving in the right direction the right way, and my big hope is that it will take us less than fifty years to get there.

I am comparing our two countries not because I think that the Russian corporate governance will necessarily grow towards the Anglo-Saxon model, but to emphasize that here in Russia we have the advantage of a hindsight and do not have to reinvent the wheel. This is why I am hopeful that it will take Russia less than fifty years to go where the developed markets are now in terms of the corporate governance. And the market practitioners hand in hand with institutional investors and regulators can push the corporate governance reform along the track. We are confident that together we can achieve the corporate governance goals in a speedy and acceptable manner. We believe so at Troika and this is why we are trying to help the market to grow into maturity, because what is good for the market, is good for the market practitioners.