

## INDEPENDENT DIRECTORS IN THE WEST AND IN RUSSIA

*Interview with Lord Skidelsky,  
Independent Director at Janus  
Capital Inc., and Pavel  
Eroshkin, Director of  
Transnational Insights.\**



Robert Skidelsky



Pavel Eroshkin

### What are the theoretical and practical roles of an independent director?

**Robert Skidelsky:** The recent series of major scandals in corporate America (Enron etc.) have focused society's attention on the role of independent, non-executive directors. The key duty of an independent director is to protect the interests of investors. The

See page 2

## CONTENTS:

**Independent Directors in the West and in Russia**  
P. 1

**Investment Appeal and Board of Directors Composition**  
P. 3

**Balanced Scorecard Systems in Russian Retail**  
P. 5

**Independent Directors' Roles in Managing Public Companies**  
P. 7

**Regional Program Development**  
P. 9

**Our Research**  
P. 10

**Independent Director Code**  
P. 11

**Corporate Governance in Financial Markets**  
P. 12

Cadbury Committee's Report stated that "non-executive directors should bring an independent judgement to bear on issues of strategy, performance, resources, including key appointments and standards of conduct" (paragraph 2.1 of the Cadbury Report). An independent judgement can only be brought to bear if the non-executive director is truly independent, and not just independent on paper.

### **Practically speaking, what can non-executive directors do to protect shareholder rights?**

**Robert Skidelsky:** "The Wall Street Journal" (June 23, 1999) wrote that corporate governance is a matter of "protecting shareholder rights and raising the shareholder value of a company." Independent, non-executive directors can stand up for shareholder rights in different ways. Among the possibilities are:

1. Supervising corporate compliance with applicable regulations and laws and corporate governance best practice (for example, by taking an active part in the work of the company's audit committee);
2. Balancing the interests of senior executives and the company's shareholders (for example, by taking an active part in the work of the executive compensation committee);
3. Defending the principal of executive and director accountability to shareholders;
4. Advising executive directors on strategic development issues, including such issues of long-term interest to shareholders as the environment.

**Pavel Eroshkin:** While shareholders are in theory supposed to be able to control what non-executive directors do, in reality the scope for control is severely limited. Given that the theoretical role of a non-executive director is to serve the interests of all shareholders, there is a need to create an accountability mechanism. Shareholders on the ground often find it very difficult, if not impossible, to get rid of directors who turn out to be playing ball for a group of senior executives who are in control of the company.

---

\* Lord Skidelsky ([www.robertskidelsky.com](http://www.robertskidelsky.com)) is member of the House of Lords, Chairman of the Center for Global Studies, Professor at the University of Warwick, Director of Transnational Insights Ltd. and Independent Director of Janus Capital Inc. He is also a Trustee of Talents Foundation, Trustee of the Manhattan Institute and a Director of the Moscow.

Pavel Eroshkin ([www.erokhine.com](http://www.erokhine.com)), analyst at the House of Lords, researcher at the Global Research Center, Director of Transnational Insights Ltd., and member of the Board of Directors of the Our Talents Fund. Eroshkin participated in the task force that developed the IDA's Independent Director's Charter.

### **What factors have the greatest impact on the effectiveness of an independent director?**

**Pavel Eroshkin:** It would be fair to say that in the West, and even more so in Russia, independent, non-executive directors are still a long way from acting to the full extent of their capacities. There are two reasons for that. For one thing, independent directors are effective only in cases where a certain balance of power has been reached on the BoD and representatives of the management no longer dominate. All too often, they are too few in number and lack sufficient information to have a meaningful impact on the decisions made by the BoD, and end up simply rubber-stamping documents already decided upon in advance by the management. It is hardly surprising therefore that in the United States, for example, the Sarbanes-Oxley Act requires corporations to set up auditing committees staffed solely by independent directors. Secondly, non-executive BoD members are not always independent in the strictest sense of the term. It happens not infrequently in the West that groups of shareholders muscle in their "own people" onto the BoD to push for their own interests. This is sometimes done "for the sake of form", or to ensure that "the documents approved by the BoD are consistent with the letter of the law". Furthermore, non-executive BoD members nominated by minorities serve the interests of the minorities that nominated them, and those interests do not always coincide with the long-term interests of all shareholders.

An important consideration is independent director compensation. Qualified professionals come at a price. An independent director's compensation package must provide a sufficient work incentive and must consist of two elements: a) a fixed salary plus compensation for each BoD meeting attended, and b) an element of compensation that makes the director's personal income dependent on increased shareholder income (by awarding the director a stake in the company, for example).

**Robert Skidelsky:** The effectiveness of a non-executive director depends on the provision of timely and quality information and the format in which such information is provided. Information that is delayed, inaccurate, incomplete, or, vice-versa, replete with unnecessary detail, can seriously hamper the performance of an independent director's functions and, accordingly, impair the director's capacity to protect investor interests. Furthermore, inadequate compensation removes a director's incentive to accord sufficient time to the company's affairs.

## Are independent directors materially liable, and what legal protections are afforded to them if so?

**Pavel Eroshkin:** As has already been said, much depends on the provision of timely information to the independent director by the management. Sometimes, it takes time to digest the masses of data received, and even more to see what is missing and fill in the gaps.

Moreover, the management of a company is not always inclined to assist (or at least not to actively hinder) an independent director in carrying out his functions, and without such assistance it can be very difficult indeed for the director to operate effectively. This is particularly true in cases where there is a serious misbalance between the number of executive and non-executive directors on the board (in Russia, where BoDs are commonly controlled by a small group of people, this happens almost universally).

In that light, a non-executive director who puts his signature to a document he does not fully understand risks having to bear all of the potential consequences of such an action. In order to protect themselves, independent directors need to ensure that they are always acting within the law, document any reservations or objections they raise, and ensure that the company has taken out liability insurance.

## What, in your view, is the role of the IDA in fostering a professional community of corporate directors in Russia?

**Robert Skidelsky:** First and foremost, the IDA must focus on promoting corporate governance best practice among Russian corporations. Russia is unquestionably suffering from a dearth of qualified Russian independent directors, and no better candidate than the IDA for the role of head-hunting, training, and introducing such people to Russian corporations. The IDA must also serve as a venue where directors can obtain training, network with colleagues, and share experiences and new ideas. In many ways, the functions of your organization are similar to those carried out by the British Institute of Directors, and given that Russia lacks other organizations tackling these issues from a global perspective, the role of the IDA can only expand.

## INVESTMENT APPEAL AND BOARD OF DIRECTORS COMPOSITION

A. Filatov, Ph.D. in Economics, IDA Executive Director  
O. Tarilova, IDA Manager

Notwithstanding the substantial increase in investment in Russia in 2002, a gap continues to exist between real investment and the country's investment needs.

Investment in Russia accounts for only a small proportion of total worldwide investment in emerging markets.

Among the factors investors have cited as hampering inwards foreign investment in Russia are economic instability, red tape, the lack of a legislative framework, the high tax burden, the overly large state sector, and others.

While Russian business leaders bewail a lack of investment that is hampering the development of enterprise, potential investors are unable to find profitable enterprises with sufficient investment appeal.

Research conducted in 2002 with a view to identifying the factors that determine investment decision-making yielded surprising results: corporate governance standards are becoming an increasingly important factor in investment decision-making, especially in emerging market countries. According to the McKinsey Global Investor Opinion Survey on Corporate Governance, in 2002 more than 85% of potential investors cited corporate governance standards as equally important alongside the financial indicators of an enterprise. Investors are prepared to pay a premium for shares in companies with strong corporate governance standards. The average corporate governance premium on shares in Russia is 38%, which is higher than in such countries as China, Poland, Brazil, the United States, and Germany. Good corporate governance pays off.

**Table 1. The average premium investors are prepared to pay on shares in a company with high corporate governance standards, % (from the McKinsey Global Investor Opinion Survey on Corporate Governance, 2002)**

<b>Russia</b>	<b>38</b>
<b>China</b>	<b>25</b>
<b>Brazil</b>	<b>24</b>
<b>Poland</b>	<b>23</b>
<b>USA</b>	<b>14</b>
<b>Germany</b>	<b>13</b>

See page 4

Independent directors have an important contribution to make to good corporate governance. In western corporate practice, independent directors are commonly seen as a recognized international standard of doing business. In 2002, the leadership of the New York Stock Exchange (NYSE) approved new listing regulations that require companies to allocate greater BoD powers to independent directors as one of the main conditions for obtaining a listing. Companies undergoing listing procedures at the NYSE today are required to allocate at least 75% of their BoD positions to independent directors. The criteria used to determine independence have also been tightened up.

An impetus for change in the corporate governance situation in Russia came with the publication of the recommendations of the Fourth OECD Round Table and the FCSM's program for the improvement of corporate governance in Russia. The program has provided a foundation for enhancing the role played by the BoD at companies and promoting high professional standards among directors and an increased role for independent directors, and has made a weighty contribution to more efficient corporate management.

The Corporate Governance Code, which is recommended by the FCSM, contains the following recommendation: independent directors should hold at least one quarter of the seats on the board of directors of a company and should not be fewer than three in number. A set of criteria has been devised for classifying BoD members as independent. The Russian Corporate Governance Code establishes fairly strict requirements with respect to BoD members classified as independent. An independent BoD member is not an employee of the company, is not a member of any other body of the company besides its BoD, is independent of officers of the company and of its related parties, and is not involved in any relationship with the company that could impair the independence of his/her judgement.

Companies are however free to address the issue of appointing independent directors basing on their individual needs and objectives.

Independent director practice is relatively new to Russia. Whereas in 2001, some 38 independent directors were appointed to the BoD of Russian companies, by 2002 that figure had risen to 70. The practical impact of corporate governance and independent director practice can be seen in the example of OAO NK YUKOS, whose common stock price on the RTS rose from \$0.3 in June 1999 to \$9.58 in April 2003 following the adoption of the corporate governance code and the appointment of independent directors to its BoD.

Yukos's average annual market capitalization rose seven-fold over the period 2000-2003 to \$22.328 billion in April. Over the same period, the market capitalization of LUKOIL, YUKOS's peer in terms of reserves and output, rose by only 20 per cent to \$12.165 billion in April 2003.<sup>1</sup>

The presence of independent directors on the BoD is a key indicator of a company's investment appeal. Most investment funds (portfolio, direct, and venture capital) view the presence of independent directors on a company's BoD as a key condition for investment decision-making. Ernst & Young conducted a survey of investment funds operating in Russia to measure the relative significance of such investment decision-making criteria as corporate transparency, transparent ownership structure, and BoD make-up.

One of the most important conclusions drawn from the results of the survey was that the composition of a company's management is a more important consideration for investment funds than the size of the company or even its current earnings. Many respondents cited an effective and aboveboard management team as their number one concern when planning investment projects.

The presence of independent directors in a company's BoD was cited as one of the factors having an unconditionally positive impact on investment decision-making. Direct and venture capital investment funds invest in private or non-listed companies, and for many such funds the size of the company is of no importance.

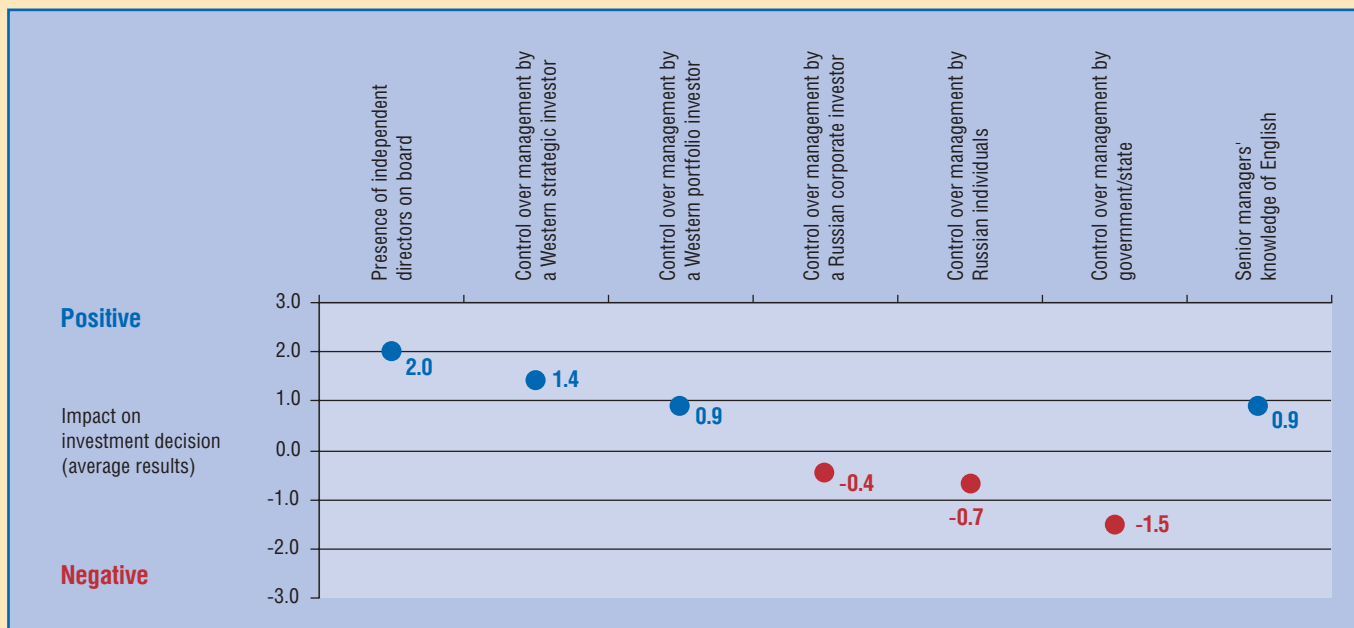
Even more interesting, investors who prefer to invest for periods of two to six years (four years on average) for a return on investment of 40% (36% on average) cited the following (in descending order of importance) key criteria influencing investment decision-making: the shareholder/management composition, transparency, the exit strategy, and control over the invested assets.

Most investment funds (portfolio, direct, and venture capital) now view the presence of independent directors as a key condition for investing. Almost half (45%) of those surveyed cited this as one of the most important positive factors influencing their investment decisions. Other important factors cited included the presence of a Western strategic or portfolio investor with control over the management and the management's English language competence.

---

<sup>1</sup> The market capitalization data used in the article were provided by SKRIN Agency.

**Table 2. The impact of the "Shareholder structure and management composition" factor on the investment appeal of a company (from Ernst & Young research materials)**



Corporate practice confirms that a transparent BoD structure that incorporates independent directors represents an important corporate value driver.

Full text of the report can be obtained at [www.nand.ru](http://www.nand.ru).

## BALANCED SCORECARD SYSTEMS IN RUSSIAN RETAIL



*Oleg G. Musaeu, Doctor of Business Administration, Kennedy Western University, IDA member*

Many Russian banks offer a broad range of products and services, but few stop to think about strategy:

how and by what the company is defined and how the efficiency of its management can be measured.

In 1990, two Harvard professors, R. Kaplan and D. Norton, researched into various systems for measuring the performance of major corporations. The results of their research work were used to devise a balanced scorecard system (BSS) based on a cause-effect relationship between the strategic objectives, their key parameters, and the key success factors for achieving target results. BSS has four components: financial, client, internal business processes, and staff training and development, the goals of which are defined in terms of financial and non-financial indicators.

Achieving that goal requires clearly defined client service processes and procedures tailored to targeted segments, and, of course, trained staff.

The system enables the alignment of strategy and business operations, which is crucial from the point of view of ensuring BoD supervision of management activities.

### Strategy

Firstly, introducing a balanced scorecard system is strategy implementation rather than strategy development. It implies that the enterprise already has a clearly formulated strategy. Secondly, the new concept should be seen more as a comprehensive management system rather than a system of indicators.

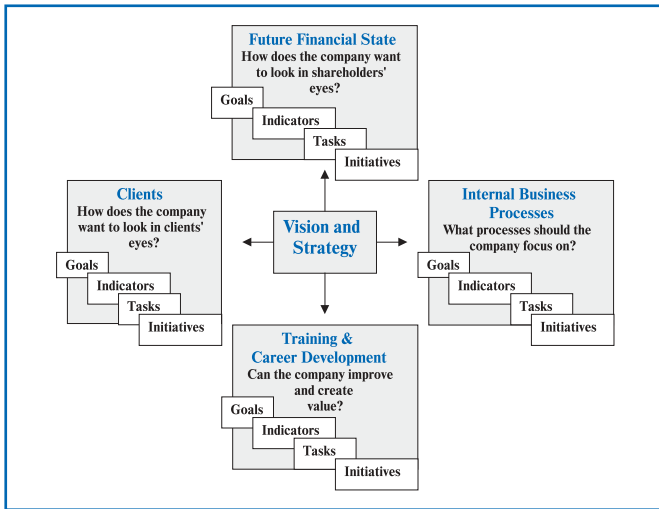
For innovative companies, BSS can serve as a long-term strategic management tool.

- Formulate a clear strategy and translate it into specific strategic goals.
- Align strategic goals with the target performance indicators and communicate them to all sub divisions of the company.
- Plan and define objectives and strategic initiatives.
- Expand strategic feedback and awareness.

The balanced scorecard system has one surprising specific feature: even at the very first stage of implementing the system it is able to significantly improve business performance. This effect is achieved through helping owners and top management move to a

"mapped" mode of thinking, which makes it easy to identify the factors holding back growth.

**Fig.1 The Balanced Scorecard System is used to translate general strategy into operational process terms.**



The first step towards introducing the balanced scorecard system involves senior management in discussing the issue of defining specific strategic tasks on the basis of an adopted strategy. Definition of financial objectives involves making a choice between raising profitability and winning a market share or "taking in the harvest": maximizing cash flows from core activities.

Management must clearly identify the target market segments in which the company intends to compete for clients.

### Defining strategic goals

The strategies of a bank interested in defining its objectives and building a balanced scorecard system.

#### 1. Revenue growth

Stabilize revenue inflow by creating new sources of revenue in the form of new products and services offered to clients

#### 2. Productivity

Improve productivity by transferring non-performing assets to more cost-effective arrangements and by conquering new local banking product and service markets

Where applicable:

#### Financial component:

- Raise profitability
- Expand the revenue structure
  - Revenue growth
- Cut costs
  - Improved service costs structure

#### Client component:

- Improve client satisfaction by expanding the range and improving the quality of service
  - Market segment share
- Raise client satisfaction post-service
  - Maintaining the client base

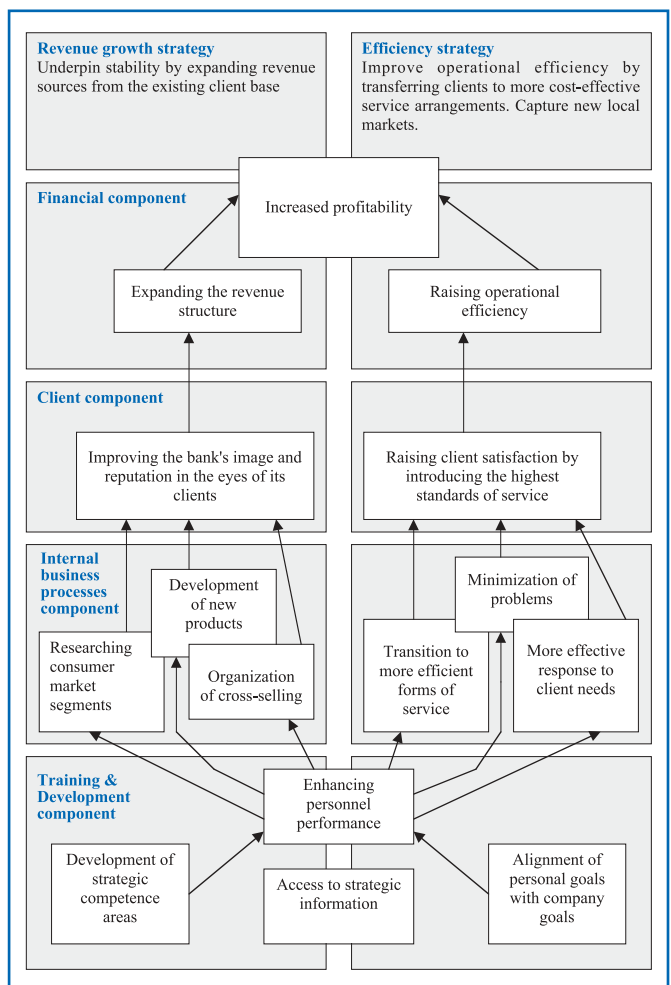
#### Internal business process component:

- Get to know the client
- Create innovative services
  - Revenue from a new service
- Cross-servicing
- Transfer clients to more cost-effective servicing arrangements
  - Modified service structure
- Minimize operational problems
  - Number of service errors
- Introduce flexible servicing, including new markets
  - Request response time

#### Training and development component:

- Developing strategic competence areas
- Providing strategic information
- Correlating personal goals with bank goals
  - Staff satisfaction
  - Revenue per employee

**Fig. 2. Bank strategy**



## Strategic indicators

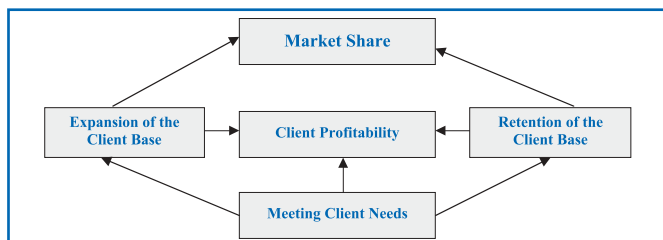
Strategic performance indicators provide a "balanced" view of the general strategy that in addition to the traditional financial component reflects the client aspect, the internal business processes component, and the training and development component. This approach facilitates an early assessment of how successful the credit organization is.

Once the financial goals have been defined, such as expanding sources of revenue and creating new added-value offerings, the financial institution needs to work on building a solid and reliable reputation.

The financial component is a sequence of actions carried out within the framework of all four system components in order to achieve a long-term target. The common indicator is the growing sales volumes and an increased share of the target market segment.

The client component defines the target range of clients and segments of the consumer market where the company intends to operate. The selected segments represent the source of income earmarked for expansion in the financial component of the balanced scorecard system. Key client component indicators, namely meeting client needs, client loyalty, profitability, and retention and expansion of the client base, enable comparison with consumer price groups and market segments, and the identification of the consumer value of offerings. These are key indicators for measuring the results of client service operations.

**Fig. 3. Client component indicators.**



The internal business processes component identifies the activities that play a key role in achieving consumer and shareholder goals.

The scope of creating new financial products for targeted consumers depends on the income from their sale, while the ability for selling them via the best possible distribution channels is contingent on the ratio of transactions performed to transactions via other channels.

The main goal of the internal component is to boost performance by increasing client numbers in target segments of the market, on the one hand, and by creating stronger relations between the bank and its clients, on the other hand. Two interrelated indices are used to measure delivery of products and services to clients:

- "approaching dissatisfied clients"
- customer satisfaction

The complete version of this article can be found at the IDA's website: [www.nand.ru](http://www.nand.ru)

## Opinion:

### Role of Independent Directors in Public Company Management Process

*A. M. Telegin, ZAO «National Cartographic Corporation», a member of the Independent Directors Association*

Due to many years of economic experience the society worked out the present most efficient public company management model to include three tiers of authority: shareholders, directors, managers. The first category includes company owners who can independently participate or not participate in the management process depending upon their wish and opportunities. The second category comprises directors who are involved in general management of the company, are responsible for managerial decisions, and may or may not be company's shareholders. The third category consists of managers in charge of day-to-day operations of the company and usually in charge of technical functions.

The board of directors elected by shareholders plays the major role in this authority triad. The board may consist only of shareholders and managers but may comprise people to represent interests of owners of the company in relation to resolution of certain tasks. The latter may comprise people who are not members of the company's executive bodies, are not close relatives of these bodies' officials, and are not affiliated with the company and form the category of independent directors. The place and role of such directors in the board is primarily determined by the company's development strategy.

One might single out three types of the strategy: conservative, balanced, and aggressive. Each type is characterized by a specific board of directors' structure, its own management style, low or high risks of adopted decisions, appropriate revenue growth rates, and other company performance indicators.

The conservative strategy pursues, first of all, the objective to ensure reliability of the company after a minimum possible revenue level is achieved as a result of its operations during the period of activity of the specific board of directors' membership. Reliability may be expressed

**Professional directors are, essentially, independent directors who on the basis of trust management have to resolve within a short period of time the most important problems faced by a company, to ensure its expedient development.**

in terms of confidence that the present board of directors will not worsen the position of the company, will preserve its assets and ensure generation of the revenue not less than the expected inflation level. Shareholders may obtain such confidence only through their independent participation in the board of directors' operations as well as participation of their dependents that will play technical roles in the composition of the board. Relatives and managers often play this role. That is why the composition of the board of directors to carry out the conservative strategy will be, first of all, determined by shareholding directors, directors –relatives of shareholders, and executive directors to a certain extent. Such composition of the board will be characterized by a restrained management style and a low decision-making risk level. Accordingly, the growth rate will not exceed 20% per annum.

The balanced strategy's objective is to preserve the achieved company's revenue level at the level of average industrial profitability in the market niche occupied by the company and to create prerequisites to increase profitability through possible price increase, new markets' penetration, or production of new goods. Preservation of the average industrial profitability level and creation of prerequisites will demand higher level of professionalism from members of the board of directors which may require to increase number of directors-managers and invitation to the board of directors of people not depending on shareholders and who will add such qualities to the company which may facilitate achievement of objectives of the balanced strategy. Such qualities may encompass, for example, organizational capabilities, popularity, and knowledge. Such board's composition will be characterized by an active management style, moderate market risk level related to decision-making, and the growth rate of about 25-35% per annum.

The aggressive strategy's objective is to achieve profitability which significantly exceeds the present company's level through use of all possible strategic and operational marketing instruments and strategic growth levels: intensive, integrative and diversified. Significant strengthening of the company demands management decisions which correspond with company's capabilities and its development problems and which high-level professionals are capable of taking. Depending upon market ambitions of shareholders such professionals may make them idle in the Board of directors and give them the

opportunity to become fully engaged in matters of ownership but not in matters of management. We are talking here of a board of directors made of a team of professional directors in favor of aggressive management and supplemented to a certain extent by company's managers. Professional directors are, essentially, independent directors who on the basis of trust management have to resolve within a short period of time the most important company's problems and to ensure its expedited growth. Such board will be characterized by a very active management style and high risks of taken decisions and by expected growth rate on excess of 40% per annum.

Thus, with increase of the level of the company's management activity a board of directors is more in need of independent directors who, unlike shareholding directors, have no right to act only for personal benefit and to vote in favor of dubious deals but have to represent interests of all shareholders and to pursue interests of the company in general. Such tendency in its condensed form is reflected in the crisis management principle, which represents one of the types of aggressive strategy and the idea behind which is to as actively as possible undertake special measures to get the company out of the state of insolvency or, if impossible, to implement bankruptcy procedures. In case of such management the board's membership will definitely be increased through addition of new independent directors and eventually will be capable of completing its transformation into a mechanism of external or receivership management.

One may ascertain that independent directors became a necessary feature of the public company management process. Stronger presence of independent directors in boards of directors is required not only in connection with the necessity to expedite growth and to increase company's capitalization but in connection with the new Russian corporate legislation, which granted them the rights any other board members are devoid of: to take decisions in relation to biased deals as well as to evaluate large deals. Thus we are talking about significant changes in the structure of the public company management that acquires more trust features and independent character.

## IDA REGIONAL PROGRAM DEVELOPMENT

*IDA and IFC are implementing the project to restructure corporate governance system in four pilot regions of Russia*

In 2002 the Independent Directors Association in cooperation with the International Finance Corporation (IFC) initiated a regional project the objective of which was to assist regional open joint-stock companies to restructure their corporate governance systems according to international standards and facilitate their access to investments.

The Russian Corporate Governance project was commenced in April 2001 and has been successfully implemented in Russian North-Western, Volga, and Urals regions. This spring the project was officially launched in Rostov-on-Don. From the very first days of its operations in the Southern region IDA has worked in close cooperation with IFC. Association representatives took part in the project's presentation and are relying on future implementation of joint programs to increase corporate governance level and to promote best management practice in relation to activity of independent directors in Russia.

According to Natalia Arabova, manager of the Russian Corporate Governance project in the North-Western region, cooperation with IDA is an important component of IFC's activity in the regions as the Project team and the Association are both interested in improving performance of joint stock companies. Association's representatives actively participate in events organized by the Project team in Saint Petersburg and speak at seminars and conferences devoted to the role of independent directors and their contribution into development of companies and attraction of investments.

The poll of participants of seminars and conferences demonstrated significant interest to the institute of independent directors, and companies which successfully positioned themselves in the market and achieved positive financial results with clear-cut strategic development plans, including attraction of long-term investments, would strive to introduce independent directors into their BoD. North-Western Telecom is an example of a Saint Petersburg company which already perceived the significant role of an independent director and elected one into its BoD.

"Nevertheless," - according to Natalia Arabova, - "the majority of companies are still familiarizing themselves with this institute. They are wondering how to find a qualified independent director, what are his actual functions and responsibilities in the board of directors, how to avoid leakage of information, what is the cost of an independent director, and what actual benefits the company receives through having an independent director in the company's board."

There are no doubts that the efficient cooperation between the Russian Corporate Governance project and IDA within the framework of subsequent joint events will help answering these questions."

Saint Petersburg's poll results are confirmed by the study carried out in Yekaterinburg by the Independent Directors Association and the Corporate Law Center in partnership with the Elite Corporate Governance Club which unites the major issuers in the Urals region.

Preliminary study results show that the majority of medium-size companies, unlike large issuers such as Sverdlovenergo, Uralsvyazinform, Urals mining and metallurgical company, are poorly informed on matters of corporate governance and are not interested in enhancement of transparency and disclosure of information.

The majority of companies are prepared to consider the matter of inclusion of independent directors into their boards within a 3-year period.

Representatives of Volga region companies also point out that from the practical point of view they will be prepared to consider inclusion of independent directors into their boards of directors not earlier than in 3-5 years. Managers of more than 20 Samara issuers, who took part in the "Independent Director" round table held in April 2003, share this opinion.

Olga Anikina, head of the Samara representative office of the Russian Corporate Governance project and the round table organizer, explained that the "Independent director" subject was put forward by participants themselves and that proved that regional issuers were interested in activity of independent directors. Olga indicated that the agenda subject fully corresponded to objectives and framework of the Project and that presupposed further cooperation between IFC and IDA in this sphere.

IDA plans to continue working in the regions and to systematically organize and participate

in corporate governance events. Alexander Filatov, IDA Executive Director stated: "The level of corporate governance in the regions in general is lower than the corporate governance level of Moscow enterprises. We fully understand the necessity to change the present situation through provision of information and training of corporate directors in matters of best management practice as the level of corporate governance in a company is one of the major factors which affect decisions taken by investors who wish to invest their resources."

## OUR RESEARCH

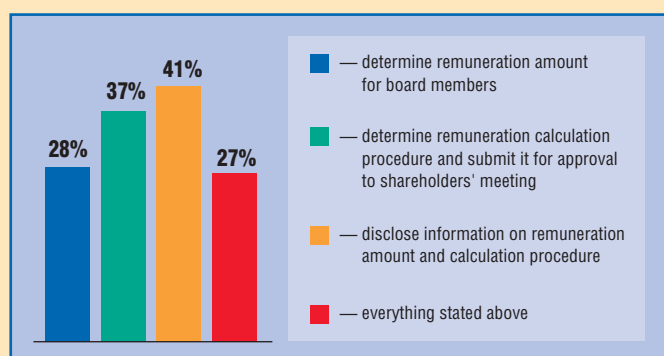
*Within an IFC project*

In 2002-2003 the Independent Directors Association interviewed managers and members of boards of directors of Russian companies on matters of remuneration of board members. Representatives of 100 Russian companies took part in the survey.

According to findings of the survey, half of interviewed enterprises (55%) apply the system of remuneration of members of board of directors, at the same time 14% of respondents confirming that their enterprises established or plan to establish remuneration committees.

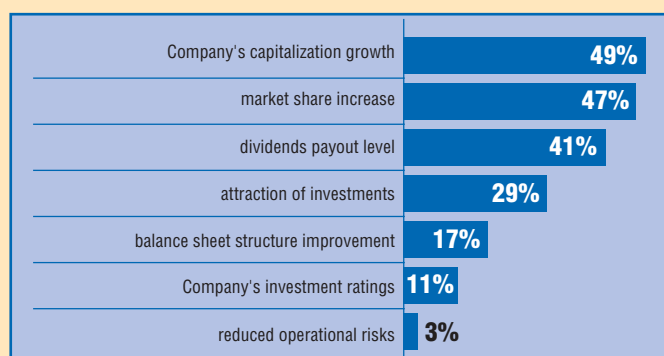
The majority of respondents (79%) agreed that a board member should receive information on the amount and procedure of remuneration prior to taking office.

The question on the functions of the remuneration committee brought the following responses:



The majority of respondents agreed that the remuneration committee had to disclose the information on the remuneration amount and calculation procedure (41%). Distribution of replies between 4 almost equal groups demonstrates that several major functions none of which is considered a priority function are included into the terms of reference of the remuneration committee.

In the opinion of respondents, remuneration of members of the board of directors should be conditioned by the following performance factors:



The number of replies shows high proportion of those in whose opinion the board members' remuneration amount

should be dependent on growth of market capitalization of the company, which is in line with global practice.

It should be pointed out that the popular Western practice of providing stock options to members of the board is still not widely used in Russia. It is related, first of all, to under-development of the Russian stock market, consistently low capitalization of the majority of public Russian companies.

Nevertheless, taking into account that the stock of the majority of Russian companies is still characterized by low liquidity and only a small number of issued shares is in circulation, influence of the financial and economic performance indicators of the company on its shares price is not so significant as in developed markets. Thus at the present stage exclusive orientation on market capitalization growth is not the only optimal criteria for remuneration of members of boards of directors.

Systems of criteria to be used to determine remuneration amounts has to be further developed and tied to a balanced set of more valid indicators including, among others, increase of efficiency of return on assets and use of borrowed capital.

Here is a possible system of remuneration payments to members of boards of directors (remuneration structure). Please, indicate component elements to be included into it (several replies):

No	Remuneration components	Percentage
1)	Compensation of all expenses related to board meetings' attendance	98%
2)	Compensation of all expenses related to visits to company's facilities	86%
3)	Fixed annual bonus	45%
4)	Fixed bonus per meeting	23%
5)	Bonus by the results of the company's quarterly performance according to criteria approved by shareholders (see p. 8)	17%
6)	Bonus by the results of the company's annual performance according to criteria approved by shareholders (see p. 8)	29%
7)	Option on Company stock or obligations	26%
8)	Insurance policy granted by the Company for the period of board membership:	
	a) to insure liability of a Board member under article 71 of the Law "On Joint-Stock Companies"	18%
	b) life insurance and casualty insurance (life insurance)	3%
	c) medical insurance	6%

The majority (about 90%) of respondents agree that companies should fully compensate members of the board for all their expenses related to their board's operations but few (18%) agree to grant liability insurance to board members at the expense of the company.

## INDEPENDENT DIRECTOR CODE

*Within the framework of round tables held by IDA as well as the international conference "On Corporate Behavior in Financial Markets" organized the MICEX and NYSE in partnership with the Independent Directors Association a draft Code of an Independent Director was presented to the public for consideration.*

The draft code was developed by the Independent Directors Association jointly with the Russian Institute of Directors in partnership with International Finance Corporation, Moscow Interbank Currency Exchange, and Good Governance Program of the International Trade Administration, US Department of Commerce.

The objective of the code is to formulate standards of performance and professional ethics of independent directors in Russia. Compliance with high ethical standards in the activity of independent directors, conscientious and professional implementation of their responsibilities shall enhance trustworthiness of the institute of independent directors in the eyes of the investment community and companies. Introduction by independent directors of the best corporate governance practice into operations of boards of directors enhances management efficiency, favorably affects company image, and contributes significantly to growth of equity value.

The code is drafted to follow up on the Corporate Governance Code put forward by the Russian Federal Securities Commission and the charter of the Independent Directors Association. The code takes into account OECD Corporate Governance Principles as well as the best international corporate governance practice. The Code takes care of specific and legal aspects of the activity of board members of Russian joint-stock companies. The code is an open document and can be supplemented in the course of development of operations of independent directors.

The Code contains basic professional ethical principles, regulates relations of an independent director with the company, shareholders, and third parties. The Code's important section deals with "Business reputation and professionalism" issues.

The Code is recommended to all independent directors working in boards of directors of Russian companies. Compliance with the Code is obligatory for members of the Independent Directors Association when working as independent directors in Russian companies.

## Definition of an independent director adopted by IDA in the Independent Director Code

1. Satisfies the following criteria of independence of the Corporate Governance Code proposed by the Russian Federal Securities Commission:
  - over the last three years has not been, and at the time of election to the board of directors is not, an officer (manager) or employee of the company, or an officer or employee of the managing organization of the company;
  - is not an officer of another company in which any of the officers of the company is a member of the appointments and remuneration committee of the board of directors;
  - is not an affiliated person of an officer (manager) of the company (officer of the company's managing organization);
  - is not an affiliated person of the company or an affiliated person of such affiliated persons;
  - is not a representative of the government.

And also meets the following criteria:

2. does not possess personally as well as through affiliated persons equity stock in the company sufficient to be independently nominated into the board of directors;
3. does not receive remuneration for advisory or other services provided by him/her to the company with the exception of the remuneration for work in the board of directors;
4. does not represent interests of consultants and counterparties working with the company;
5. enjoys solid business reputation, adheres to high ethical standards, and possesses necessary leadership qualities and entrepreneurial experience;
6. publicly declared his/hers status of an independent director prior to election into the board of directors.

Unabridged text of the Independent Director code can be obtained from IDA or at the IDA site: [www.nand.ru](http://www.nand.ru), or [www.independentdirector.ru](http://www.independentdirector.ru).

## CORPORATE BEHAVIOR IN FINANCIAL MARKETS

By materials of the conference of April 22, 2003.\*



Long ago specialists acknowledged the fact that optimization of activity of a company, attraction of investments, and, consequently, improvement of investment climate of a country depended on the corporate governance level. Noticeable changes have taken place in US and European approaches to corporate governance practice triggered by bankruptcies of the largest industrial corporations.

The conference focused its attention on issues of dependence of the national economy on Corporate Governance, on importance of enhanced corporate governance level at Russian enterprises and commercial banks, and on international experience of settlement of corporate governance quality enhancement issues.

Russian governmental agencies, public organizations, and the largest companies undertake certain efforts to increase the corporate culture level. Adoption of the Corporate governance code initiated by the Russian Federal Securities Commission, development of codes by the largest Russian corporations, inclusion of requirements to comply with FSC's Corporate Governance Code into listing rules of MICEX and other Russian exchanges – this is a non-exhaustive list of measures to study and improve corporate governance practice.

The conference considered development and implementation of corporate governance codes in Russian companies, results of studies of the corporate governance practice in Russian companies.

It was also pointed out that the banking sphere was an important area of application of corporate governance principles. Quality of corporate governance in banks immediately affects trust of depositors and investors, promotes capital influx, protects shareholders. In 1999-2002 the RF Central Bank adopted a number of legal acts devoted to fundamental principles of corporate governance in banks. First of all, it was the Bank of Russia's regulations #191-P dated July 30, 2002 "On Consolidated Reports" and a number of other documents. The issue of application of corporate governance and banking supervision principles by banks was also included into the conference's agenda.

---

\* The Federal Securities Commission together with the Moscow Interbank Currency Exchange (MICEX), New York Stock Exchange (NYSE) organized the conference on "Corporate Behavior in Financial Markets". Co-organizers of the conference include the Russian Lawyers Union, Russian Chamber of Commerce, International Finance Corporation of the World Bank Group, National Economy Academy attached to the RF Government, Federal Council's Committee on Financial Markets and Money Circulation, National Stock Market Association (NSMA), Moscow Banking School of the RF Central Bank. The conference was attended by management of the RF Central Bank, Russian Federal Securities Commission, and other governmental agencies, deputies of the RF Federal Council, heads of the largest Russian companies and banks, members of the Independent Directors Association, National Association of Stock Market Participants, American Chamber of Commerce in Russia, Russian and foreign corporate law experts.

Sadovnicheskaya Nab., 77/ 1

Moscow, 115035, Russia

Tel.: (095) 938-6651

Fax: (095) 755-9701

[www.nand.ru](http://www.nand.ru)

[www.independentdirector.ru](http://www.independentdirector.ru)

e-mail: [info@nand.ru](mailto:info@nand.ru)

© 2003 Non-Commercial Partnership  
for assistance of professional activity  
"Association of Independent  
Non-Executive Directors".

All Rights Reserved