

## **RECENT DEVELOPMENTS IN BRIC'S CORPORATE GOVERNANCE WITH A FOCUS ON RUSSIA - INNOVATION OR IMITATION?**

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### **Abstract**

The practice of joint-stock companies in Russia and other BRIC countries suggests that the development of the corporate sector and the stock market requires a corporate governance level of the companies that corresponds to international standards.

The Russian Code of Corporate Conduct was implemented in 2002 and has not been revised for many years. The same is true for Codes of other BRIC countries. 2013 the situation has changed. Russia published a Draft Code of Corporate Governance that should reflect the changes in Russian Corporate Governance over the last 10 years. The paper critically analyses this draft code and gives implications about the future of corporate governance in Russia. We are doing so in comparing Russian Corporate Governance Initiatives with those of other BRIC countries.

**Keywords:** Corporate Governance, Ownership, Control, Russia, BRIC, Code

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### **1. Introduction**

For a proper investigation of the legal corporate governance issues in Russia, understanding the previous corporate structure and legal rights of shareholders is essential (Ikemoto and Iwasaki, 2004, 21).

For this purpose the main stages of the development of corporate governance laws in Russia are presented in table 1 (see as well : Yakovlev, 2004, 6-7; Redkin I., 2003).

From the latest improvements having influence on Corporate Governance legislation in Russia, following documents can be highlighted:

Federal Law "On the Central Depository" (07.12.2011)

Amendments to the Law "On the Securities Market" (29.12.2012)

Amendments to the Law "On Joint Stock Companies" (19.04.2013)

FFMS Order "On the approval of the Regime of the securities admission to organized trading" (30.07.2013)

According to Russian authorities, because of the adoption of these laws the situation in protection of

share ownership rights has improved substantially, as well as in disclosure and information transparency of Russian companies and payments of dividends (Russian Draft Code of Corporate Governance 2013, hereafter Code 2013). However, weak legislation system for corporate relations is not the main problem in Russia's Corporate Governance. The main problem where Russia lies behind its BRIC peers (Brazil, Russia, India, China) is law enforcement.

The key features of corporate governance in Russia include high concentration of ownership and leading role of majority shareholders in companies' management, with the state often being one of the largest shareholders. Inconsistency in the development of CG in Russia, in terms of correspondence with a particular model, lies in the fact that practically the whole history of the Russian legal base formation followed the German (Continental) model; recent corporate practice and corporatization, however, have been actively developed in accordance with Anglo-Saxon tradition.

**Table1.** Main stages of the development of corporate law in Russia

Stage	Characteristics
Late 1980s – 1994: Emergence of demand for corporate corporate.	Development of legal institutions connected with the consolidation and re-distribution of rights on private property assets. Low regulatory potential, systemic gaps in the legal regulation of corporate relations, high conflict potential and lack of legal ways to solve conflicts within the business entities. Corporate law is viewed not as an instrument of attraction of investors into business but as an instrument of power redistribution and companies' takeover. Numerous conflicts on the stock market contributed to the growth of demand for legal regulation of corporate relationships.
1995 – 2000: Improvement of the quality of corporate law.	Significant improvement in the quality of legal regulation of corporate relations due to the introduction of legislative basis for regulation of shareholder relations, creation of Federal Commission for the Securities Market (FCSM Russia). Adoption of the first part of Russian Civil Code in 1994 and of the second part in 1996. Growth of demand for securing of property rights. Adoption of the Federal law on Joint Stock Companies in 1995 and the Federal law on Securities Market. However, corporate legislation had only a regulatory nature lacking sufficient legal sanctions in case of violation.
2000 – present: An integrated approach to the development of corporate law combined with enforcement mechanisms.	More integrated approach to regulation of corporate relations and improvement of the measures of compliance with legislation. New editions of the Russian Code on Administrative Violations and Russian Arbitration and Procedural Code, as well as the new Labour Code, based on market realities (unlike its forerunner from the Soviet time) and amendments on other laws were issued in 2002. New Chapters dealing with the crimes in the stock market were added to the Criminal Code.

## 2. Development of Russian Corporate Governance Codes

Among the central goals of corporate governance are maximization of company's performance, minimization of the risk and protection of the interests of shareholders.

A whole range of investment and consulting companies operating in Russian market has started to promote a culture of corporate governance among Russian companies. They developed standards and codes, valuation methodologies, tried (and are still trying) to explain to the management of Russian companies the need of corporate governance culture improvement. Some foreign investment companies assessing risks of investments in shares penalized Russian companies for the absence of a corporate governance code. Major international institutional investors (pension and investment funds) followed the example of OECD and engaged in the development of their own recommendations.<sup>12</sup>

It started in 2001, when the Russian Federal Commission for Securities Market proceeded with development of the Code of Conduct. It does not come as a surprise that in countries with emerging markets codes tend to pay most of its attention to the

basic principles of corporate governance (such as for example the fair treatment of shareholders, disclosure of information about the owners of the company, its financial performance, the procedure of Annual General (Shareholders) Meeting. Structure of the Russian Code is quite similar to codes of other emerging economies.

The new Code 2013, like the predecessor, is based on voluntary standards (for a discussion of directives vs. standards see Braendle, 2013). However, many large issuers have already declared their readiness to follow recommendations of the Code. For example both biggest state-owned banks have declared readiness to change internal documents (the Code of Corporate Governance in the Savings Bank (SberBank) and the Code and Regulations - VTB), if required by the changing norms of the Code (Газета "Коммерсантъ", №80 (5111), 15.05.2013). Besides, some provisions of the Code, such as those concerning independent directors comply with the listing rules of the Moscow Stock Exchange. As soon as the new document is approved, the Stock Exchange will update listing requirements in accordance with provisions of the Code. As for the content of the Code 2013, the following chapters are included in the code:

Introduction  
Principles of Corporate Governance  
1. Shareholder rights and equality

<sup>12</sup> Экспертно-аналитический доклад «Практики корпоративного управления в России: определение границ национальной модели», 2011, 5

2. Board of directors
3. Executive bodies of the company
4. Corporate Secretary of the company
5. System of remuneration of directors, the executive bodies and other key management employees of the company
6. System of risk management and internal control
7. Disclosure of information about a company
8. Major Corporate Actions

### 3. What is new in Russian Corporate Governance?

The Code 2013 includes some new issues, such as different approaches to remuneration of directors and risk management, which were introduced owing to the recent crises and contain information about incentives for managers and measures to be taken in case of unfortunate events. Main difference/additions to the Code 2013 in comparison with the Code 2002 are summarized in the table below:

Main Issues	Code Edition	
	2002	2013
General Shareholders Meeting (Shareholder rights and equality, 2013)	Shareholders have a right to participate in General Meeting	Participation in General Meeting as a <i>fundamental right</i> of shareholders
	Information about General Meeting min 20 days before	+ electronic notification and information availability (via internet)
		Right to gather a meeting with <= 2% of voting shares
		Prohibition of voting for "treasury" and "quasi-treasury" shares
	List of voting modes	+ electronic voting
	Warrant of Repeated Meeting in big companies (min 500 000 shareholders) with participants owing 20% voting shares (joint)	
Board of Directors of the company	Functions, duties and responsibilities of the board	Clear definition of jurisdiction and functions of the board of directors in the articles of association and differentiation of the powers of the Board of Directors, executive bodies and the General Meeting of shareholders
	Recommendation for independent directors and its definition	More detailed and advanced criteria of independent director definition
	Description of possible committees	Creation of committees is a <i>must</i> for effective functioning of the Board
	Equal Remuneration for all directors	Different approaches to remuneration
		Consideration of interests of such stakeholders as environment
		Establishment of <i>long term</i> oriented goals and perspectives
Executive Bodies of the company	No directorship in other companies except for subsidiaries	No record of directorship prohibition in other companies
		New issues: delegation of powers of the sole executive body to the managing organization
Corporate Secretary of the company	Recommendation of Corporate Secretary position introduction	Corporate Secretary position as a necessity
	Duties of Corporate Secretary	Definition of Corporate Secretary status
		Detailed description of Corporate Secretary functions
Major Corporate Actions	Major (big) transactions, reorganization, liquidation	Listing and delisting of shares, company takeover, increase in the authorized capital of the company
New Chapters		System of remuneration of directors, the executive bodies and other key management employees of the company (different approaches to remuneration)
		System of risk management and internal control.

The new Code is better adapted to international standards of corporate governance. It is more detailed and takes into account latest events in the world economy. The standards of the Code are still not obligatory for application, however, in contrast to the first Code, they are presented in such a manner that implies fulfillment of the standards by the companies or explanations of the reasons of non-implication (comply or explain).

It can be noted, that, in comparison to its forerunner, the new Code 2013 defines participation in General Meeting as a fundamental right of shareholders. Nothing special if compare to best practices, but for Russian realities where concentrated ownership prevails and minority shareholders rights are often disregarded, it is a step forward.

Furthermore, the Code 2013 prohibits "treasury" and "quasi-treasury" shares voting, what used to be a frequent practice, and lowers the minimum threshold for gathering a shareholders' meeting. IT progress is reflected in electronic means of information disclosure as well as electronic voting opportunity.

As for the Board of directors, the CG Draft Code 2013 clearly defines jurisdiction and functions of the board of directors in the articles of association and differentiation of the powers of the Board of Directors, executive bodies and the General Meeting of shareholders. Existence of committees becomes a prerequisite for effective functioning of the Board. Interests of stakeholders such as the environment are now included. The new Code takes into account current business environment and suggests long term oriented goals and organization of risk management. The system of remuneration of directors, executive bodies and other key management employees of the company is also revised in the new Code and a whole new chapter now.

The chapter on major corporate actions was increased by more detailed guidelines in each kind of action, paying a lot of attention to listing and delisting of shares and its redistribution. The position of Corporate Secretary acquires practical meaning and changes from the status of "accessories" of the companies' corporate governance system to the guarantor of the minority shareholders right.

The main problem of still insufficient quality of corporate governance in Russian companies, including those listed on Moscow Stock Exchange, is formal compliance with many of corporate governance code's provisions, that are of voluntary adoption character, and practical non-compliance or only partial compliance with the rules not directly prescribed by the law (Kozarzewski, 2007).

Moreover, in case of some serious corporate conflicts or shareholders rights violation, some issuers and companies try to use even such sort of opportunities, which are for sure a violation of legislation. This can happen, for example, in case of imperfection of approaches to the interpretation of the rules in the current arbitration practice, lack of

sanctions or technical issues, as it can make it difficult for regulating bodies and other shareholders to counteract violators (Kuznetsov and Kuznetsova, 2009, 453).

The problems that are directly touched upon in the Code are according to Shevchuk, 2013, 3:

- Problem of reporting about compliance with the Code
- Disclosure of information for general shareholder's meetings
- Problems concerning activities of the board of directors
- Control over financial and economic activity
- Effectiveness and potential of Audit Committee

In practice committees very often do not exist and their powers are not passed to operating committees. This can have negative impact on effectiveness of the Board's decisions concerning some important for the company and its shareholders issues. According to Russian Boards Survey 2013 made by PWC, only 39% of respondents mentioned clear division of responsibilities for analysis and monitoring of key risks between the board of directors and its committees (PWC, 2013), which can point at limited role of committees in risk management.

The main point of the problem is that shareholders of Russian companies do not have secured by legislation and the Code possibility to receive quality materials for shareholders' meetings in the most convenient for shareholders form in comfortable for them time constraints. Many listed companies announce the date of the ledger closing on the date of its closure. The problem is of major importance especially for foreign shareholders, who are practically being prevented from execution of their right to vote on the general meetings at the level, allowing studying all the materials and making a reasonable decision. Companies often disclose information about forthcoming shareholders meeting strictly in accordance with mandatory requirements of current legislation, but these requirements are not sufficient for international investors (McGee, 2009).

Even the notice of 20 days before the meeting does not allow international investors to vote in absentia, having a reasonable position on every matter of the day's agenda, since they may have a long chain of depositories, each of whom also has its internal voting deadlines. The main reason for weak practical shareholder rights protection is compliance by firms with only minimal requirements of legislation on information disclosure.

Second issue in Russia is that insider directors often do not have required knowledge while independent directors with field-specific experience play rather formal role. Although the institute of independent directors in Russia is actively developing, corresponding changes to legislation are lacking. Criteria of independence do not correspond with international and best Russian practices. Independent director's rights and instruments of

effective influence on the strategy of the Board are limited, which influences the effectiveness of the board of directors. Evaluation of the work of independent directors does not take place in practice or has a formal character (Shevchuk A., 2013, 8). Currently, the role and place of the board of directors in the system of CG in Russia is being qualitatively redefined. Minority shareholders (portfolio investors) have also become more active in processes of votes consolidation for election of independent directors (Ivashkovskaya and Stepanova, 2011, 607).

Apart from the weaknesses of the Code, directly related to its text, there are Corporate Governance problems, not directly touched upon in the Code of Corporate Conduct, that influence the equality of CG and decisions of potential investors:

- Mandatory tender offer when buying 30% and more of the shares
- Fulfillment of obligations by the entities, acquired 95% and more shares of the company, to buy out the shares of remaining shareholders at a fair price
- Participation of "quasi-treasury" shares in the decision-making process during general shareholders' meeting
- Approval of related party and large-scale transactions in accordance with the best corporate governance practices
- Control of parental company over activities and transactions of subsidiary and dependent companies (Shevchuk 2013, 3)

#### **4. Features of Russian Draft Code of Corporate Governance 2013**

As mentioned above, the new draft code puts an emphasis on minority shareholder protection. Other important issues that were paid most attention to are:

1. Structure and operation principles of Board of Directors
2. Transparency
3. Effective mechanisms of minority shareholders rights protection
4. Reporting on compliance with the Code (Litvack 2013, 2)

##### **4.1 Structure and Operation Principles of Board of Directors**

###### *Candidates' nomination for the Board of Directors*

The purpose of Nomination Committee is described in paragraph 2.1.4.4.3. of the Code:

*The nominating committee helps the board of the director achieve a higher professional level and work more efficiently, by making recommendations in the course of proposing nominees to the board of directors* (Russian Draft Code of Corporate Governance 2013, 32).

Thus, the Code makes the role of the Nomination Committee more important, directly including in its mission the task of managing the

process of candidates' nomination for the Board. Here ensuring independency of the Committee from major shareholders influence is very important.

Another positive improvement of the Code, noticed by investors is inclusion in objectives of the Committee of an...

*.....interaction with the shareholders with a view to finding those who can be nominated to the board of directors. Such interaction should be aimed at forming the board of directors in such a way that it would be most suitable for the purpose and objectives of the company and should not be limited to largest shareholders only* (Russian Draft Code of Corporate Governance 2013, 33)

In particular, investors welcome direct call for *such interaction should not be limited to largest shareholders only.*

###### *Independence of directors*

Understanding of the fact that *the board of directors should enjoy the confidence of the shareholders; otherwise it will not be able to function efficiently* (Russian Draft Code of Corporate Governance 2013, 20) is very important for the management of Russian companies. Taking into consideration the lack of clear and consistent definition of independency in current Russian legislation, it is strongly advised for the new Code to include the definition corresponding to best international practice. Thus, it is seen as a very positive improvement that the Code includes detailed description of the factors defining independency of directors (paragraph 2.1.3):

*...persons who are not executive directors and, in addition, who are independent of any officers of the company, its major shareholders, their affiliates, legal entities controlled by the company, and its major trading partners and who have no other relationships with the company which may affect their independence of judgment.*

*In determining specific requirements (criteria) to be met by an independent director, such directors should be presumed to be able to make objective and fair judgments, free from the influence of the company's executive bodies, any individual groups of its shareholders or other stakeholders.(page 21)*

Also very important is increased attention to detection and resolution of conflict of interests, as directors involved in it cannot be defined as independent. Setting the minimum number of independent directors to 1/3 of the board's members may increase the general level of independency of the Board, which will definitely be welcomed by potential investors.

However, it should be noticed that in order to gain the trust of investors some practical evidence of increasing transparency and responsibility of Board's activities is needed. In this sense minimum number of independent directors at 33% is not good enough for companies with dispersed ownership, where this number should account to 50% (Litvack, 2013).

Risks caused by independency from cross-membership in committees (except for short mentioning of positions in remuneration committee) are not touched upon in the Code. The number of shares, above which the director is no longer seen as independent, is too high with 5% (PWC 2013, 11). It is recommended to decrease this parameter. Also, issues, concerning appointment by the government of directors not being executive members of the company should be specified in the Code, as this increases standards of independency.

#### *Committees*

Since most of the Russian companies have only the minimum set of committees – Audit, Nomination and Remuneration, and many companies have no committees at all, recommendation of the Code to create such committees and other permanent or temporary operating committees is seen as a positive step. Moreover, the Code also recommends for chairmen of these committees to be independent directors and the audit committee to be completely independent (Russian Draft Code of Corporate Governance 2013, 25). Nevertheless, it should not be forgotten that effectiveness of these committees depends on its quality, independency and personnel membership.

#### *Risk management and internal control systems*

The board of directors has to provide a proper level of supervision over the system of internal control of the company in financial, operational and reputational fields. Thus, provisions of paragraph 2.1.1 of the Code are seen as a good step forward, as they concern the interests not only of shareholders, but also of stakeholders:

*Board members should carry out their duties reasonably and in good faith, with due care and diligence, and solely in the interests of the company and of its shareholders in order to achieve sustainable and successful development of the company. In addition, the board should consider the interests of stakeholders, including employees, creditors, suppliers of the company, and people living in the territory in which the company operates. In this regard, the board of directors is recommended to take decisions in compliance with accepted environmental and social standards (page 13).*

In addition to this provision, recommendation of the Ministry of Finance (2011) referring to disclosure of ecological information in financial report of the company can be noticed.

#### *Board's supervision of controlled companies*

As it was noticed above in description of the weaknesses of the Corporate Governance Code 2002, effectiveness of the Board's activity is limited by its powers to supervise and make decisions only with regard to direct activities of the company, but not with regard to activities of controlled companies. Therefore, the Code should define the jurisdiction of the board of directors quite broadly, in order to enable the Board with authority to gain information and

make decisions concerning activity of its subsidiaries (Kuznetsov and Molotnikov, 2012, 10). The Code recognizes the problem and stimulates directors to request additional information and, which is very important, urges companies to fix the duty of the company's officers to provide the board members with such information in its internal documents (paragraph 2.1.1):

*The efficiency of work carried out by board members (especially non-executive directors and independent directors) largely depends on the form, timing and quality of information they receive.*

*The information that is periodically presented to board members by the executive bodies is not always sufficient to enable the board members to properly perform their duties.*

*In this regard, board members are encouraged to request additional information when such information is necessary to make an informed decision. The duty of the company's officers to provide the board members with such information should be set forth by the company's internal documents (page 14).*

## **4.2 Transparency**

#### *Disclosure of information about beneficial ownership*

It is a good improvement that the Code urges companies, when needed by investors, to disclose even such information that is not required by law, including information about controlled companies (paragraph 6.4):

*In order to enable the shareholders and investors to make informed decisions, the company should disclose all material information about its activities, even if publication of such information is not required by law. The company should disclose information not only about itself but also about any legal entities which are controlled by and are material to the company (page 50).*

Boards of directors should take responsibility for disclosing information about all important transactions with related parties and for providing this information for examination and approbation by independent outside directors. This recommendation depends a lot on appointing properly qualified and independent outside directors.

Proposed provisions with regard to transactions with related parties on the "Novyj Rinok" are seen positively by investors, however, they warn about limited role of independent outside directors in proposed standard of the "Novyj Rinok" (Litvak 2013).

Furthermore, the Code requires disclosure of information about transactions with related parties to be done in accordance with criteria set by IFRS, where the criteria of materiality for disclosure of the terms of the transaction is 1% (for comparison, Russian legislation sets this criteria to 2%). Also, the IFRS requires more detailed description of

transactions, which is, according to the Code, to be disclosed for transactions with related parties.

Investors welcome provisions of the Code that confirm the responsibility of the board of directors to treat all shareholders fairly:

*In cases where the decision of the board of directors may have different effects on different groups of shareholders, the board should treat all shareholders fairly (page 14).*

Nevertheless, the Code does not say anything about difficulties faced by holders of depositary receipts; neither does it say anything about disproportionate access to information by shareholders owning 25% shares.

#### *Remuneration*

Russian legislation does not empower the board of directors to supervise the policy of remuneration payment to executive bodies, which, as international practice shows, leads to a sharp increase in payments. Also, there is a considerable gap between developing global and Russian best practices for shareholders supervision of remuneration payments for managers (Reznikova, 2012).

The Code contains recommendation for independent from major shareholders remuneration committee to be engaged in development of remuneration policy, which *must comply with the principles of transparency and accountability* (paragraph 2.1.2.5, page 17). How this policy should be implemented, in view of the absence of any practical mechanism of supervision by shareholders, is not mentioned in the Code.

There are also some positive improvements, for example, recommendation to forbid hedging the Board's participation in the share capital of the company (paragraph 4.2.4.).

Also, a very good standard concerning full information disclosure about remuneration of executive bodies and key employees is being established. It includes fixed fee, short- and long-term motivation, severance pay, incentive motivations wrongfully obtained policies. Taking account of risks policy deserves special attention, as it states the need for adjustment of remuneration paying respect to risk management systems and increase in the price of share capital in a long-term perspective (Sharma 2013, 23).

### **4.3 Effective methods of minority shareholders rights protection**

When talking about minority shareholders rights protection by the Code, international investors concern following issues:

1. Equal rights for all shareholders
2. Additional means of shareholders' protection in controlled companies
3. Mandatory offer for shares redemption
4. Voting of shares, belonging to entities controlled by the issuer

### **5. Preemptive right**

Speaking of equal rights for all shareholders, it should be noted that shareholders owning more than 25% of shares have unlimited access to information. However, minority shareholders should also have access to all information, including about subsidiaries and related parties. All shares of the same type should provide for the identical rights.

Main concerns of international investors, which could be solved by additional means of shareholders' protection in controlled companies, add up to a widespread of controlled entities' ownership structures. First of all for the reason that such structures are often associated with inequality of minority shareholders in comparison with major shareholders. Therefore, the Code should include provisions calling for controlled companies to provide for additional means of protection of minority shareholders' rights and interests.

One of the positive issues about the new Code is that it clearly urges companies to follow its principles and not just to comply with the formal requirements of the law, as well as to fill in the gaps in legislation focusing, in particular, on important transactions involving controlled companies (Paragraph 7.4 of the Code, page 104). According to the Code, the board of directors is to be a leading hand when deciding on validity and fairness of the transaction's price for minority shareholders.

Another positive issue concerns principles, related to delisting of shares. They require transparency for this action. According to the best case scenario, the buyer should send a voluntary buyout offer on fair conditions and should not allow a mandatory delisting (Serve et.al, 2012, 3). The paragraph 7.1 of the Code includes another good recommendation: it prompts the boards to enlist the services of independent estimator for market price determination of the assets in case of big transition or transaction with related parties even when a legislative requirement for such an action is lacking.

In general the Code consists of a number of recommendations, capable of lessening old and serious concerns of investors. If its provisions will lead to visible practical changes, it will be a positive step on the way to restore investors' confidence.

### **5. Russian vs. BRIC Corporate Governance**

In this section we will compare the Russian draft code of with BRIC country initiatives (and here a special focus will be on Brazil).

In spite of differences in the history of corporate governance institutes, Brazil, Russia, India and China have a lot in common in benefits and infrastructure of regulating principles, which in many ways ensure their attractiveness for investors. Liberalization of government regulation and dynamic economic growth in biggest developing countries predetermine their

(BRIC countries) growing importance on international financial markets. One of the factors that hold back investment attractiveness of BRIC's companies is corporate governance risks, which is especially true for long-term investments in share capital. In conformity with Standard and Poor's, Russia has the most effective legal infrastructure of corporate governance among BRIC countries. However, its market infrastructure seems to be moderately effective because of the considerable participation of the state in the ownership and tightness in financial markets. Russia yields to India and Brazil in effectiveness of regulating structure, because CG regulation affects significantly only 22 out of 320 public companies in Russia in comparison to all 4985 companies in India and 97 out of 442 in Brazil. And finally, Russia is inferior to all BRIC countries in information

infrastructure in view of disadvantages of accounting standards in Russia and belated change to IFRS (officially in 2012 for some group of companies, including listed ones). For comparison, China introduced very similar to IFRS standards in 2007, India and Brazil use more advanced than in Russia standards and changed to IFRS in 2010 and 2011 correspondingly.

In addition, the latest version of the Code of Best Practice of Corporate Governance in Brazil was issued in 2009 (like in India), which is more recent than in Russia (2002) and China (2004).

For a visual comparison of the state of economy in BRIC countries some socio-economic characteristics of involved countries are presented in the table below:

**Table 2.** Selected Socio- Economic characteristics for BRIC countries

Index	Country				
	Russia	Brazil	China	India	
Population (million), 2012, World Bank	143,5	198,7	1 350,7	1 236,7	
Number of listed domestic companies, 2012, World Bank	276	353	2 494	5 191	
GDP-PER CAPITA (PPP), 2012, World Bank	23 549	11 909	9 233	3 876	
GDP average growth rate (5 years, 2008-2012), World Bank	1,9	3,2	9,3	6,5	
Corruption perception index (scale 0-100; 0-highly corrupt, 176 countries sample), 2012, Transparency International	Score	28	43	39	36
	Rank	133	69	80	94
Sovereign Credit Rating, 2012, Standard & Poor's	Rating	BBB	BBB	AA-	BBB-
	Outlook	Stable	Negative	Stable	Negative

Source: Based on World Bank Data, Transparency International, Standard & Poor's

Russia cannot be compared with China and India in terms of population; also, there are a lot more listed companies in these countries. Moreover, GDP growth rate in Russian Federation decreases more rapid than in other 3 countries and have reached now the level of developed countries which, in case of Russia, is an evident sign of the start of stagnation. By the middle of 2013 economic growth has practically stood still, construction and industry are on the last year's level (Forbes, 2013). However, Russia's GDP-PER CAPITA (PPP) is still notably higher than in other countries. Russia also "wins" in the rating of corruption perception index, which does not really attract new investments in the economy. The government concentrates on support of the state-owned companies, thus preventing establishment of entrepreneurial culture – the basis for a long-term growth.

Comparing Russian Corporate Governance with Brazil makes sense, as the number of listed companies in Russia and Brazil are similar, both countries have lower average GDP growth rate than China and India and both have the same sovereign credit rating. Furthermore, according to Standard & Poor's, in terms of compliance with legal regulations, among other BRIC countries investors feel themselves more

comfortable in Brazil. Furthermore, the problem of poor enforcement of legislation is one of the most important ones.

While investors can feel themselves relatively safe, Brazil cannot cope with real's (BRL) strengthening, which causes the price increase. When the prices are so high (which is also the case for Russia), something must be wrong with the economy. According to comparison of accommodation prices in Four Seasons hotels (19 countries), most expensive rooms are in Moscow, second place belongs to Sao Paulo. In addition to problems with the national currency, the government started a lot of costly projects, which motivated the growth of expenses and taxes in Brazil (Forbes, 2013).

Among other BRIC countries, Russia's legislation identifies the right of minority shareholders most widely owing to low ownership threshold, which allows nominating of candidates for the board of directors; annual re-election of the board of directors; and compulsory use of cumulative voting procedures. Changes to Russian legislation in the end of 1990s – beginning of 2000s eliminated normative deficit that made gross violations of minority shareholders rights in 1990s possible.



However, among extant imperfections are late holding of annual meetings, long-term dividend payout, questionable independence of share registrars, as well as lack of obligation to disclose information about indirect ownership of shareholding, which leads to risks of consolidated share holdings formations behind company's and minority shareholders' back.

As for Brazil, an essential weakness of Brazilian law that regulates mechanisms of corporate governance is a high participation limit in the capital of non-voting preference shares with a floating dividend (up to 67%). This provokes the situation when considerable amount of shareholders receives an income dependent on performance of the company, while having paltry opportunities to participate in its management. Owners of preference shares have the right for conjoint election of only one member of the board of directors and one member of revision commission. At the same time, the only substantial financial compensation of preference shares owners is the right to receive dividends per share in amount of

110% of the dividends per common share. In Russia, for example, the usual ratio is 300%, although, as a general rule, this standard is secured in charters of companies and has no legislative support (Borodina and Shvirkov, 2010)

Other weaknesses of Brazil law infrastructure applied to restrictions on proxy voting at general meetings and opportunity of companies to secure in the chapter an exclusion of additional shares redemption from preferential right (e.g., by placement on Stock Exchange or by additional issue in an effort to merge with payment in shares). Obligatory offer in case of transfer of control in most cases did not apply to preference shareholders. The latest edition of the Code affects this situation.

Finally, judicial system is known for its inefficiency, especially with respect to joint-stock commercial conflicts.

The following table compares main issues of Russian and Brazilian Codes of Corporate Governance:

**Table 3.** Main issues of Russian and Brazilian Codes of Corporate Governance

Issues	Russia	Brazil
Ownership		
One share = one vote	+	+
General Shareholders' Meeting		
Call notice	Law -20 days; Code - 30 days; (notification by mail, personal delivery, or publication of the notice)	30 days
Agenda and documentation	Start of the registration of participants, where registration is conducted, and the person to whom shareholders may address their complaints	Minutes of listed companies
Availability of the participants list	From at least 1% of votes	Any shareholder
Quorum of reconvened general shareholders meeting in large joint stock companies	If shareholders holding on aggregate at least 20 % (30 % in law) of voting shares of the company take part in the meeting	No information in the Code
Anti-takeover mechanisms	Part of Major Actions chapter, along with reorganization and liquidation of the company	+
Family council	-	+
Dividend policy	Individual chapter, main issues: dividend amount determination, payment, consequences of incomplete or untimely payment along with transparency of procedures	Must contain, among other things: the frequency of payments, the benchmark used to define the amount; the process and the parties responsible for dividend payouts; the circumstances and factors that may affect a payout
Board of directors		
Issues of corporate risk management, sustainability, spokesman policy	-	+

Issues	Russia	Brazil
Composition	Executive directors - max 25%; Directors must be in a possession of required knowledge, skills and experience	Recommendation of formation exclusively by external and independent Directors. Clear list of skills and qualifications for the board membership
Number of members	-	min 5, max 11
Number of independent directors	Min 33%	Majority of members; nubber depend on the level of maturity of the organization, its life cycle, and its characteristics
Term of office	-	Should not exceed 2 years, reelection is desireable; maximum number of years of continuous Board service should be defined
Serving on other boards and committees	-	Exact recommendations depending on the type of directorship
Separation of Chairman and CEO roles	-	The CEO should not be a member of the Board, the CEO should attend the Board meetings as a guest
Guests to Board meetings	-	Occasional invitation of other organization officers, technical assistants, or consultants
Committees	Strategic planning, audit, human resources and remuneration, and a corporate conflicts resolution; <i>ad hoc</i> : e.g. risk management and ethics	Among others, audit, human resources/compensation, governance, finance, and sustainability
Ombudsman and Reporting Channel	-	+
Secretary of the Board of Directors	+	Including his/her functions responsibilities
Documentation and preparation for meetings	Well in advance, detailed meeting minutes	Minimum of 7 days in advance; meeting minutes
Relationships with shareholders, the CEO, other officers, committees, the Fiscal Council and auditors	-	+
Remuneration	Equal for all members	-
Liability of its members	+	-
Executive bodies		
Regular reporting	Reporting to shareholders at the annual general shareholders meeting	At least on the web-site on all aspects of firm's business activities
International standards	-	+
Internal controls	+	Should be reviewed at least once a year for effectiveness
Transaction approval	Equal or in excess of 5% - notice to the board of directors; equal or in excess of 10% - approval by the Board	
Corporate Secretary	Individual chapter	
Disclosure of information about company	Information policy, forms of disclosure, insider information	
Independent auditing	+	Approval by shareholders for rehiring after 5 years
Fiscal Council	Mentining only of internal control and audit service, acting independently of executive bodies, report to the board of directors	Separated from audit committee, internal audit and independent auditors, report directly to shareholders

Source: Based on the Brazilian Code of Best Practice of Corporate Governance (4th edition), 2009; Russian Draft Code of Corporate Governance, 2013

In general, Brazilian CG code is better structured and more compact, any issue can be easily and promptly found, while Russian Code is not so easy to follow, the information is scattered all over the place with frequent paraphrasing of already given information. It pays a lot of attention to the issues of the board of directors, definition of independency, issues regarding managerial board, liability of board's members (both board of directors and managerial board), transparency of procedures and confidentiality of information. All in all issues that a country with an "entry level" of corporate governance has to cope with.

In this respect Brazilian Code of CG is more up to date than the Russian. It follows the changes in the Brazilian organizational environment, stresses the value of the best practices and adapts them to the new market demands and realities. First addition of the Code (1999), focused on the Board of Directors alone, and was revised in 2001 to include recommendations for other agents of corporate governance – such as shareholders, managers, auditors and the Fiscal Council. The document was revised again in 2004, with updated content adequate to the country's market demands at the time.

Looks like the issues, on which the Brazilian Code concentrated in 1999-2004, play the major role in the Draft of the Russian Code, which means that even issuing the new Code on Corporate Governance, Russia will be lagging behind the standards of CG in Brazil.

As it has already been said, according to Standard & Poor's, in terms of compliance with legal regulations, (among other BRIC countries) investors feel themselves more comfortable in Brazil. This might have something to do with the fact that Brazilian companies participate in US listings, which have more strict regulations. In other words, Brazilian companies have no choice but comply with legal regulations if they want to be listed on US Stock Exchange, which they do. So, probably, stricter listing requirements would also help Russian companies in lending creditability to investors. After all, Russia is a country that belongs to transition economies, where clear directives are of more use than general legal criteria – standards (Kostyuk et al., 2007).

## **6. Implications for Russia**

Summed up, positive comments on the 2013 Draft Code are:

- The Draft Code covers all JSC
- Nomination committee discusses potential board members with all shareholders irrespective of number of shares own
- Detailed definition of board's independency
- All committees should be chaired by independent directors, whereas audit committee should be fully independent

- The board has to "consider the interests of stakeholders, including employees, creditors, suppliers of the company and people living in the territory in which the company operates" Russian Draft Code of Corporate Governance 2013, 14)

- Companies have to provide additional information to board members when requested, which is considered to be a part of their formal written duties

- Annual evaluation of board's effectiveness, which is to be carried out by an external party at least every 3 years. Disclosure of individual board members meeting attendance for measurement of their effectiveness

- The Code motivates companies (including affiliated ones) to disclose all material information even if not required by law

- Companies trading their securities on foreign markets should make domestic and international disclosure of material information simultaneously

- The Code requires disclosure of pay policies for executives and other managers and recommends majority-independent remuneration committee

- The Code sets out a substantial number of recommendations that seek to allay serious and longstanding investor concerns (e.g. provisions related to delisting of shares require transparency thus urging the buyer to make a voluntary offer on fair terms which prevents forced delisting)

- Explicit disapproval of multiple share structures, support for one share – one vote system, demand for new placements not to violate dividend rights

Criticism and recommendations on the Code:

- The minimum proportion of independent directors should be raised from 33% to 50%

- Audit committee must be composed of financially literate independent directors, whose function has to be explicitly separated from the function of revision commission

- Code's definition of financial literacy falls short of that normally regarded as necessary

- The role of whistleblower protection is underappreciated

- Appointment of the audit firm for IFRS financial statements should be approved by shareholders

- The code neglects clear guidance regarding the balance between audit and non-audit services

- No information about on-going board training and development in the Code

- Disclosure policy should be fair to all shareholders and continuous to all material developments

- The Code could issue a set of best-practice investor relations guidelines against which the companies could be benchmarked

- Disclosure of pay policy should apply beyond the board level and cover highest –paid

executives; Say-on-Pay provision could be introduced.

- The Code should stimulate companies to introduce takeover regulations, especially mandatory tender offers and squeeze-outs, owing to the absence of these amendments in the JSC law

- Application of the Code on Comply or Explain basis is recommended

As we can see, the new draft code has a lot of improvements against the Code of 2002, however many things still have to be included into the new edition of the Code for Russia to fulfill its ambition about Moscow being a new international center by the year 2020. Less than 20% of listed companies fully comply with provisions of the Russian Code of Corporate Governance 2002 with no explicit reporting obligation and no sufficient power of the Exchange to verify reported information (Shevchuk 2013, 25). This cannot be found attractive by investors, therefore it is necessary for Russian listed companies to lift governance standards.

However, as it has already been mentioned before, market participants claim that high standards of corporate governance itself are not a determining factor for investors. In evaluating potential investments, institutional investors are paying attention to the practice of corporate governance. CEO of "Uralsib" Yuri Belonoschenko asserts that investors are more interested in the specific facts of corporate governance such as a change of the ownership or top management, composition of the board of directors. "When a company is just entering the market, investors scrutinize corporate governance practices, but in general for managing companies it is a secondary factor. When the financial or credit analysis of the issuer is being conducted, we are primarily interested in the financial statements,"<sup>13</sup> - said the head of the management company "Promsvyaz" Alexey Ishchenko. In Russia the standards of corporate Governance are becoming higher, but its implementation still remains a problem.

For the new Russian Code of Corporate Governance to become an effective mechanism of best corporate practice formation and identified problems solving, some actions should be taken. Among them are:

- Introduction of changes to legislation and other regulating documents by supplementing provisions of the Code

- Changing the requirements concerning compliance with the Code by stock exchange for companies, included in quotation lists on different levels

- Adoption of voluntary commitments to comply with the Corporate Governance Code (Shevchuk 2013, 27).

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