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THE CRISIS WON'T LAST LONG, AND OUR COMMON TASK IS TO SOFTEN THE BLOW



In crisis conditions, it's critical to make the most effective use of administrative and intellectual resources and to find the funds needed to keep promising business structures that are capable of leading the recovery from going under. Independent Director asked Ernst & Young Managing Partner Alexander Ivlev, a member of the Foreign Investment Advisory Council under the auspices of the Russian government, to discuss measures aimed at solving these urgent problems.

Ernst & Young is a member of the Foreign Investment Advisory Council. Could you say a little about the council and its objectives?

Alexander Ivlev: The Foreign Investment Advisory Council was formed in 1994 on the initiative of foreign companies doing business in Russia. FIAC's activities are overseen by the Prime Minister of the Russian Federation. Once a year FIAC's members meet with the prime minister as well as with ministers in the economic bloc and deputy prime ministers. Seven very effective groups operate under the aegis of FIAC. Between council sessions, these working groups provide a forum where foreign investors can meet with government officials responsible for specific areas. Over the years FIAC has worked to formulate recommendations for improving the investment climate in Russia, and it has helped to resolve many issues in these fourteen years.

What were those issues?

Alexander Ivlev: FIAC has been actively involved in the process of modernizing the tax and customs codes. Much has been done to improve the banking and financial systems. Among other things, FIAC pioneered the introduction of international financial reporting standards in Russia.

FIAC led the way in actively discussing corporate governance and introducing standards in that area. All these issues are strategically important for Russia, because they are watched closely by the world community as it follows the development of the Russian economy and government.

Naturally, Russia can learn a lot from the experience of international companies that know how these issues are resolved in Asia, Africa, Latin America, Europe and the US and can give advice on how to make investors feel comfortable in Russia. Comfort is the key word, because attracting foreign investments means, above all, creating comfortable conditions for investors.

Today FIAC is the most effective forum for interaction between the Russian government and foreign investors. Above all, this has to do with the fact that FIAC is chaired by the Prime Minister of Russia and involves deputy prime ministers and ministers. This all helps in resolving issues promptly and keeping track of how FIAC's recommendations are being implemented, which makes it unique. Ernst & Young is an active member and helps to coordinate FIAC's activities on behalf of foreign investors.

What are the priority issues being worked on right now during the crisis?

Alexander Ivlev: Many of the issues raised in the summer remain relevant today and are on FIAC's agenda for October 2008. Naturally, there are new concerns having to do with the global financial crisis, but I wouldn't say the essential issues discussed by FIAC have radically changed. .

Can you give an expert opinion on foreign investors' attitude toward Russia?

Alexander Ivlev: Investors today approach almost any market with caution – the markets they currently operate in and those they hope to enter. Even in their own countries they're very cautious. Investors are taking this approach because no one has any good understanding of how the situation will develop. Companies are taking a wait-and-see attitude. In no way does this mean that business activity has ground to a halt. Many believe that now is the time to improve their business, to strengthen its position in one or another industry or segment. And with the right strategy and approach, this can be done.

In other words, you feel that Russia is in the same position as other countries as far as investors are concerned.

Alexander Ivlev: Russia is no less attractive for investors than China, India and Brazil.

Could Russia end up last in line for money?

Alexander Ivlev: There are many reasons why Russia can't end up last in line for money. I wouldn't even use the words "last in line for money", but say, "trailing in world economic development". We have certain advantages. The first of these is that the Russian financial system is less complex and cumbersome than the financial systems of developed markets. That is to say, we can react more flexibly to changes taking place in the world and can restructure our financial system with fewer losses. The second advantage is that Russia has a good reserve of natural resources. That's also in our favor. The third is investor

IDA News

On **April 24, 2009**, a "**Government and Business**" roundtable was held in the framework of a joint program sponsored by the Independent Directors Association, Ernst & Young and OPORA Rossii, with the support of the Center for Entrepreneurship USA/Russia. Legislative initiatives taken by OPORA Rossii to help entrepreneurs were discussed, as were tax issues for entrepreneurial companies.

Those who spoke at the roundtable included **T. V. Dermeneva**, a Director in Ernst & Young's Tax and Legal Department; **D. V. Krylova**, Head of the Entrepreneurial Examination Center and member of the Management Board of OPORA Rossii;

V. A. Moryzhenkov, Doctor of Economics, Professor and Head of the Financial Risk Management Department at the State University of Management; **A. A. Pozhalov**, Director of the Entrepreneur of the Year Awards with Ernst & Young; **A. A. Filatov**, Managing Director of the Independent Directors Association and member of the MICEX Exchange Board; and **F. B. Shanayeva**, lawyer, member of the European Association of Lawyers and head of the legal area of the State University of Management's MBA program

The **Government and Business** Program is designed to promote entrepreneurship in Russia, enhance the role of small and medium-sized business in the country's

behavior. If we look at the development of business overall, we'll see that foreign investors are staying in Russia. We're not seeing foreign investors leaving the Russian market en masse. Naturally, volumes are declining, but that's happening on markets everywhere. Considering the general trends, I don't see any signals that Russia is trailing behind other countries.

What actions is FIAC taking so that investors will feel comfortable in Russia?

Alexander Ivlev: At a FIAC meeting once, a former state official said, "You're proposing a huge number of minor legislative amendments. Make one big proposal that would fundamentally change the investment climate". There's no such thing. There are a huge number of "minor" issues that have to be progressively resolved in order to create a favorable investment climate.

What are the priority issues that FIAC plans to deal with in the next few months?

Alexander Ivlev: Above all, of course, the financial system has to be stabilized. It's also important for reforms to go forward. That is to say, further economic diversification is essential. FIAC is giving priority to infrastructure, because infrastructure is unfortunately one of the key barriers to foreign investments. The high level of administrative barriers is a third key item on FIAC's agenda.

Another pressing issue is corruption. Today this issue is coming to the fore, and the government is showing that it's ready to take concrete steps to resolve it. This is a good sign, and progress has already been made. All these tasks are essential, and the government must keep working on them in spite of the crisis. We hope that's what will happen.

For five years Ernst & Young has run the Entrepreneur of the Year Program in Russia. This gives you expert knowledge of the situation faced by small and middle-sized companies, which have been hit hard by the crisis. What actions do you see the Russian government taking to support these companies?

Alexander Ivlev: Small and middle-sized companies create 70%-80% of the jobs in developed markets, so they need to be supported. In mid March, representatives of parliamentary fractions met with the President of the Russian Federation, and many of those present said that, during the crisis, efforts should be focused on support for small and middle-sized companies. I can tell you that in countries that did focus on middle-sized business in October and November of last year, stabilization has gone faster.

What countries are those?

Alexander Ivlev: The US, for example, has taken measures to see that money gets to end consumers. That is to say, resources have reached small and middle-sized companies as well as end consumers. Many countries in Europe are making similar efforts. This is happening in Russia too, but unfortunately the existing infrastructure is cumbersome (one-company towns, social issues), which complicates the recovery process. But that's the reality we have to deal with. It would be good, of course, for entrepreneurs to get more relief, help in restructuring their business and liabilities incurred as a result of the crisis as well as help in obtaining working assets. If this is done and we pool our efforts, I think we'll come out of this crisis, and the consequences won't be as dire as many economists today think.

economy and lower administrative and bureaucratic barriers standing in the way of business.

On **April 9, 2009**, a meeting of the IDA Directors Club was held to discuss "**The Financial Situation in Sectors of the Russian Economy and the Role of Corporate Governance**".

There was a roundtable discussion of the effectiveness of Russian external and internal investment policy, barriers to attracting funds from external and internal investors and anti-crisis measures to regulate the financial markets and create conditions so that funds get to the real sector.

On **March 31, 2009**, a meeting of the IDA Directors Club included a viewing and discussion of the film **Putting It All on the Line**, produced by PriceWaterhouseCoopers.

The film described the actions taken by a major company's board of directors (audit committee), management and legal and financial consultants in response to instances of fraud, bribery and corruption in the company.

The state is taking steps to support small and middle-sized companies. Does small and middle-sized business have its own resources and mechanisms to soften the blow of the crisis?

Alexander Ivlev: Russia has excellent associations of entrepreneurs, such as the Russian Union of Industrialists and Entrepreneurs, OPORA Rossii and Delovaya Rossiya. Naturally, they keep close track of how entrepreneurship is developing in Russia and provide help and support for small and medium-sized business. Active cooperation with these organizations on the part of entrepreneurs is yielding positive results.

Do you plan to develop the Entrepreneur of the Year Program further?

Alexander Ivlev: The crisis shouldn't be allowed to stand in the way of the general development of entrepreneurship. The market correction will come to an end, and growth will resume. I think we should continue to promote the entrepreneurial spirit in Russia, talk about its benefits, share positive experience and get more people involved in entrepreneurship. Russian business has already outgrown the short pants it wore in the mid 1990s. In the international arena, Russian entrepreneurs have moved into the heavyweight category. Today, winners of the Russian Entrepreneur of the Year Awards arriving at the international finals in Monte Carlo are on an equal footing with their colleagues from the US, France, Italy, Spain, Germany and some forty other countries. From the point of view of the methodology and technology of business and innovation, Russian entrepreneurs are no less professional than their colleagues in the West.

Are you planning any additional programs to promote entrepreneurship in Russia?

Alexander Ivlev: We have a Young Entrepreneur Week Program, and, in cooperation with the Center for Entrepreneurship USA/Russia and OPORA Rossii, we're sponsoring a number of programs to train and develop entrepreneurs. We're seeing a lot of interest in such programs on the part of entrepreneurs at all levels in a variety of spheres. People are actively attending the events, asking questions and trying to understand what entrepreneurs are doing in other markets during the crisis. In fact, this is one way for business to recover and survive: entrepreneurs talking to one another, sharing ideas and learning new things.

What would you recommend to owners and top managers of small and middle-sized companies so that recovery from the crisis will go more smoothly?

Alexander Ivlev: Hire good consultants. Today you need to look at a range of factors and assess a company's situation. If management can make the right decision and pull a company out of the crisis on its own, that's great. But if a company is in a difficult situation, business restructuring should be handled by people with wide experience and a broad perspective. If I had my own business, I wouldn't hesitate for a moment to bring in specialists in various areas – from business valuation to mergers and acquisitions. This is essential in order to see all the possibilities – whether a business can be sold or restructured, which financial models should be used. This applies mainly to medium-sized companies. For small businesses, engaging consultants can be a burden financially, but there are always options for cooperation.

Congratulations on being chosen for the President's talent pool. Can you say something about how the selections were made?

Alexander Ivlev: No, I can't, because I wasn't in the group of the experts who proposed candidates for the pool.

Can you say who coordinated the selection process and how it was conducted?

Alexander Ivlev: The process was coordinated by the presidential administration. Those chosen for the pool were selected in accordance with certain criteria, one of which was age. Over 170 experts from business and government were involved in evaluating candidates.

Do you know what those chosen for the talent pool can expect, and what timeframe is involved?

Alexander Ivlev: It's clear that, in order to achieve its objectives, the state requires knowledge – an understanding of the current situation and the economic and political processes going on in the world. Our government will need resources to develop the economy further, and the president's talent pool is just such a resource. Among the people I saw on the list are a great many leading specialists – genuine experts in their fields. And if the government makes good use of their experience and potential, it will make considerable progress toward the goals it has set. Half of the job is correctly placing the resources that

have already been accumulated. The most important thing is to determine precisely where each of these people can be of maximum use and to utilize each in his or her area of expertise. Those included in the talent pool will be called upon to fill top positions in our country's ministries and agencies as well as state corporations and companies in which the state has a significant interest.

Thank you, Alexander. Is there anything you'd like to add?

Alexander Ivlev: I'd like to add that, observing the development of the crisis, we can state that the world economy hasn't gone through such upheaval in a very long time, but I'd like to share my conviction that this

period of decline and depression won't be as long as was originally thought and, despite the forecasts of some experts, won't last for decades. Today we're already seeing the first signs that within a year and a half to two years the situation will stabilize, and we'll be able to adjust to the market correction and resume normal economic growth rates. Our common task is to do all we can to make the economic downturn less painful for everyone. A stable and bright tomorrow will definitely come.

Life goes on.



THE FINANCIAL SITUATION IN SECTORS OF THE RUSSIAN ECONOMY AND THE ROLE OF CORPORATE GOVERNANCE

On April 9, 2009, the Independent Directors Association held an extended session of the Directors Club to discuss "The Financial Situation in Sectors of the Russian Economy and the Role of Corporate Governance".

There was a roundtable discussion of the effectiveness of Russia's external and internal investment policy, barriers to raising funds from external and internal investors and anti-crisis measures to regulate the financial markets and create conditions so that funds get to the real sector.

Speakers:

A. E. Abramov, Professor at the Higher School of Economics State University, stock market expert

A. P. Bychkov, President and General Director of OAO RUSS-INVEST

R. A. Kokorev, Deputy Director of the Corporate Governance Department of the Ministry of Economic Development of the Russian Federation

A. L. Savatyugin, Director of the Financial Policy Department of the Ministry of Finance of the Russian Federation

A. A. Filatov, Managing Director of the Independent Directors Association

Opening the session, **A. L. Savatyugin** said:

"I want to express my gratitude to the Independent Directors Association, which has long promoted corporate governance, and to MICEX, which regularly provides a venue for discussions.

"The Russian government is currently discussing an anti-crisis program that I won't go into, since it's available in the Internet. The first version, which appeared in September, gave priority to supporting the banking system and stemming panic on the part of depositors. These problems we managed to solve, and now we can think about developing our economic system in order to make a graceful recovery from the crisis. The Strategy for Development of a Financial Center in the Russian Federation was approved in January 2009, and shortly, in cooperation with the Central Bank, we're planning to present a Strategy for Development of the Banking Sector.

"The latest version of the anti-crisis program includes a wide range of measures. I can say that, as far as the variety of market support mechanisms, our program is considerably richer than the programs in the US and a number of European countries. Today social policy and support for the

regions have been brought to the fore. But our anti-crisis program leaves corporate governance virtually untouched. Why? The answer is simple: We don't regard corporate governance as an anti-crisis measure. It's a normal practice that should be in place regardless of the situation. The government has given a lot of attention to corporate governance. On the boards of directors of most state companies, including those that are 100% state-owned, only a small number of officials remain. They've been replaced by independent directors.

"State companies make various decisions on dividends. Companies that are 100% state-owned won't pay dividends, but allocate funds for development. Listed companies that are partially state-owned, such as Gazprom, Rosneft, Sberbank and Vneshtorgbank, will pay dividends at last year's level of 10%. This is a necessary step if we want companies and the Russian market as a whole to be attractive as investments."

Commenting on sources of long-term internal investments, **A. E. Abramov** said:

"I want to view internal savings as a source of investments and try to understand what's deterring private investors from entering the market.

"The first deterrent is high inflation. This has to be brought down in order to attract internal investors, because it's not possible to attract conservative internal investors and foreign investors at the same time with 13% inflation. At that level of inflation, an investor who borrows cheaply abroad can afford to invest at a rate of 8%-10% p.a. But an internal investor will have a negative effective yield. For this reason, ruble bonds remain unattractive for internal investors. An internal investor needs to have not only shares in his portfolio, but also bonds, because otherwise he's vulnerable to a financial crisis and can lose up to 80% of his funds. His portfolio needs to be diversified, including instruments with a fixed income. Today these instruments are ruled out by high inflation. In a crisis, bonds can of course be replaced with bank deposits in a portfolio, but it would be good if the stock exchange also offered a variety of instruments. Reducing inflation is the most important anti-crisis measure. The government is working on this, but it needs to do even more if we want to make Russia a financial center relying on internal investors.

"The second deterrent is a lack of information systems to facilitate informed investment decisions. At best, people use a technical analysis for investments. Ten percent of those who learn to do a technical analysis can use it to advantage. Ninety percent can't, and those 90% can lose money and become disillusioned with the market. Not only technical but also fundamental analysis needs to be made accessible to the private internal investor. In Russia, for example, the information made available to private investors by the RBC Fundamental Analysis system covers only a limited number of companies and is often delayed. Access to this resource costs \$700 a year. In the US, the site

www.Smartmoney.com is a simple resource that has information on the great majority of issuers and costs \$58 a year to use. We also lack ratings and other systems for the evaluation of brokerage and investment companies.

“Another key issue is how the value of long-term investment is promoted in investment companies’ products. In Russia, most products are aimed at short-term investors. Today 40% of private investors enter the market in order to speculate”.

O. I. Kalinsky’s talk cited analysts whose latest data show a declining interest in Russia on the part of foreign investors. Against this background, interest in China, Brazil and India is growing. In addition to a decline in the overall volume of investments, the risk premium Western funds expect to receive here is rising. The reasons for this include poor media coverage of the government’s anti-crisis measures and the reluctance of investors unfamiliar with the situation in Russia to make long-term investments due to potential government interference in business.

O. I. Kalinsky said:

“In today’s conditions, it’s important to discuss not only how to bring foreign investors to Russia, but also what to do so that companies like Alcoa that have been here for years and invested huge sums won’t leave. We need to solve pressing internal problems that are deterring investors – develop infrastructure, make administrative procedures simpler, more transparent and efficient and contend with the lack of qualified labor and corruption.

“It’s essential for such professional associations as the Russian Union of Industrialists and Entrepreneurs, the Independent Directors Association and OPORA Rossii to be actively involved in these tasks. It’s they who will help establish the civilized market partnership between business and government that’s so essential in a time of crisis. I especially want to stress the importance for Russian companies of broadly introducing principles of corporate governance. This will not only significantly bolster Western investors’ trust in Russian business but also guarantee a speedier recovery from the crisis as a result of increased efficiency.”

In his contribution to the discussion, **R. A. Kokorev** emphasized cooperation between government and business:

“To what extent can government influence the process of recovery from the crisis? Isn’t there an element of self-deception in the idea that government can overcome the crisis? Isn’t business deceiving itself by expecting the government to come to its aid in a crisis? In a crisis situation it’s important to establish effective cooperation between government and business. Business should make systemic proposals, and government should listen. Today there are no clear formats or procedures for cooperation between government and business. Procedures will never be developed to perfection – it’s a living system – but it’s essential to create and implement effective cooperation mechanisms”.

Discussing the undervaluation of Russian public companies on world markets during the crisis, **A. P. Bychkov** said:

“In 2008 the Russian stock market lost nearly two thirds of its value, falling to the level of five years before. This year investors have been overestimating the risks of investing in Russian assets. Despite strong growth in demand for Russian securities in 2009, base financial ratios show that Russian companies are trading at a discount off the assets of BRIC countries. Thus, the average price-to-earnings ratio for Russian companies in the RTS Index fell to 4.7% as against 11.5% for China, 11.4% for India and 6.8% for Brazil. Investors’ cautious attitude toward Russian assets is understandable because of risks that the Russian economy will sink deeper into recession. But the Russian economy also has good prospects of overcoming the crisis. Ruble devaluation is increasing the role of import substitution as a support for domestic production, and measures to support the banking system have stabilized the situation on the credit market, which should normalize the financing of working capital in the economy. Monetary expansion in the world financial system is creating an appetite for risk and is capable of strengthening the flow of capital into emerging markets, including the Russian market.

“The Russian stock market’s problems remain the same: the dominance of short-term speculators, weak investment activity on the part of the public, low free-float, a comparatively small number of companies quoted on exchanges, insufficient market liquidity and low standards of corporate governance in public companies. The latter problem is especially important. Global investors look closely at compliance with corporate governance standards when making investment decisions. Investors are prepared to pay as much as a 40% premium for shares of companies with a high level of corporate governance. Raising standards of corporate governance is an essential step in improving the assessment of Russian companies as compared with their foreign competitors”.

The risk of fraud: what can be done?



Valery Lepekhin
Member of the
Independent Directors
Association

How may you, as a board member or top manager, be impacted by fraud that does your company significant harm? Do you know how much your company is losing due to the risk of fraud? Do you understand where the risk is coming from and what has been done or is planned in order to avoid it? Do you get the impression that the problem of fraud is far more complex than it seemed at first glance? Let's begin our search for answers to these questions.

What's the Cost?

What consequences can fraud have?

1. Partial loss of investments or profit. Leading specialists put average losses from the risk of fraud at 6% of annual revenue. Ten percent is possible in a crisis, and 15% is quite possible in Russia. Simple calculations for your company can produce startling results.
2. Loss of all investments or profit. The shareholders and executives of Enron, Tyco, WorldCom and a number of financial companies have already experienced this.
3. Disqualification for officers: executives and board members.

What are we talking about?

What is fraud? The answer would seem obvious. Theft and deceit are the first things that come to mind. We fight back and watch sadly as the company loses colossal sums in loss-making investment projects and intricate financial schemes, encounters unforeseen circumstances or loses its strategic advantage on the market due to an incorrect vector of strategic decisions. An unfamiliar picture? I'm very happy for you.

I came across an approach where the concepts of "fraud", "negligence" and "work-related error" were combined in one definition based on "damage" and "lost profit": "a wrongful act (offense) is a violation of the rights and interests of Group companies and their shareholders caused by actions (inaction) by individuals or legal entities and taking the form of damage or lost profit or a risk of damage or lost profit".

That said, we can note a number of material factors and risks in connection with fraud:

1. submitting unrealistic or aggressive plans, transactions or decisions for approval
2. exceeding authority (for example, by concluding disadvantageous transactions in violation of internal instructions)
3. subjecting the company to excessive risks by failing to take adequate measures to minimize risks.

Conditions and risk factors of fraud in Russia

In Russia there are a number of factors that magnify the risk of wrongful acts and make them difficult to contend with.

First, the system of management in Russia, both today and historically, has never had good internal control procedures. Recall how we set goals: "Do as you like, but get it done!", "Results at any cost!" Also, subordinates (the management of a remote subsidiary, for example) aren't always eager to reveal their inner workings and respond by saying, "You set the goal, and we'll figure out how to meet it". Managers say, "It's because of complex and needless procedures that deadlines haven't been met. Get rid of them! They're the problem". As a result, it's extremely difficult in Russia to implement a key element of any antifraud system: a system of internal control procedures.

Second, we can note the weak legislative base and inadequate efforts to hold employees accountable for violations.

Third is "group solidarity", when the lack of systemic procedures makes it difficult to identify those responsible for risks or decisions, when documents are approved by a multitude of people (and it's totally unclear what the approvers are responsible for), employees cover for each other, etc. It's as if the Russian system of management protects itself collectively against external threats (dismissal of managers, etc.). This is all a heritage of our past (by no means only the Soviet past) and has to be taken into account.

What can be done?

For a start, there needs to be an experienced manager who can lead the efforts to minimize the risk of fraud. Special attention should be given to his practical experience in this area and personal characteristics. A plan for implementing an antifraud system should be prepared, then reviewed and approved at a meeting of the company's board of directors. Listed below are the key elements that such a plan should focus on.

Creating an atmosphere of openness and high ethical values:

- Tone set from above: unconditional support, involvement and personal examples on the part of board members and top management. Open communication to

employees, in word and deed, of a policy of intolerance toward wrongful acts, even in cases where they partially benefit the company. Equality of employees at all levels as regards these principles.

- A mandatory code of ethics and practical mechanisms for implementing it. Written confirmation at least once a year by all employees that they accept the code (and adoption of a decision on employees who refuse). Monitoring of compliance with the code, a standing ethics committee, unfailing reaction to the committee's reports.
- Reports to the board of directors on sanctions imposed in all significant cases of code violations or when harm is done to the company
- Making each employee understand the consequences for all of fraud by a single person (poorer financial result, resulting in lower bonuses). Antifraud training for every employee.

Preventive internal-control procedures (based on a map of risks and reasons for fraud risk):

- Demonstration of an uncompromising attitude toward violations or deviations from procedures and the inevitability of sanctions. When employees react by saying, "Then get rid of all these unneeded procedures", the board of directors and management should have a single response: "It's your responsibility, as the process owner, to develop internal-control procedures ensuring a reasonable balance of performance and risk minimization, after which they must be followed unconditionally. Internal audit is responsible for checking their effectiveness".
- Periodic evaluation of control procedures and risk factors

Examples of such procedures are: transparent selection of counterparties, restrictions on the adoption of decisions and conclusion of transactions (no powers of attorney that are delegable, are valid for more than one year or involve a broad range of transactions or unlimited/substantial transaction amounts), review of agreements before assets (goods, funds) are disposed of, periodic rotation of employees in positions entailing a risk of fraud, etc.

Examples of regulatory documents are: an antifraud policy, rules for reacting to signs of fraud, a responsibility-allocation map for fraud prevention.

Ensuring discipline:

- detection procedures (internal hotline, anonymous employee surveys, pre-termination interviews with employees, audits and other checks)
- evaluation of potential or actual harm to the company
- internal investigations by a special department
- inevitable and appropriate actions with respect to offenders (to the extent of filing materials to initiate criminal proceedings)

- publicizing facts of violations and sanctions taken
- proposing and implementing systems of preventive measures based on facts uncovered

Creating a positive working atmosphere in the company:

- involvement of employees so that they don't feel ignored or threatened or that their rights are infringed
- clear separation of duties and responsibilities at all levels of management, from the board of directors to those who implement decisions.
- recruitment of employees who share and support the company's ethical values
- avoidance of an authoritarian style of management
- realistic goal-setting
- a system of motivation that supports these goals and ensures transparent and appropriate evaluations and compensation
- career development and substantial equal opportunities for employee growth, depending on compliance with ethical standards
- adoption of decisions taking into account the principles of teamwork and involvement

Oversight:

- a professional internal-investigation department
- periodic reviews by the management board, audit committee and board of directors of progress in implementing the program
- professional external and internal audits and a review board
- oversight by executives, legal service, security service, etc.

Conclusion

It can't be done all at once, but a journey of a thousand miles begins with a single step. Good luck, and take care!

EFFECTS OF THE CRISIS: CORPORATE FRAUD



Sergei Yeliseyev
Crisis Manager,
Management
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The world financial and economic crisis is progressing. According to experts, it still hasn't hit bottom. Signs of crisis in the Russian economy will multiply: a long decline in industrial output and export, an increase in loan defaults, a second wave of bankruptcies in the banking sector, widespread budget and staff cuts, rising unemployment, a decline in purchasing power, growth in consumer prices due to strengthening foreign currency and the foreign-currency component of domestic manufacturing, rising unit cost in conditions of falling output, arbitrary price formation on the part of monopolies. The ratio of income to expenses for all levels of company personnel will also worsen, and personal demand for money will grow.

Market turbulence significantly alters the structure of sales channels and the understanding of the relative cost of products. Thus a subjective factor – the desire to maintain quality of life and income level – and an objective factor – tectonic shifts in the commodity-flow and price-formation system – create a powerful incentive for growth in corporate fraud.

The antifraud function is an inevitable part of a crisis manager's work. Relaxed security and increasing losses from corporate fraud are characteristic of companies in crisis. This brings the practice of fraud into focus and allows generalization.

Principal fraud schemes

Falsified records and misdescription

A widespread scheme involves the supply of raw and other materials used in manufacturing. When, for example, scrap metal, alloying materials or sunflower seeds are received, a false amount, better quality, higher active content, less impurities, etc., are recorded. In the case of weighing, dirt, pieces of reinforced concrete, off-grade fraction, etc., are used to increase the weight. There have been extreme cases in which, after the first weighing,

trucks weren't even unloaded but went around a second time. The supplier pays off the receiving clerk or his supervisor for such false reporting – sometimes right on the spot. The scheme works in combination with relaxed incoming control and unmonitored write-offs of production costs.

A similar scheme is used with commercial output. Expensive metal ingots are exported as cheaper metals. Printing products of normal quality are rejected and sold as off-grade products at reduced prices – as a rule, to the same firm. The products then go on the consumer market at prices close to the market level.

Déjà vu: repeat purchases and write-offs

Valuable items follow the scheme: purchase (real), write-off (part-real, part-fictitious), then a second purchase, this time fictitious. The supplier, the person involved in receipt and storage and the person responsible for installation or use and write-off are involved in the plot. The scheme works well with spare parts and assemblies for vehicles and equipment as well as with fittings and fixtures. There have been some extraordinary cases: A four-member commission did a two-day inventory of parts, assemblies, materials and structures relating to the chief mechanic's function in one production facility and found that six of eight 20-ton containers were filled with items that had already been "written off". In conditions like this, repeat purchase doesn't present a problem, and the enterprise had four such production facilities. Another example: basic equipment is written off as scrap metal and exported, then upgraded and imported as new equipment. Exportation is not an essential link in the scheme; upgrading can also be done domestically.

Unrecorded production

This scheme relies on inflated technology allocations and/or unrecorded raw materials that yield unrecorded commercial output. The current situation with allocated consumption of raw materials, energy and labor can only give rise to concern. As a rule, new facilities with imported equipment lack substantiated allocations. Production facilities remaining from Soviet times use the allocations of that time. It should be kept in mind that each of the "red directors" in ministries and sector institutes had one task: to increase "scientifically" determined allocations. Directors used inflated allocations as a reserve to cover losses, shortages, irresponsibility and theft. There was no other way to survive in conditions of total resource allocation and the principle "ask for extra to get what you need". So you have either a lack of effective allocations or ineffective Soviet allocations. And it gets even better. Responsibility for adjusting, developing and improving allocations is handed over to manufacturers, who are products of the Soviet era. Unrecorded raw materials are often the result of inflated allocations

at previous stages. There are chains like this in the alcohol industry (grain – alcohol – alcoholic beverages) and the furniture industry (wood – particle board – furniture parts). The following story is instructive: Law enforcement agencies arrested a criminal group involved, among other things, in theft from the N-sky Plant. A scheme involving the export of unrecorded output was interrupted, and excess output worth over a million dollars piled up in the first month. The sale of unrecorded output is just a matter of technique. There are various means of exporting such output: through a hole in the fence, in vehicles with hidden compartments, by arrangement with border guards, under false documents or real documents with a double insert. For example, goods are officially sold to an employee to be exported by private transport. In fact, the goods are exported several times. If the guards don't search the trunk, the export is illicit. If they do look in the trunk, the real documents are presented showing "purchase for personal use".

Price manipulation

This category involves purchases at inflated prices, low prices for individual orders, higher discounts, etc. In any case, the counterparty receives an additional amount of money out of which it pays an employee who adjusts the price. Common justifications are: the client's importance, the need to expedite the transaction, the supplier's reliability, the lack of options, the counterparty's familiarity with our business, etc. Mutual offsets provide a convenient opportunity for price manipulation. Another example: Actual prices are kept secret, and higher prices are quoted to the purchaser. When the purchaser suggests "coming to an arrangement for a fee", he is offered prices from the current pricelist. It would seem a harmless game. After all, the company hasn't lost anything. But the actual losses are a distortion of price formation and employee motivation, guaranteeing a lower return on sales. All these schemes operate in the absence of working rules for price formation and an analysis of the price situation.

Other varieties of manipulation don't depend on the effectiveness of price formation. For example, an employee of a firm selling finishing materials to a usual customer (the owner of an apartment) makes out the sale to a customer with a higher discount level (a designer), and the difference in price is pocketed. A kickback scenario is encountered in complex and high-priced sales: money intended as a payoff for the buyer is split, and part is kept by the seller.

Contract work

It's a big topic, but we'll look at five key points in this article.

1. *False recording of amounts.* Common examples:

- use of exaggerated units of measurement in an estimate
- use of a single layer of new roofing material over the old layer, while indicating two new layers and removal of the old in the estimate
- exaggerated area of hidden work to prepare surfaces (leveling, plastering, priming and sealing)
- inflated amounts of dirt removed, gravel filled in, and asphalt laid in connection with road repair

2. *Unjustified use of multipliers.* Including for nonexistent adverse or confined working conditions, for fictitious use of hoisting mechanisms, scaffolding, etc. In one slightly unusual example, ordinary the need to repair a chimney and the related estimate were based on a calculation that was "mistakenly" done for a 150-meter chimney, whereas the chimney was actually less than 30 meters high! The mistake was worth 35% of the project's cost.

3. *Doubled costs.* Aggregate and unit prices for double work are used simultaneously in an estimate, or customer-supplied materials are simultaneously included in an estimate and used. The latter scheme is possible when the accounts department doesn't write off costs per unit.

4. *Repeated repairs of items or equipment.* One such juicy project is the repair of crane tracks: aggregate prices per meter of track are high, while actual repair expenses are minimal.

5. *Regular capital repairs of a continuous-cycle installation.* Here the stakes are high! Each day idle means substantial losses due to underproduction. In the Soviet period, enterprises operated autonomously and had everything they needed to repair continuous-cycle installations. Now major repairs have to be done by contractors. In practice, however, something else is going on: contracts are canceled, and the work is done by the company's own employees, who are paid in envelopes. In one case, a new general director canceled the services of "irreplaceable" contractors; the same amount of repair work was done on an installation in the same amount of time, and costs were reduced by a factor of 2.5.

Embedded businesses

This is a tricky subject, and there are numerous variations. In general, a business is usually embedded according to comedian Mikhail Zhvanetsky's principle: "you can milk whatever is in your charge". A commercial director embeds a selling firm. A supply director embeds a supply firm. A production director embeds a supplier or uses an industrial cooperation scheme. A personnel director embeds a training center or recruiting agency. Businesses embedded by a financial director are rarer, though in one case a firm was involved in conversion into cash.

To give an example of masterful embedding within a group of companies, metal stolen in one business unit was bought up off-site and used as raw material for the production of semi-finished products purchased by another business unit.

Tenders

It's commonly thought that all tenders are fixed – the winners are known in advance. If the predetermined winner is a real firm, each of those involved in the scheme gets a cut of the commercial payoff. If the winner is "one's own" firm, the contract is resold to one of the real manufacturers along with the firm, or the work is subcontracted. All other actions are intended to create the appearance of a tender.

If a tender is avoided under the pretext of inefficacy, lack of real alternatives or exigency, which is often created artificially, other methods are employed.

1. *Reducing the real competitiveness of independent participants.* This is achieved by restricting information on a tender and the details of complex projects, introducing formal criteria and obstacles to timely registration and requalification.
2. *Limiting independent participants' ability to win.* The main techniques are:
 - participation by a number of "own" firms
 - low-balling in order to win the tender and then reviewing the price for purposes of indexation, a change in specifications, or additional and unforeseen work
 - tailoring the technical assignment and terms to a specific proposal
 - gearing technical parameters to a specific manufacturer
 - setting exaggerated requirements and then accepting lower parameters

Manipulation of technical parameters ranks high among fraud techniques. According to a specialist with a well-known firm selling large-scale technology and energy equipment, employees are paid to formulate technical parameters ensuring victory in major tenders in nearly every case. The contracts, after all, are worth millions of dollars.

Another story: Two companies were interested in supplying dyes for packing materials. One had already supplied such dyes for some time, and the second wanted to win over the consumer with better terms, which appealed to top managers. But repeated tests failed to yield positive results. When the new supplier's dyes were tested, the installation consistently failed to meet process parameters. Temperature, speed, tension and dye consumption were constantly off balance. Everything went fine with the original supplier's dyes.

The seemingly progressive policy that domestic manufacturers can win at prices up to 25% higher is in practice

a source of fraud. A domestic producer wins a tender at a higher price, then uses units, modules and assemblies of foreign manufacture.

Life is richer than any schemes! This is not a complete list of fraud schemes, and the list is growing. In situations where the human factor is decisive, we can state confidently that there is no instruction that can't be gotten around or adapted to the needs of defrauders – all the more so if they take part in its formulation. Unique, super-effective rules don't have any real effect either. It's obviously impossible to fight fraud successfully with security-service methods and internal-audit checks, but it's essential to keep up the fight. Attempts to calculate and foresee everything and take countermeasures for each scheme are also unfeasible. So what is the solution?

Hope in a hopeless situation

The solution is a simple one – to create a system that prevents risks, keeps ahead of events and targets the source of fraud. You don't need to fight darkness in order to defeat it; you need to turn on the light. Lack of transparency and inefficiency are the causes of corporate fraud, and fraud will decline as transparency and efficiency grow. Also, an antifraud system should originate at the highest level of management and involve a number of coordinated elements. Let's look at these factors in greater detail.

Effective monitoring and investigation

Since the Department for the Prevention of Misappropriation of Socialist Property was liquidated, the lion's share of this work has been done by internal security services. As a rule, economic security services are short-staffed. Their employees come from law enforcement agencies, where the system armed them both literally and figuratively – with weapons, authority and means of coercion, criminal and procedural codes, expertise, access to information on individuals and to any other organizations. The move to corporate security services deprives them of resources, makes accustomed methods inaccessible and changes their group of associates and objectives considerably. Short-staffing, lower efficiency and a mass of details prevent economic security services from identifying and investigating all cases, and most fraud is discovered by accident.

It is nonetheless important to investigate each serious case, regardless of the results, so that employees know that the company is dealing with fraud and that poor control will not be tolerated.

Diagnostic of weak signals

The identification of weak signals plays an important role in conditions where resources for monitoring and investigation are limited. Special attention should be given to the following signals:

- Agreements that lack specific terms and have a large number of addendums

- Unusually eloquent justification of a project, setting it apart from normal documents, or unusually quick approval of agreements
- Various forms of incentives, lobbying on the pretext of great exigency, uniqueness or lack of alternatives
- Extremely loyal counterparties that perform work for a long period without pay, on credit, as assistance or, conversely, counterparties that are granted preferential terms.
- Regular off-hour work in the absence of supervisory personnel without any apparent increase in results
- Regular malfunctioning of measuring and control equipment. Use of standard instead of actual weights (where possible)
- Repeated emergency repair work at a single facility
- Proportional growth in production costs or a proportional decline in income
- Unrecorded railway shunting operations
- Repeated purchases by employees of products not used for household purposes
- Attempts to shift client contacts to a private telephone or email
- Failure to dismiss a sales manager who has shown extremely low sales figures for a long period of time
- Appointment of an employee who is clearly not independent to a managerial position permitting him or her to dispose of resources and set the terms of agreements
- Employee expenses that do not correspond to their official income
- Invitations for employees to attend conferences and international demonstrations at the expense of a potential supplier
- Supplies by a single firm of products with varying profiles and origins
- Lengthy production cooperation via a company that does not have its own stock of equipment
- Settlements with firms whose details include addresses used for mass registration and accounts in banks found to be involved in conversion into cash
- Settlements with firms whose founders or management bodies include employees (or their relatives) who make decisions on purchases, sales, price formation or the selection of resources and suppliers.

A quality diagnostic involves obtaining and studying signals as well as determining directions for a detailed analysis or investigation. Depending on company specifics, this may be based on a single strong signal or a combination of signals relating to a single employee or group of individuals.

Reliability of reporting

It is important, not that the balance sheet and income statement agree with primary documents, but that the

primary documents reflect the nature of production activities and cost formation. To this end, the following methods are used:

- Control and minimization of unit costs (materials and energy resources) for goods manufactured
- Balance of metal or other basic raw materials on the basis of real weighing or measurement
- Control in places where remaining merchandise and especially surplus goods are stored
- Costs (work and materials) strictly per unit of contract work and requirements with respect to the correct preparation of forms KS-2 and KS-3
- New high-cost modules and assemblies are marked; used modules and assemblies are placed in a special warehouse and only then utilized in the presence of a commission

The use of a combination of methods helps to prevent or considerably minimize losses from potential fraud schemes involving unmonitored write-offs of raw and other materials, modules and assemblies.

Contracting

The contracting procedure is the element of the system that has maximum antifraud resources. It is well known that cost effectiveness originates, not when payment documents are signed or even when agreements are concluded, but when technical solutions are formulated and risks allocated. Lawyers should not be expected to solve the problem by providing ideal documentation rules, because the ultimate cause is to be found in the decision-making process and in the quality of decisions. There are two consecutive stages: the choice of what to purchase and whom to purchase from.

At the first stage, the key factor for repair and restoration work is a damage report. An objective document should indicate the actual types and amounts of work, the conditions for carrying them out, technical needs and a list of materials to be used. Based on a real determination of defects, a fair cost and a substantiated estimate can be obtained.

Projects involving modernization and the introduction of technology presuppose responsibility for the formation of project parameters and subsequent monitoring to ensure that these parameters are met. The parameters may include productivity, product attributes and quality, unit costs and operating costs as well as the absence of unscheduled purchases and work. Naming guilty parties after the fact doesn't deter but actually encourages fraud, because responsibility for announced project parameters should be preventive in nature. In the early stages of a project, when technical solutions are still being discussed and developed, managers and specialists should understand that each cost and efficiency figure will be signed for and monitored during realization, become an element of personal responsibility and an item

in the incentive program, and may in some cases come under investigation.

The second stage – choice of a counterparty on a competitive basis – has four preconditions: an effective decision at the first stage, complete information on a wide range of potential participants, free (nondiscriminatory) access for participants and confidentiality of information on competing proposals. Effectiveness is considerably improved if a company has the reputation of making purchases on a competitive basis and holding real tenders. Competitive purchases are unthinkable without effective monitoring of market prices. In this way, purchase prices can be kept from significantly exceeding average market prices. In many cases, however, market prices already contain a commercial payoff and don't rule out the element of fraud. This element can be further reduced and an optimal price approached in conditions of competition, which is why several independent suppliers are brought together at one place and time in real tenders.

System sensitivity to the magnitude of fraud

Sensitivity to the magnitude of fraud is a useful setting that allows scarce resources to be concentrated on what is most important. This setting is similar to the fineness of nets for catching fish of a given size. It's true that technical settings can sometimes become a managerial mindset. There's a minimum level of theft above which stealing isn't recommended, but below that level it's safe. That kind of transformation is dangerous for a company, because people get the impression that fraud is acceptable. The information quickly and surely spreads throughout the organization. The amount is a technicality. All you have to do is stay within limits. The attitudes "you can steal no more than ..." and "stealing is unacceptable, but it's expedient to focus on amounts over ..." obviously give different results in the fight against fraud.

Conclusion

Following our survey of the range of fraud schemes and an antifraud system, the main conclusion is this: fighting fraud can't be a temporary measure or a set of responses to specific challenges. It should be preventive, systemic and interdisciplinary in nature. Successful results can be expected when a healthy corporate culture strives for transparency and rejects fraud in any form. Here lies a company's chief problem as well as its key resource.

Corporate culture is shaped by the environment and can be changed only extremely slowly by the top level of management: the owner and shareholders or their representatives. We're familiar with the environment and its negative impact, but the influence of owners depends on the individual. Unfortunately, it's often the case (in companies in crisis, almost always) that the owner is ineffective. He doesn't focus on the company's long-term maintenance and consolidation but, on the contrary, tries to

squeeze as much out of it as he can in the short term and runs it into the ground. Such motivation is typical of owners who receive a business as a result of the redistribution of assets. This encourages redistribution of assets by means of fraud at lower levels as well. At the opposite extreme are owners engaged in building their business, who are motivated to create a stable and efficient organization. Owners are not always a uniform or small group and not always inclined to make changes, especially in the current situation.

In all cases, however, independent directors can create an atmosphere and a corporate culture promoting efficiency, transparency and integrity. This undermines the causes and conditions of corporate fraud and enables financial, legal, internal audit and security services to play an effective part in the overall antifraud system. Independent directors can do this. The question is, who has an interest in this and is ready to accept independent directors in such a role?

Evolution of CORPORATE GOVERNANCE DURING THE CRISIS



Eldaniz Shikhlinisky, a professional in the sphere of corporate finance and venture investments. Vice President of Aurora Finance, independent member of the Board of Directors of OJSC Granit

Summary of the Market Situation

In the last three yearly quarters, our attention was especially focused on the balance shift in most of the foreign, international and Russian markets. The Russian companies' strategic management should in its work take account of the changes in the macro-environment when resolving internal problems. Members of the Boards of Directors bear great responsibility in this respect. Russian business may possibly overcome the crisis soon, but adequate and effective solutions are still needed to settle the existing problems.

The global financial crisis is pivoted on the depreciation of many assets. A decrease in the capitalization of the financial markets has attained the level of the world annual gross product (-90% of the global GDP), and the financial system lacked liquidity. A balance shift and the adjustment of the plans for operations and investment activities of many players on the industry markets are due to the lack of cash flow coming from financial activity.

In summing up the events of the current global financial crisis, I believe that the following three points are crucial:

1. The application of stringent restrictions when implementing the financial strategy. This applies first and foremost to the plans for attracting and servicing foreign financial resources.
2. Greater risks, especially financial and operative risks. Market risks as well as the risk of default of the contracting party grow considerably due to the unstable demand for the output of a certain industry as a result of the redistribution of demand in the related industries.
3. A general drop in consumption on the global and local markets: household expenses and net export tend to decrease.

In this respect, the following should currently be done on every efficient Board of Directors:

1. Anti-crisis steps should be taken to bring the Company's current activity and plans in line with the guaranteed opportunities.

2. The financial, marketing and investment strategies should be adjusted.
3. Steps should be taken to make the work of the Board of Directors more efficient in the new circumstances.

The first two points are specific for each company and should hinge on the high level of anti-crisis and strategic management. Frequently, companies reduce their activities and consequently cut their commercial, general and administrative expenses (on personnel, rent, etc.) and adjust plans up to the end of 2009.

No apparent measures are being taken to make the work of the Board of Directors more effective. In this article, I would like to point out a few aspects which are food for thought. The topics given further may be discussed in an open dialog. I believe this could be done at the forum on the website www.nand.ru (at the website with limited access).

Financial strategy

The main difficulty of the financial strategy is that there is no clue of how successful the company will be in attracting external financial resources and on what terms the resources will be provided. In this respect, the most conservative prerequisites should be taken into account. If the volume and the terms of attraction of external financial resources are not guaranteed, the company's financial plans should be based only on the possible versions. At the same time, the tactics of action should be thought out beforehand when a more or less successful version is to be implemented.

A member of the Board of Directors should join the work-group which has direct relations with financial institutions. On the one hand, this will add weight in negotiations with the contracting parties and, on the other, the Board of Directors will be informed more objectively on the situation concerning relations with investors and lenders.

When taking part in attracting financial resources, a member of the Board of Directors who is responsible for the company's financial strategy should be very skilled and experienced, i.e., qualities which were not required earlier. Therefore, it would probably be expedient to hand over this function to a more experienced member of the Board or hire a professional financial advisor.

Effectiveness of the Board of Directors

Most members of the Board of Directors represent the interests of various investors. Obviously, things are not going so well for some of them in the current situation. Problems in a certain sphere may force investors to change their strategy in relation to other projects. Therefore, investors with investments in the capital

of various companies will probably be obliged to pay more attention to certain projects and less to others.

Such circumstances are institutional and are difficult to overcome. Naturally, it is the right and not an obligation to represent the interests of investors (shareholders, co-owners) on the Board of Directors. Board members assume obligations after functions are distributed between them at a Board meeting. However, the obligations are nominal, and no one is punished for failing to fulfill them (including late fulfillment or fulfillment with no due effort or quality).

Because of the existing difficulties, more Board members should be engaged in managing a company. If a director is less active due to problems in other spheres of his activity, he becomes "weak" from the standpoint of efficient work on the Board. His obligations become less reliable, and his work on the Board, less efficient. Foreseeing such consequences, the possibility of changing (redistributing) the directors' functions should be considered.

A company's investors (shareholders, co-owners) are in essence partners acting within a coordinated strategy. A change in one of the investors' strategy of participation in a company's capital may not be in line with the arrangements made earlier by investors. The compelling mechanisms of Russian jurisdiction are illegitimate. When there is a crisis, it may be far too difficult to reach a new understanding; this will require enormous efforts and a constructive approach by the parties concerned, which are not their inherent feature in many cases. A failure may give rise to opportunistic intentions of a certain Board member and create an atmosphere of distrust or lack of understanding.

To prevent such situations, discussions should be held regularly (within the framework of the Board or individual talks with the Board's chairman) with the representatives of the key investors on their possible strategies. In the event of conflicting situations, an independent director may be an internal arbiter. In this respect, his reputation and objectivity should inspire confidence in the successful outcome of the situation.

Administrative business processes

There are several traditional problems of corporate governance which have been relegated to the background, but which may augment the risks, high as they are now, if the problems are ignored. This pertains to the efficiency of performance of corporate procedures. When staff is reduced, functions must be redistributed among the remaining employees. Earlier, the performance of administrative business procedures could take up less than half of all working hours, but now, when the staff size has been cut on average by 30% at companies, administra-

tive business procedures may take up more than two-thirds of the employees' working hours. If account is taken of the increased number of business issues being resolved, the overall load on personnel may be far more than 100%.

It follows that red tape should be urgently eliminated in business procedures, and not anarchically, but in a controlled manner. It would be reasonable to concentrate all the proposals (starting from the proposals made by other directors to the proposals made by the company's rank-and-file employees) in the hands of one person. It would be very effective to entrust the internal audit director or the relevant committee with the management of the process in rationally simplifying administrative procedures.

Business traditions

As efforts have a far smaller yield and more demands are made on employees, the activity of the business circles has increased in order to sustain the required yield level (employees started to work more, although they worked overtime earlier).

Among the consequences of this situation is the growing demand for effectiveness in strategic management as a whole and in the adoption of strategic decisions in particular. These processes can be accelerated by:

1. applying new forms of relations when resolving management issues, e.g. by creating workgroups with the direct participation of certain members of the Board of Directors. Thereby, a more responsible attitude will be taken when resolving key issues, and strategic decisions will be adopted promptly;
2. more actively using advanced means of communications: electronic document flow when coordinating actions and endorsing documents, and direct mobile phone calls or other methods of instant communication.

Hence, the current crisis can substantially affect the culture of conducting business. When work becomes more effective, the number of operations can be reduced and insignificant issues can be rejected. For instance, it has been observed that business meetings have on average become shorter than one hour, and the participants as a rule show consideration when some of them must answer urgent phone calls during negotiations.

Significance of corporate governance as a whole

Evolution of corporate governance is a substantial achievement of Russian business in the last ten years. Its quality is in many respects inferior to that in countries whose example is worthy of being taken, but far superior to that during the crisis in 1998.

At the same time, the quality of corporate governance is rather costly for a company; it includes the cost of independent directors, maintenance of the transparency mechanisms when there is a shortage of manpower, and increased red tape of business processes.

However, the corporate principle of governance should not be a burden preventing a company from successfully overcoming the crisis and raising its efficiency. Moreover, the principles of corporate governance should not be inert.

The concept of quality currently somewhat differs from that during economic growth. Companies should reconsider their requirements and possibilities, work out new criteria of quality and adjust the current principles of corporate governance. That should be included in the package of anti-crisis (perhaps temporary) measures.

FORWARD TO THE PAST



Valery Borin, Advisor to the Executive Director of OAO Nizhegorodskaya Generiruyuschaya Kompaniya

In the last few years, much has been written on the subject of corporate governance in Russian specialized mass media. The authors actively discuss its advantages and shortcomings and the ways of its development. However, one of the fundamental aspects of the possible development of corporate governance is not taken into account.

Being behind the iron curtain for 70 years, Russia “dropped out” of the international process of management development. Having returned to global economic space in the 1980s, we began to study the experience gained by the West and the East in our historical effort to “catch up and outpace...” All the former “heads” and “supervisors” immediately became “managers” and “top managers” and were enchanted by three-letter abbreviations (BPM, BPR, ISO, TQM, ABC, FSA, BSC, TPS, ERP, CRM, etc.). Many of them began to introduce those latest fashionable technologies at their enterprises, but examples of their successful implementation fall short of expectations.

Many of those who began to introduce the above technologies took no account of the fact that global management advanced to those “three letters” in the course of 70 years without us, and during that time it succeeded in creating and becoming accustomed to fundamental (regular, administrative) management. Such management existed at all enterprises, and the introduction of superstructures, including those mentioned above, was discussed. In the early 1990s, fundamental management practically did not exist in Russian companies, but we immediately began to introduce superstructures. The companies which saw that fact and started by laying the foundation had made headway in their development, while those which failed to see that fact (most companies) are where they first started.

It is not possible to implement FSA, BSC or ERP if an enterprise has no organized structure or a relevant strategy, the basic and auxiliary business processes are not outlined, the powers are not clearly delimited, the accounts department has no analytical accounts of the required level, there are no management accounts, etc.

At many enterprises, orders are usually issued to remind employees that they should perform their duties. Orders are frequently fulfilled if one wishes to do so and to the extent that one understands them. All this is done instead of outlining and describing business processes, which should be carried out without any additional reminders and in strict compliance with the regulations. Such factors constitute the basis of the system of an enterprise's management on which all the contemporary technologies of management should rest. We can attain important results in our economic development only when our enterprises return to the sources of management which exist in countries with a developed economy. Fortunately, the road has already been laid, and we do not need 70 years to pass it, but nevertheless we must pass it. There are also technologies adapted for Russia, but they should be used wisely.

Currently, everyone is aware of the fact that 95% of an enterprise's success is ensured by the management system, whose quality is the investors' focus of attention. The risk that investors may lose their money is sharply reduced when the system of an enterprise's management is clear-cut, thereby raising the enterprise's and the top managers' rating.

Corporate governance is also among the superstructure technologies. What kind of effectiveness is it when the whole staff works for an entire week under emergency conditions to prepare a relevant reference at the request of a member of the Board of Directors or even the general director?

Most of our top managers are overloaded with operative work because there is no adequate management system at enterprises. They have no time directly to participate in organized development and in forming a system of the company's strategic management. As experience shows,

it is usually not enough simply to approve these processes or allow middle-grade managers to engage in them. The process is at a standstill without the personal participation of top managers. Obviously, the situation can be overcome if the Board of Directors takes part in resolving the problem.

The fact that the Board of Directors should play a greater role in a company's management is discussed in publications, at conferences and in the 2007 survey of the National Council for Corporate Governance "Corporate Governance in Contemporary Russia: Experience and Prospects". I would like to draw the management community's attention to a certain subject, i.e. the role of the Board of Directors in creating the enterprise management system. The matter in question is not the replacement of managers in operative management, but support in strategically developing a company.

Most boards of directors on which committees are formed have a committee for strategy and development. At least one of its members should take part in creating an enterprise management system, e.g., as a curator or supervisor of the relevant project. This role can best be played by professional non-executive directors, who are not encumbered with operative management and work only on the boards of directors. Certainly, they should have the relevant qualification in creating management systems and know the technology of project management.

A company has the following advantages when a non-executive director participates in a project:

1. only remuneration as a board member is paid
2. the project is seen as being important by personnel and the external community (internal and external PR)
- 3) maximally possible participation in the project by non-executive and executive directors is ensured
- 4) a personnel reserve within the company is revealed and trained when there is a shortage of top managers on the labor market
5. personnel are partially trained by the company itself to use new technologies
- 6) the quality of the services is assessed when engaging an advisor

By implementing this project, a sound foundation will be laid for introducing advanced management technologies in company management using, inter alia, trained and stimulated personnel. In turn, this will prompt the development of corporate governance in a company.

TIME TO "Unify" COMMUNICATIONS



Mikhail Kochergin,
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Unified Communications

It is usually difficult to control the work of enterprises having a ramified regional structure from the central office. Companies bear considerable transactional costs due to the great flow of reports and communications. However, it is exactly these expenses which are primarily cut by any organization during an economic slump.

Such issues can be resolved by implementing an up-to-date communications system. That is exactly what the federal state enterprise Departmental Security of Railway Transport of the Russian Federation (DSRT) did.

To control the activity of regional offices and make prompt decisions, the management of DSRT was obliged regularly to hold selector conferences with regional representatives. Branch employees spent much time to arrange meetings in Moscow, and considerable expenses were incurred. Audio and video conference communications were implemented at the enterprise on the basis of Microsoft Office Communications Server 2007 for external conferences in which deputy general director, heads of the Moscow departments of DSRT and CEOs of 17 regional offices usually take part. The task of implementing the project was assigned to a Microsoft partner and a systemic integrator of Softline Consulting Services specializing in building systems in the field of corporate communications. As a result of the project, the client received the possibility to hold full selector conferences by using the means of audio and video conferences, and also the groundwork was created for making the relations between workgroups far more effective.

Since the project was aimed at providing all the 20 DSRT branches with audio and video communications equipment, the main decision-making factors were functional flexibility, simplicity of use, an acceptable quality of communications, and inexpensiveness. The traditional equipment systems for audio and video conferences existing on the market did not meet the requirements of DSRT in various respects, including the cost. An assessment was made of the initial outlays on the implementation of a decision, the cost of subsequent development and growth, and the expenses on support and management. After all the parameters were analyzed,

a choice was made in favor of a software application for the universal means of communications Microsoft Office Communications Server 2007.

That decision allows company employees to get in touch with their associates irrespective of their location by using the type of electronic communications which is best suited for a given situation. The employees are provided with simple and reliable means of instant message exchange and file transfer, and audio and video devices. The presence status, displayed next to the name of the contacting person in any of the Microsoft Office applications, shows whether an employee is currently at his workplace and also the best method to use to get in touch with him. In addition, the users of Microsoft Office Communicator 2007 can leave information concerning their status (e.g., "On vacation" or "Will be in the office after lunch"), allowing their associates to choose the best type of communications and not to waste time on waiting or making additional phone calls. The project for implementing the platform of Microsoft Office Communications Server 2007 at the DSRT enterprise is being carried out by the engineers of the subdivision Softline Consulting Services, which is in the Softline group of companies.

Currently, the use of the audio and video conference communications system based on Microsoft Office Communications Server 2007 in DSRT is at the level of

the planned loading capacity. Video conferences are held periodically, and employees of several regional branches, apart from the Moscow office's management, take part in them. To resolve the current issues of mutual relations, traffic controllers of regional departments regularly use the opportunities of audio and video communications as well as the opportunities to send data and messages. Oleg Logvinov, head of the department for automatic control systems and software of DSRT, said: "Now several traffic controllers from different cities are communicating with one another in real time via the Internet on the basis of the decision concerning video conferences. Certainly, this reduces the time of promptly reacting to emergencies and saves us a considerable amount of money."

The first few months of the industrial operation of the system showed that a considerable amount of financial resources can be saved. The management of the federal state enterprise Departmental Security of Railway Transport of the Russian Federation has declined to use the services in renting a special place to hold telecom conferences outside the office, and has cut expenses on long-distance phone calls and the number of business trips for its employees. With regard to the planned loading capacity, one session of video conference communications is arranged daily for CEOs, and several branches give an account of their work to the general director of the enterprise.

NEW IDA MEMBERS

- S. B. Vlasova**, Deputy Director, Rossvyazokhrankultura
- I. V. Golovchenko**, General Director, RTK-Leasing
- A. I. Yevstafiyeva**, Expert, Corporate Management Department, RusGidro
- I. V. Ivanova**, Sales Director, Major Cargo Service
- Y. G. Kuznetsov**, Receiver, Sakha Avia National Airline
- A. N. Medvedev**, Director, Logistical Support Department, Alliance Oil Company
- D. V. Morozov**, Director, Legal Department, Meta Chelyabinsk Pipe Mill
- N. O. Naumovich**, Legal Director, Comstar–United TeleSystems
- D. V. Paly**, Deputy CEO, Zdorovye Interregional Social Charitable Fund for the Support of Healthcare
- K. V. Panagushin**, General Director, ChameleonStroy
- S. I. Poma**, Independent Consultant
- A. G. Rastorguyev**, General Director and CEO, Comcom Commercial and Industrial Group
- M. Roazen**, Chief Consultant on International Affairs, Alfa Bank
- V. I. Sinyakov**, General Director, GARAMIR
- K. Y. Solodukhin**, General Director, Rostelecom
- V. I. Sukhov**, General Director, RGASstroy Management, Design and Construction Company
- K. P. Tereschenko**, Senior Analyst and Advisor, Leader Management Company (Gazfond Non-State Pension Fund Management Company)
- V. G. Tugolukov**, Executive Director, Citilink Professional Services
- I. S. Tyagun**, Senior Manager, PricewaterhouseCoopers
- O. A. Frakin**, General Director, Profbiznes

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