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SESSION IV: THE ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE

ROLE OF THE BOARD OF DIRECTORS AND STAKEHOLDERS IN THE AREA OF CORPORATE GOVERNANCE

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¹ Thesis of the statement.

This conference should have two fundamental objects:

First, joint discussion should lead to a greater understanding of the conference's participants of actual processes, which take place today in the field of corporate relations, as well as of the role, which stakeholders play and have to play in the corporate governance.

Second, both government representatives and business community representatives have to clarify themselves the general ideology and objects of further work on improvement of the corporate culture in Russian companies and enhancement of the legal regulation in the corporate governance field.

It is important to note that actual processes and practices of the corporate behavior in Russian companies are gradually changing to the better. It is too early to talk about substantial changes, however, loud scandals with armed takeovers are being replaced with more "civilized" methods of fight for the corporate control. This is an inevitable stage of the evolution of the corporate economy.

However, two key issues of the Russian CG [corporate governance] are still urgent – "withdrawal" of assets and dilution of shares of certain types of shareholders. It is important now to have a clear idea about what impels participants of the corporate relations to resort to various quasi-legal schemes of takeover of enterprises and withdrawal of assets. Why are these schemes so easily accessible? Why, even considering a risk, do they require less expenses than civilized technologies of business conduct? Why is it not advantageous now, but even dangerous, to be a full owner of a corporation, without hiding yourself behind nominal owners?

Substantial changes would not take place, while "rules of play" in the field of the corporate governance, established by the state and business community, make "bad" corporate behavior more attractive for the participants. There is no doubt that besides "rules of play" the factors of political instability, economic situation, factors connected with the results of mass privatization exert influence on the investors, creditors and directors of companies.

The general picture of negative processes in the corporate behavior practice can be described as follows.

Two main approaches are practically implemented for the purposes of takeover of enterprises – "dilution" of shares (participation interests) and intentional bankruptcy. Decrease of partner's share is usually implemented through "gaps" in legislation, of which the most important are the following:

- ◆ shortcoming of legal basis of functioning of the accounting system (when actions of registrars result in impossibility of the shareholders to implement their property rights to the shares);
- ◆ low level of the law enforcement practice (for example, it is possible to initiate arrest of the shares as a result of illegal decisions and, therefore, for a certain period of time to deprive the shareholders of the voting rights in the course of making decisions on the charter capital change);
- ◆ insufficient regulation of the procedure for preparation and holding of general shareholders meetings (when the shareholders lose their right or opportunity to vote on issues of the charter capital change).
- ◆ Availability of the bankruptcy procedures in combination with carelessness or insufficient developmental work on the legally established procedures result in use of such institute more likely for the purposes of the ownership redistribution, rather than for financial recovery and strengthening of the payment discipline. Therefore, the role of creditors in the corporate governance is being distorted.

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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- ◆ The problem of assets “withdrawal” arises by virtue of the possibility of obtaining of the corporate control, which is incommensurable with available share in the charter capital. Such possibility appears as the consequence of a number of legal problems, and the most typical are the following:
- ◆ contradictions between labor and corporate laws on issues of the rights and liability of executive bodies of joint stock companies (for example, labor legislation does not exclude unlimited financial liability of single-member executive body, there are legislative contradictions in issues of pre-term dismissal of director from performance of his functions, etc.);
- ◆ insufficient regulation of the procedures and requirements for the information disclosure necessary for making decisions at general shareholders meetings;
- ◆ insufficient regulation of criteria for determination of “major” transactions and transactions which have an “interested party”, as well as definition of “common business activities” (for example, balance value of assets used for determination of a major transaction can substantially differ from market value, assets can be transferred from one organization to another as a result of transfer pricing, etc.);
- ◆ inconsistency between financial reporting standards, applied by the majority of enterprises, and international standards, and as a result impossibility of shareholders to control company’s financial and business activities.

Therefore, even superficial analysis of the corporate governance problems allows to make two important conclusions in many aspects the role of shareholders and stakeholders in the corporate [governance] depends on the legally established rules; state policy in this field should have comprehensive and system character and include several spheres of the state regulation, which can be identified quite clearly today:

- ◆ Regulation of the legal forms (laws on joint stock companies and limited liability companies).
- ◆ Regulation of certain relations (legislation on affiliated companies, insider information).
- ◆ Regulation of the activities of holding companies and financial-industrial groups (legislation on holding companies and FPG [financial-industrial groups]).
- ◆ Regulation of the activities of professional participants of stock market (licensing, certification, registration, reporting, antimonopoly legislation).
- ◆ Regulation of insolvency (bankruptcy).
- ◆ Tax regulation (with respect to taxation of incomes on securities).
- ◆ Antimonopoly policy (with respect to economic concentration, acquisition of major stock).
- ◆ Regulation of labor relations (with respect to rights and liability of executive bodies of companies).
- ◆ Regulation of the investment activities and activities of collective investors (legislation on investments, investment funds, NPF [non-state pension funds], insurance legislation).
- ◆ State policy with respect to self-regulating organizations (legislation on SRO).
- ◆ State policy with respect to standards of financial reporting and audit (legislation on accounting and audit activities).
- ◆ Regulation of appraisal activities (legislative rules requiring obligatory participation of independent appraisers, legislation on appraisal activities).
- ◆ State policy with respect to privatization, nationalization and management of state property (first of all with respect to establishment of legal regime of activities of joint stock companies with state participation in joint stock capital).

State policy in the field of regulation of legal forms should be aimed, first of all, at creation of the conditions for free choice of one or another legal form depending on the purposes of company’s foundation and operation. It is very important that at the present stage enterprises have an opportunity to increase effectiveness both at the expense of industrial and organizational and legal reorganization, especially since the process of concentration and re-profiling of production continues in Russia, in the course of which enterprises are actively acquiring certain plants and subdivisions for the purposes of vertical and horizontal integration, and getting rid of non-specialized and minor productions.

One of the state measures in this field is to work out a draft law “On Reorganization and Liquidation of Commercial Entities”. This draft law envisages solution of many problems, including:

- ◆ regulation of the rules and conditions of participation of enterprises of various legal forms in reorganization;
- ◆ introduction of the necessary means of protection of the rights and interests of participants and creditors of enterprises under reorganization;

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- ◆ regulation of the legal capacity of enterprise under reorganization for the purposes of ensuring of its current activities in the process of the reorganization.

Regulation of issues of affiliation and use of housekeeping (insider) information in the course of conclusion of transactions is now resolved within the framework of working out of draft laws “**On Affiliated Entities**” and “**On Insider Information**”. Adoption of these laws would substantially decrease opportunities for assets “withdrawal” and use of insider information in the course of conclusion of transactions with shares.

Regulation of professional participants of stock market should ensure high level of independence and liability of depositaries and registrars, especially with respect to issues concerning protection of the shareholders rights. Reliability of registration institutes should be increased, first, at the expense of legislative changes – the Government is working out relevant amendments to the law “On Securities Market”, second, through strengthening of the role of self-regulating organizations at stock market.

In the field of legal regulation of accounting and audit activities it is necessary to ensure implementation of differentiated approach based on the enterprises’ needs and opportunities in transfer to the international accounting standards. The state task is to ensure sufficient conditions for application of the international standards of financial reporting (MSFO) and international audit standards by Russian enterprises.

It is necessary to elaborate and to adopt new federal law “On Accounting” as a priority measure. The law should ensure forming of the accounting system, which meets the requirements for reliability, openness and transparency of financial information on activities of enterprises.

It is necessary to adopt new strategy of reform of financial reporting and accounting system for medium-term period, which would take into account the experience of the previous stage of reform and ensure system approach to forming and implementation of the state policy in the field of accounting.

It is necessary to note that along with the necessity of reform of the financial reporting and accounting system, forming of the effective management reporting system is also important for increasing quality of corporate governance. Implementation of modern mechanisms of the management reporting allows the management and owners to have access to actual information about all sides of business and financial activities of the enterprise in on-line mode during the whole reporting period.

By now major Russian enterprises use mechanisms of the management reporting in their activities, performing independent elaboration with use of the international experience. However, absence of any uniform methodological developments in this field significantly hinders formation of management reporting system at many Russian enterprises. Therefore, Mineconomrazvitiya [Ministry for Economic Development and Trade] of Russia considers reasonable to initiate working out of the professional methodical recommendations for introduction and keeping of the management reporting.

Antimonopoly policy with respect to control over capital concentration requires changes at conceptual level.

Today antimonopoly regulation is built on the basis of prerequisite that it is easier to prevent strengthening of domination, monopolization of markets, rather than to be engaged later in revealing of abuses of monopoly position. However, lack of development of the Russian infrastructure of law enforcement results in practice, when preventive measures can be applied only to the obvious forms of integration. At that, the agreed anticompetitive actions, which are not transparent, are not limited. It is obvious that it is more difficult to reveal facts of abuse of dominant market position, but unnecessary preventive measures through control over acquisition of shares may result in containment of economically effective integration processes.

Active legislative work is also being performed **in the field of regulation of insolvency (bankruptcy)**. Today the role of creditors as stakeholders is not adequate to the economic conditions. If someone analyzes statistics on bankruptcy, then one would see that the most part of cases on bankruptcy deals with bankruptcy with the purpose of corporate control takeover.

Draft law “On Insolvency (Bankruptcy)”, being developed by the Government, assumes limitation of opportunities of willful bankruptcy. In particular it establishes the right to appeal decisions on introducing supervision and appointment and dismissal of provisional manager. It is necessary to stipulate the right to appeal decisions establishing the amount of creditors’ claims as well as refusal in establishment of such claims.

It is proposed to change the conception of the external management with respect to granting owners with the rights to take certain decisions regarding enterprise, in particular, the opportunity to perform additional issue of shares for replenishment of circulating assets of the enterprise or converting of creditor’s indebtedness into shares for the purposes of further conclusion of amicable agreement.

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State policy in the field of privatization, nationalization and state property management exerts direct influence on practice and level of corporate governance in Russian companies. The state is one of the major shareholders in the country, which as a shareholder has additional rights in corporate relations in accordance with legislation on privatization. In particular this includes additional rights to control executive bodies, rights to retain shares in the event of additional issue of shares, “golden share” right. In particular from this standpoint the state can be considered as stakeholder in the corporate governance. Moreover, by participating in management bodies of joint stock companies the state may significantly influence on the corporate culture and behavior. In this respect the issue of interests coordination becomes more acute, since the interests of the state as a shareholder, in particular social and strategic, may not coincide with the interests of other shareholders and the company’s management. Many problems arise in connection with implementation of the state rights with respect to companies, shares of which have been sold under certain conditions. These problems relate to management at these enterprises, since they are forced to restrict their activities during several years, and property relations, because ownership rights to shares is transferred only after fulfillment of the conditions.

Therefore, the state policy on issues of participation in joint stock companies should stipulate:

First, clear determination of goals and tasks of management to be posed by state representatives in management bodies of joint stock companies;

Second, ensuring of policy (implemented by representatives) aimed at observance of corporate legislation and civilized rules of corporate behavior.

Given that, the following conclusions can be made:

further work on improvement of the corporate governance should be organized, first, basing on clear understanding of practical problems, with which shareholders and enterprises are confronting; second, basing on the international principles and standards, since many specifics of the Russian business environment are of transitional nature; in order to improve legally established rules of corporate relations the agreed actions in several fields of the state regulation are required. Otherwise local changes of the legal field may not bring to the desired results.