

COMPLIANCE WITH CORPORATE GOVERNANCE PRINCIPLES AS ELEMENT OF RUSSIAN ECONOMY INVESTMENT ATTRACTIVENESS

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ABSTRACT

Over the last few years, the concept of corporate governance in relation to Russian economic realities has been used relatively recently. The concept of corporate governance in the economic practice of Russia was synonymous with production management in 1990-2000. At the same time, "good corporate governance" is a set of activities of public companies in order to ensure high demand for their shares and debt securities from portfolio investors. Corporate governance is a means of trust development both in individual companies and in the stock market of the country as a whole, which is of great importance for long-term investment attraction. According to various global ratings of the countries (for example, to the rating of the financial conglomerate Morgan Stanley, the Russian stock market is classified as an emerging market that provides increased investment returns. The article attempts to determine the main priorities of institutional investors for corporate governance in Russia. The authors come to the conclusion that the development of the corporate governance system is one of the key factors increasing the investment attractiveness of Russian companies. Government regulators take measures to create corporate governance

standards, one example of which is the recommendation to use the Corporate Governance Code approved by the Board of Directors of the Bank of Russia in 2014. In fact, the article highlights both positive and negative trends in the Russian practice of corporate governance. It provides the results of opinion polls among investors, which reveal their motivation to make investment decisions in the Russian market.

Keywords: Corporate governance; Corporate Governance Code; corporate governance quality; investors.

1. INTRODUCTION

According to research by the German investment group Bellevue Investments, the Russian stock market is one of the most undervalued in the world (Sheveleva, 2018; Veselovsky et al., 2018b).

Figure 1 shows the position of the Russian stock market among the countries of the world in terms of the CAPE (cyclically adjusted price-earnings) indicator, which is the ratio of the current share price of companies in the country stock index to the average profit over the past 10 years, adjusted for consumer inflation (Eliseeva, 2019; Pintea et al., 2020).

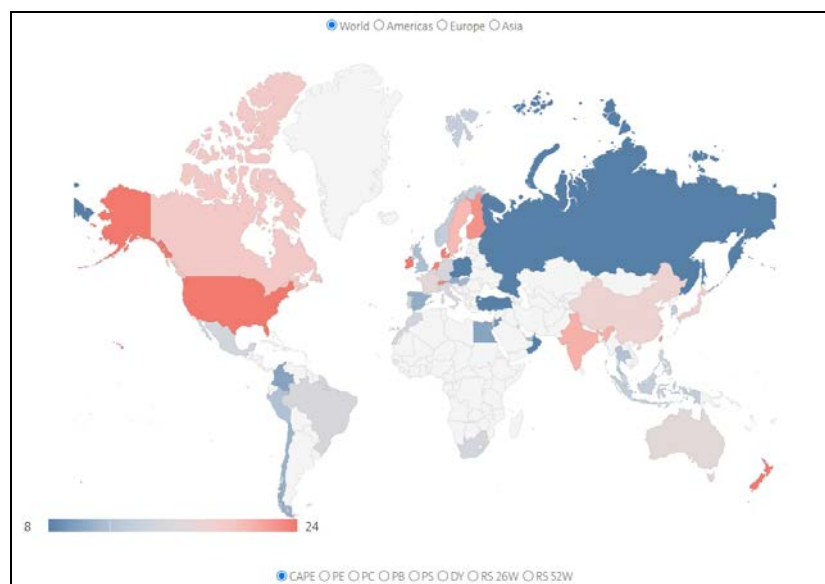


Figure 1: The ratio of the countries according to the CAPE indicator
Source: Izmailova et al. (2018)

Obviously, the lower the CAPE indicator, the more attractive the investment in the country.

Nevertheless, Russia is one of the countries in the world with a relatively low level of direct foreign investment.

Attraction of investments is becoming one of the most pressing problems for Russian companies. According to the report of the United Nations Conference on Trade and Development (UNCTAD) for 2019 (Izmailova et al., 2018), the inflow of foreign direct investment to Russia is 19 times less than to the US economy and it continues to decline.

Figure 2 shows a comparative map of the countries with the representation of their area according to the stock market capitalization.



Figure 2: The ratio of countries by stock market capitalization

Source: Bloomberg, (Here's the map of the world, if size were determined by market cap. MarketWatch, 15.08.2015)

The authors believe that the reasons for the low level of investment in the Russian economy with its potentially high profitability are the low level of corporate governance transparency and the associated risks of foreign investors.

In the current terms, effective corporate governance is one of economic growth drivers, and its main task is to ensure the business environment stability.

The procedure for real disclosure of information on the activities of public companies, their business models, and sources of income generation require significant development. Control mechanisms for top management and the activities of large shareholders are also not effective enough.

It should be noted that in recent years there has been an improvement of corporate governance quality in Russia, and legislation is being improved in regulation area (Nikitichanova et al., 2014).

2. METHODOLOGY

The data base of the study is publications and analytical reports of Russian and foreign organizations on corporate governance quality, the reports and reviews of the Central Bank of the Russian Federation, the World Bank, the European Bank for Reconstruction and Development, the Organization for Economic Cooperation and Development (OECD), the United Nations Development and Trade Conference (UNDATC), etc.

The sources of information are available sources of information, such as the statements of public companies, corporate Internet sites, and news agency info.

The methodological basis of this study is a set of general logical methods (analysis, synthesis, generalization), special methods (monographic and statistical) and the methods of empirical research (observation, description and measurement).

In international practice, they use various qualitative assessment tools applied by investors: rankings, corporate governance indices (Grimminger & Di Benedetta, 2013). Raising the Bar on Corporate Governance: A Study of Eight Stock Exchange Indices, 2013, corporate governance assessment matrices (Izmailova et al., 2018), international scoring of corporate governance quality (Kuznetsov, Rastova & Sushcheva, 2018).

In Russian practice, besides the form of self-assessment of adherence to the National Code recommended by PJSC "Moscow Exchange", the Central Bank of Russia, the corporate governance rating of the Russian Institute of Directors, and the National Rating Agency, and the corporate governance index are applied. The criteria for corporate governance quality evaluation mainly include similar components: the work of the board of directors, shareholder rights, disclosure of information, reasonableness of remuneration, internal control and risk management (Veselovsky et al., 2018a).

To study the dynamics of corporate governance development in the Russian Federation, the CG INDEX scoring method for corporate governance evaluation was applied within the framework of this work.

The components of the assessment are shown in Table 1.

Table 1: Evaluation components (Methodology for corporate management evaluation CG INDEX)

Evaluation components	Maximum of points
Board of directors, remuneration, corporate secretary	25
Composition, structure, functions and procedures of the Board of Directors	

Board committees	
Rewards	
Corporate secretary	
Risk management and internal control	5
Internal audit structure and functions	
Risk management and internal control system	
Shareholder rights, significant corporate actions	9
Dividend policy	
General meeting of shareholders preparation, convocation and holding	
Significant corporate actions	
Information disclosure	15
Annual report	
Internal documents	
Information policy	

The questions are divided into main (based on listing requirements and applicable legislation in terms of information disclosure) and additional ones (based on the recommendations of the Russian Corporate Governance Code). The final grade is recalculated as a percentage of the maximum score for each component, taking into account the weight of the components.

Information about a company can be entered into the CG INDEX database, by independent analysts, by the company itself both with and without external confirmation, which is appropriately noted in the database.

3. RESULTS AND DISCUSSION

3.1. Russian corporate governance development

Efficiency, transparency of corporate governance and the need for its integration into the world economy remains one of the most important issues of economic policy in Russia.

Unfortunately, the privatization process of the early 1990-ies did not follow the path of effective protection mechanism development for investors. The privatization auctions that took place led to an extreme decrease of asset price and their concentration in the hands of large owners, concentration of property among majority shareholders, and, often, to the violation of minority shareholder rights (Belyaeva & Kozlova, 2014). The tendency of the oligopolistic structure development based on the merging of financial and industrial capital is clearly visible.

In 2002, the regulator - the Federal Commission for the Securities Market, which was a government body at that time in Russia - developed a Code of Corporate Governance (Conduct). It was based on the 1999 edition of the OECD Corporate Governance Principles,

and included broad regulation of the main aspects and processes associated with an effective corporate governance system development.

Many experts cited its compliance with the best international standards in force at the time of its creation as the strengths of the Russian Code.

Nevertheless, Russian legislation in terms of regulation degree was significantly behind the Code, which, in turn, was of a recommendatory nature, and which did not contribute to the active integration of global management principles into the economic practice of Russian public companies.

One of the most important transformations on the way to corporate governance development was the approval of the Corporate Governance Code by the Board of Directors of the Bank of Russia in 2014, the introduction of amendments to federal laws aimed at protecting the rights of minority shareholders, the introduction of new requirements for voting at shareholder meetings, increase the stability of small units of shares from "blurring" and other measures. All this acts as a big step towards meeting the expectations of foreign investors (Di Seny, 2015).

The most important changes in the Code concern clarification of shareholder right protection mechanisms and equal conditions to exercise their rights, the composition, structure, functions of the Board of Directors, prevention of artificial redistribution of corporate control, the status of independent directors, risk management and information disclosure.

Significant changes were made to the issues of remuneration and motivation of the management bodies. For the members of the executive bodies, the expediency of a more complex remuneration system introduction, providing for both fixed and variable components, the presence of a short-term and long-term motivation system is fixed.

The annual reporting of issuers according to the criteria of its compliance with the recommendations of the Code is analyzed by the regulator - the Bank of Russia.

At the same time, the document is not obligatory for execution, thus the issue of such monitoring is of particular importance.

3.2. Assessment of corporate governance quality in Russian companies

At the end of 2014, one of the leading professional associations in the field of corporate governance, the Russian Institute of Directors (RID), conducted a study of corporate governance quality among 96 largest public companies in Russia (Nikitchanova).

The total number of companies is divided into subgroups according to the levels of listing of their shares on PJSC 'Moscow Exchange'. The evaluation criteria were the recommendations of the Russian Corporate Governance Code, inclusion in the study at the suggestion of the Bank of Russia.

Further research is also carried out by the Bank of Russia and published on its official website (Prokhorova et al., 2020).

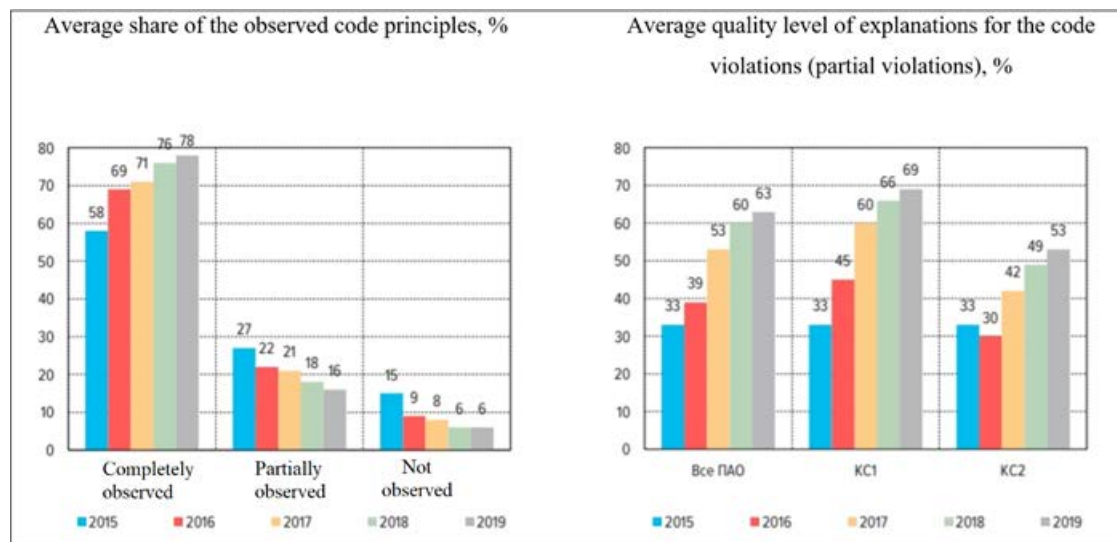


Figure 3: Dynamics of compliance with the requirements of the Corporate Governance Code by Russian public companies

Source: Central Bank of Russia (Review of corporate management practices in Russian public companies at the end of 2019)

The studies give reason to believe that there is a positive trend in the level of compliance with the Corporate Governance Code recommendations (Figure 3).

During the period from 2015 to 2019, the average level of corporate governance principle implementation increased by more than 20% and amounted to 78% in the activities of public companies whose shares are included in the quotation lists of PJSC 'Moscow Exchange'.

At the same time, attention is drawn to the direct correlation between the level of compliance with the principles of corporate governance and the company size.

So, in 2019, more than three quarters of public companies from the first level quotation list of PJSC 'Moscow Exchange' (hereinafter referred to as KC1) declared that 75% of the Code principles were observed, while the same indicator among the public companies of the second level of listing (hereinafter referred to as KC2) makes only 48% (Figure 4).

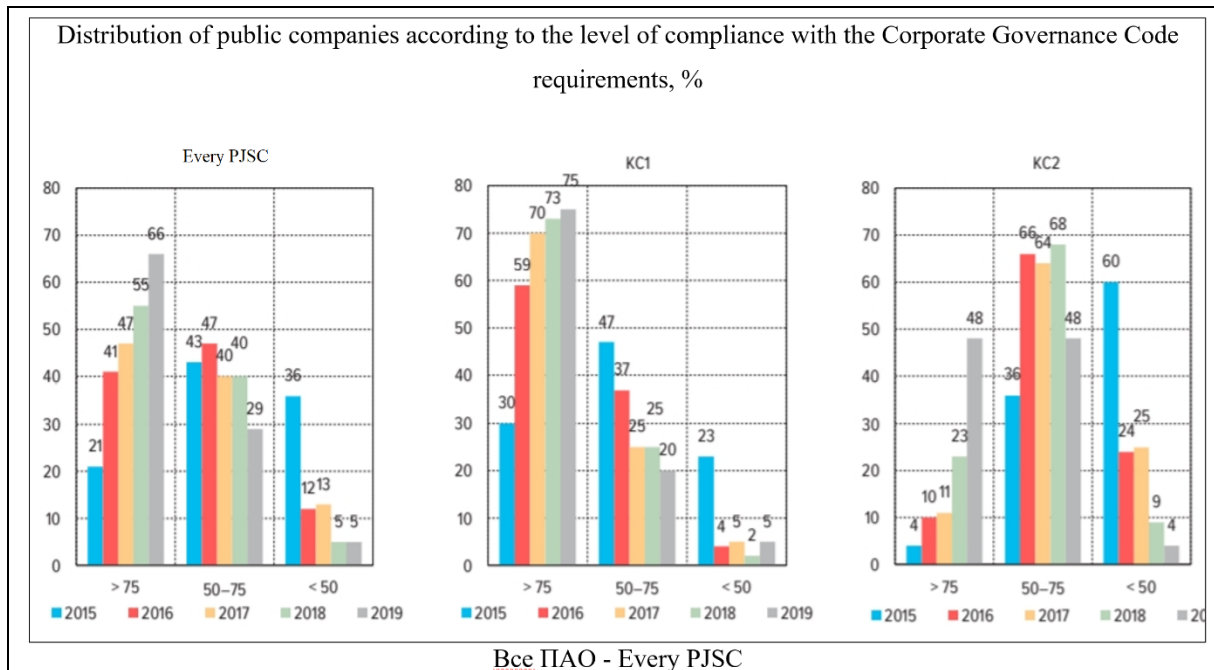


Figure 4: Distribution of public companies in Russia by the level of compliance with the principles of corporate governance, depending on the level of listing on the exchange
 Source: Mokrushin et al. (2019)

The study of corporate governance specific principle observance set out in the Code allows us to conclude that the least popular of them are the following: provision of all persons with equal opportunities to express their opinions at the general meeting of shareholders, excluding the use of other methods of profit (income) earning by shareholders at the expense of the company, in addition to dividends and residual value, disclosure of information about the plans of a controlling person, individual remuneration of an independent chairman (independent director) (table 2).

Table 2: Degree of the Code recommendation implementation regarding disclosure of information about the controlling person plans, and individual remuneration

Recommendation implementation degree, %	Recommendation implementation degree, %
The company has disclosed a special memorandum containing the plans for the company of persons controlling the company	0%
The annual report contains information on remuneration for a group of at least five of the highest paid members of executive bodies and other key executives	4%
An independent director is the chairman of the board of directors or a	10%

senior independent director has been selected among the elected independent directors	
At least once every three years, the Board of Directors is assessed with the involvement of an external organization	13%
The Charter provides for the expansion of the list of grounds of interest in the company's transactions	21%
The annual report contains information on the remuneration for the year of the sole executive body	25%
Information on whether the members of the board of directors and executive bodies have a conflict of interest	28%
The company charter defines a list (criteria) of transactions or other actions that are significant corporate actions, the consideration of which is within the competence of the board of directors	30%
The company has taken on the responsibility to adhere to the principle of inadmissibility of committing actions leading to an artificial redistribution of corporate control	30%
The annual report contains a brief overview of the most significant transactions, including related transactions, made by the company and legal entities controlled by it over the last year	37%
The work quality of the board of directors is assessed on a regular basis at least once a year	37%
The dividend policy complies with the recommendations of the Corporate Governance Code, and also establishes the minimum amount of dividends on the company shares of various categories	39%
The company board of directors has established an audit committee headed by an independent director	40%

It should be noted that after the adoption of the new Code, there have been major changes in the boards of directors of public companies, especially in large ones. The lineups changed by 26% on the average, some companies changed them by more than 80%.

It should be noted that significant rotation may negatively affect the dynamics and continuity of the boards of directors' work.

The study made it possible to identify positive trends in the practice of corporate governance by Russian companies.

One should note more detailed and systematic provision of information on compliance with national corporate governance standards, disclosure of ownership structure and ultimate beneficiaries, and information on the members of management bodies. Increasingly, companies report on the applicable criteria concerning the independence of directors; some companies disclose the applicable criteria concerning the independence of directors.

3.3. Priority factors for corporate governance development

It is obvious that the adoption of the updated Corporate Governance Code in Russia, the changes in corporate legislation are an important milestone in corporate relation development.

Nevertheless, there is a sufficient number of unsolved problems (Gaidamaka, 2015), such as the lack of a consolidated platform for the development of corporate governance, copying of existing corporate governance models without their adaptation to the realities of Russia, insufficient implementation of the “comply or explain” principle, insufficient elaboration of the corporate secretary functions, weak involvement of long-term investors in the decision-making process on corporate governance issues.

It seems that one of the most effective methods of corporate governance is to provide feedback of Russian corporations with institutional investors (Kuznetsov, Rastova & Sushcheva, 2018).

During the survey of investors to identify the areas of the Corporate Governance Code that are of greater importance to them, it was revealed that the main priorities of investors relate to the rights and equal conditions for shareholders (87.8%), information disclosure and information policy (75.8%), the work of the board of directors (66.7%), risk management and the internal control system, as well as to significant corporate actions (63.6%).

Three most important recommendations are highlighted concerning exercising of shareholder rights and equal condition creation for the exercise of their rights by investors:

- Ability to exercise the right to vote in a convenient way freely (87% of respondents).
- Inadmissibility of the existing shareholder dividend right deterioration (83% of respondents).
- Fair treatment of each shareholder, exclusion of abuse possibility by large shareholders (88% of respondents).

More than 91% of respondents also noted the high priority of efficiency and professional competence of the boards of directors of public companies, its responsibility for the appointment of executive body members. About 81% of respondents believe that the chairman of the board of directors should be available to communicate with the company shareholders.

Internal audit and internal control regulations, which should be developed to provide reasonable assurance about the achievement of the company objectives and to manage risks, are considered extremely important by investors - more than 80% of respondents noted them as high priorities.

Among the most important areas of boards of directors' activity (public companies), investors highlighted the setting of principles and approaches to the risk management system and the internal control system in a company (100% of respondents), the creation of a separate internal audit unit (94% of respondents).

The respondents also named the most important recommendations concerning information disclosure:

- Availability of some information policy that allows effective exchange of information with its shareholders, investors and other interested parties (77% of respondents).
- Systematic, timely, accessible disclosure of complete and comparable data (91% of respondents).
- Implementation of the shareholders' right to access documents and information of a company (85% of respondents).

Separately, they noted the importance of timely disclosure of information in English to help investors form an informed opinion.

4. CONCLUSION

One of the main ways of the Russian economy development is to ensure its investment attractiveness, to attract direct foreign investment into the country.

The solution to this problem is possible only by ensuring openness, transparency and clarity of public company activities in Russia, which will reduce the risks for institutional long-term investors and increase the inflow of their investments into the Russian economy.

The adoption by the securities market state regulator - the Central Bank of the Russian Federation - of the Corporate Governance Code is a serious step towards integration into the global stock market, demonstrating the adherence of Russian companies to the principles of corporate governance.

Economic practice reveals new bottlenecks that must be taken into account when they develop corporate strategies and jointly develop the interaction methods for all stakeholders. The results of the investor survey can be viewed as potential starting points for the practical implementation of corporate governance principles in Russian companies.

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