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## WHY CORPORATE GOVERNANCE MATTERS

Russia, as well as most other countries came from the former Soviet Union lacks many effective institutions and rules which, put together, make a healthy institutional environment, pre-condition for economic and social development. Corporate governance is an important component of that institutional environment. Its importance for Russia and, very likely for other former NIS countries not just from the factors which are usually cited when one talks about importance of corporate governance for advanced markets and even other emerging markets. The often cited factor is that companies become more attractive for portfolio investors due to higher protection of minority rights, higher transparency and better control over such key governance-cum-management processes as internal control and risk management, better quality of decisions Made on these issues and strategy and its implementation. Yet, in Russia, corporate governance has another important role to play. It has a potential of cultivating a culture of free professional discussions and make decisions through a consent after, if necessary, several sessions of throughout analysis and discussions.

Russian political and corporate governance, as well as management culture at the top level is quite authoritarian. Authority of person in most cases is determined by his formal mandate and the boss has the right to make final decision actually regardless of opinions expressed by other participants of the discussions provided that they hold positions inferior to the position of the boss. In private companies this style can be dampened by the need to make decisions economically efficient. Although, during the period of economic boom, especially in 2006-first half of 2008, hubris of not many big corporate bosses, heated up by high conjuncture at the international raw materials markets, gained larger scale and started to believe they are prophets with their executives having the only mission i.e. to comply with their prophecies. At the same time, emergence of a generation of effective and successful Russian executives, coming of expat senior executives to top executive positions in Russian companies and with expat directors coming to boards of Russian companies made majority owners more ready to listen to and make decisions on the basis of consent, to greater or lesser extent, regardless of whether this was outwardly recognized or not. Either for business reasons or for apprehension not to provoke a great scandal (if an expat board member is a high caliber figure with international recognition). At the top executive level, the authoritarian style is no less widespread, if not wider. It often happens that a management board recommended by the Russian Corporate Governance Code, formally exists but has little but nod function. Political governance is in a much gloomier state with “I-am-the-boss-you-are-a-fool” style being a rule in most government bodies, be it executive or legislative power.

As effective corporate governance, based on best practices, promotes dialogue culture in decision-making at board level, it may have a tangible positive effect on business culture of Russian companies at large. If adopted at board level, it may have positive effect on the culture at the executive level through top executives who normally are members of Russian corporate boards.

It may sound somewhat idealistic, but improved corporate governance standards, specifically – dialogue culture in decision-making – may have effect at the political governance level, encouraging hearing and listening at the top level of government ministries and agencies, for instance, through boards of companies in which government officials sit together with independent directors from business and expert communities.

Russian President Dmitry Medvedev has recognized that Russia lags behind advanced countries and even the growing number of countries with emerging markets and nascent democracies and called for economic and social modernization of Russia. His speeches accentuate the need for transforming Russian economy on the basis of advanced technologies. Yet, modernization purely on new technologies, most of which, at least in the new future, should be imported, will not work without new management and governance, putting aside modernization of the political system and of social policies.

In late 1960s, the Soviet Union imported from FIAT an advanced car-producing plant (named as AvtoVAZ), which manufactured cars quite popular with Europeans at that time. Car, branded as Lada, became the most popular in the Soviet Union and was even imported. But by early 1980s, it became clear that the plant lost the imported heritage without finding a new effective way of operation. Financial support provided by the Soviet government to AvtoVAZ failed to prevent degradation. For almost three decades after that AvtoVAZ continued to slip downhill. In 2008, the Russian government reasserted its control over it and rendered massive financial support to it, which was spent no visible or any other effect. Despite the switch in control – from state, to private and then back to the state - over the last two decades, AvtoVAZ has experienced no governance/managerial transformation and lived along the lines set in the Soviet era. It is a remarkable epitome of the failure to make a viable business with in-built development mechanism relying only on technocratic and technology decisions and disregarding new governance/management principles and tools.

The importance of corporate governance in economic modernization and in modernization of a broader sense stems from the fact that it is within corporate governance mechanisms and procedures decisions are made on the following vital issues which determine success or failure of companies, be they state-owned or private:

- company strategy, discussions and decisions on which may involve not only those who order it, i.e. owners/shareholders and key stakeholders, but also those who will have to implement it (company executives);
- criteria with which company performance will be evaluated, which can be abortive and shortsighted, or can incorporate goals for various time distances (short, middle, long) and may include not only financial indicators and coefficients but also the use of advanced technologies and advanced governance and management tools (like IFRS, quality management, balanced scorecard, etc.);
- evaluation of risks which company may or event have to take to become a leader on its markets and of those which should be avoided and how to manage risks taken;
- control over how the company executives follow the objectives set by the strategy and specific business plans and use company's assets.

Therefore, corporate governance is an absolutely indispensable part of modernization in a broad sense which is required for many NIS countries.

A very great danger in introducing good corporate governance principles and procedures is imitation.

When I was a schoolboy and just started to learn English, our English teacher explained specificity of English with the following joke: in English word can be written as Manchester but read as Liverpool. Such non-match between what is on paper and in reality often happened. We have seen such non-match not only in emerging markets but also in advanced markets. And, it will make little sense to point figures and to cry – “you are worse than us”. Emerging markets should keep in mind that they have less effective correction mechanisms and their institutional environment is also much weaker than in advanced markets. Practical approach is to learn from various experiences – positive and negative – of others and to seek to make corporate governance working real and efficient in your own company and country.

Herewith I want to express my genuine gratitude to the CIPE for its consistent efforts aimed at improving corporate governance worldwide for the period of almost two decades and a

priceless contribution it has made to generating aspiration for better corporate governance and supporting it in the NIS countries.