Corporate Governance in Russian electric power industry in terms of consumer requirements to its funding sources

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Abstract. The paper highlights a strong interest of energy consumers in attracting investment in the development of Russian power generation companies. The importance of corporate governance for enhancing the investment attractiveness of these companies is emphasized. An in-depth evaluation of their current corporate practices was carried out within the framework of the existing ownership structure. The study identified the indicators of corporate governance quality for the benefit of modern investors that are the least observed by the overwhelming majority of power companies. The indicators were obtained on the basis of whether or not the companies satisfy the criteria of the new Russian Corporate Governance Code, and the criteria of the methodologies of Standard & Poor's, Spencer Stuart and Transparency International. The study shows a slight increase in the transparency of the companies in the post-reform period and compares it with the information disclosure by the major corporations of Great Britain, the USA and Europe. The study shows high correlation of the approach and composition of the identified indicators of the corporate governance quality for Russian power generation companies with the 2017 Russian Corporate Governance Index. This Index is based on the international Good Governance Index methodology adapted to the Russian conditions.

1 Introduction

The main financial burden of construction of power plants after the reform of RAO "UES of Russia" was carried by industrial energy consumers under the program for power delivery contracts. Upon completion of the program, they oppose the further use of such a mechanism for financing the development of generating companies. Consumers are interested in attracting investment from these companies [1].

Creation of an environment of trust, transparency and responsibility necessary to stimulate long-term investments is facilitated by quality corporate governance [2]. In the world practice, it proved its importance in enhancing the investment attractiveness of foreign corporations, getting more affordable, inexpensive and stable sources of financing.

The domestic experience of applying the generally accepted standards of advanced corporate practices in the world is relatively small. The basic milestone in their adoption was the Code of Corporate Conduct (2002), which clearly formulated the requirements for the proper conduct of Russian joint-stock companies regarding investors. The past years have seen significant changes, including the changes in the Russian corporate practice. They required the development of a new Russian Corporate Governance Code (hereinafter - the new Code). Corporate governance in the new Code is also defined as the most important measure "... to improve the stability and efficiency of joint-stock companies, increase the flow of investment in all sectors of the Russian economy from both domestic sources and foreign investors" [3].

A slow increase in the quality of corporate governance in Russian power generation companies was noted. In most of these companies, it is formal, declarative, and has a temporary nature of improvement. Furthermore, it does not correspond to the universally recognized standards of the best corporate practices of the states of the Organization for Economic Cooperation and Development: justice, responsibility, transparency and accountability.

2 Indicators of corporate governance quality in Russian electric power industry

The study identified the indicators of the corporate governance quality in the Russian power generation companies according to the formed ownership structure [4-5].

The indicators are based on whether or not these companies fulfill the criteria of the new Russian Code of Corporate Governance, and the criteria of Standard & Poor's, Spencer Stuart, and Transparency International

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methodologies that evaluate the corporate governance quality, proceeding from the most essential objective parameters for the investor [6-23].

The results of this study made it possible to additionally assess the significance of the membership balance and the performance of Boards of Directors (BODs), to compare the transparency of the investigated companies with the information openness in major corporations in Great Britain, the USA, and Europe.

2.1 Identification of indicators by criteria

2.1.1 Standard & Poor's

The criteria of Standard & Poor's methodology allowed comparing the current transparency indices of the Russian power generation companies with their values calculated by the Standard & Poor's for these companies in the first year after the liquidation of RAO "UES of Russia" (2009). These criteria concerned: ownership structure; rights of shareholders; financial and operational information; composition and procedures of the BOD and management; fees for the management and Directors.

The values of the indices obtained by the criteria of Standard and Poor's indicate a minor improvement in the transparency and, hence, quality of the corporate governance in the majority of the Russian power generation companies over the post-reform period.

As before, the ownership structure is disclosed poorly. Beneficiaries and "other shareholders" of the companies are less disclosed. This is especially characteristic of the companies with the assets belonging to the Russian private holders having foreign offshore companies for this purpose.

The number of such companies and latent "other shareholders" has increased over the post-reform years. The increase in the offshore ownership is especially typical of the PJSC "TGK-2", PJSC "Quadra", PJSC "T Plus", and "Siberian Generating Company" LLC [5].

Low values of disclosing the content of their Code of Corporate Governance and Code of Ethics are mainly caused by the fact that they have not been updated. The Code of Corporate Governance has not been changed since 2006 in 85% of the companies, the Code of Ethics – in 63% of the companies, despite the new 2014 Russian Corporate Governance Code.

The information on BODs is classified. The policy of self-evaluation and external evaluation of the BOD performance is not disclosed. There is no uniform methodology of such an evaluation. It is not present in the new Code, whose recommendations are restricted to a simple enumeration of individual criteria, like «… professional and personal qualities of BOD members, their independence, congruence, and degree of their participation in activity» [3]. Frequently, the self-evaluation comes to simply questioning the BOD members on various organizational issues. As a result, neither shareholders, nor BODs themselves know what to do with the results of such evaluations and abandon them. In 2016, 8% of the investigated companies and 19% of the Russian companies involved the external third party to evaluate the BOD performance. According to Spencer Stuart, this is an obvious growth for the Russian companies compared to 11% and 6% in 2015 and 2014, respectively [7-9]. However, the above estimates are far from the similar indices for major public companies in some other countries. In 2016, these indices were 43.3% for Great Britain, 29% for Italy, and 28% for the Netherlands [9].

There is no detailed information on the fees for each BOD member. As a rule, there are only total data on the fees for the BOD members in the Quarterly Reports of the companies.

In the companies, there is, practically, no relationship between the fees for the BOD members and the company performance, which could bring together the financial interests of BOD and long-term interests of investors. Such a relationship was noted in the PJSC "Unipro", where the annual fees for the BOD members depend on the Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA). Herewith, the EBITDA corresponds to the values of annual financial statements of the company under the international standards, confirmed by an external auditor. The advantage of this index, compared to other financial indices, is leveling the differences between the evaluated company and its analogs in terms of taxation and consideration of depreciation charges. The annual fees are not paid to the BOD members if the ratio between actual and planned EBITDA indices is under 0, 8. This approach of the PJSC "Unipro" to the evaluation of the BOD performance, in our opinion, is more promising for the benefit of the investor, than the Code recommendations on the fixed annual fees for the BOD members.

According to the criteria of Standard & Poor's, we identified the least disclosed information components in the Russian power generation companies (less than 35%). They are referred to modern indicators of corporate governance quality for these companies:

- Number of the shareholders possessing over 10% of shares each and information about them.
- Data on the beneficiary shareholders.
- Content of the Corporate Governance Code.
- Content of the Code of Ethics.
- Announcement of recommended dividends before the date of record.
- Calendar of the future important events for shareholders.
- Information on some non-auditor services rendered by Auditor.
- Exact conditions of transactions with related parties.
- Audited financial statement according to International Financial Reporting Standards before late April.
- Social reporting (as per The Global Reporting Initiative, GRI).
- Detailed information on non-financial agreement provisions.
- Policy for the evaluation of the BOD performance.
- Detailed information on the fees for the BOD members.
- Detailed information on the fees for the management.
- Information on linkage between the fees for BOD members and the company performance.

2.1.2 New Code, Spencer Stuart, Transparency International

These criteria enabled a more thorough evaluation of the corporate governance quality in the investigated companies. As a result, we obtained additional (to those identified by Standard & Poor's) governance quality indicators. These indicators show whether the company:

❖ Provides shareholders with the information about who nominated candidates to the BOD.
❖ Has no less than 1/3 of an independent member in the BOD.
❖ Discloses the information on the attendance of the meetings of the BOD and its committees by individual directors.
• Has the principles and approaches to the organization of a system for risk management and internal control.
❖ Notifies the BOD of intentions or appointments in the governing boards of other organizations.
❖ Develops and introduces the policy on fees for the BOD members, executive bodies, and other executives, including transparency of mechanisms for determining the fees.
• Has a list of criteria for determining materiality of events.
• Evaluates the effectiveness of the risk management and the internal control system.
❖ Addresses the most important issues at the BOD in-person meetings.
❖ Pays attention whether all the members of the BOD Audit and Remuneration Committees are independent, and at least one of the independent members of the Audit Committee has the experience and knowledge of financial statement preparing, analyzing, and auditing.
❖ Involves independent directors in heading the BOD Committees.
❖ Involves the BOD in addressing the issues of corporate governance practice.
❖ Involves the BOD in addressing the issues of observance of the information policy.
❖ Has the procedures for assessing if the number of the BOD members meets the company's needs, if its individual members, committees and the entire BOD are effective, and for analyzing the needs associated with the BOD members' qualifications, their experience, knowledge and business skills, absence of conflict of interests, etc.
❖ Provides shareholders with the results of assessing all the nominees to be elected to the BOD.
❖ Involves independent directors in the procedure for assessing and approving material corporate events before their implementation.
❖ Has an expanded list of the grounds, by which the BOD members are considered to be interested in the companies' transactions.
• Approves the policy on anti-corruption enforcement.
• Discloses a complete list of the affiliated and associated companies, joint ventures, and other subsidiary structures.
• Provides the data on offshore activity zones of the affiliated and associated companies, joint ventures, and other subsidiary structures, financial expenditures in these zones.

The indicators are listed in decreasing order of the number of companies disclosing such information (under 35%) and, hence, corresponding to these indicators. Three indicators from the Transparency International that are used to assess the transparency of corporate reporting in the Russian companies finish the list. These indicators are especially significant for the investor in the Russian power generation companies with a high share of the offshore ownership. As noted above, the PJSC "T Plus" and the "Siberian Generating Company" LLC refer to such companies. They were studied by the Transparency International and showed zero disclosure of data on the offshore activity zones of their affiliated and associated companies, joint ventures, and other subsidiary structures, as well as on the financial expenditures in these zones. This study indicated a low mean index of the corporate reporting transparency in these companies for all the three indicators of the Transparency International. This index was 4.4 for PJSC "T Plus", and 0.9 (of 10 points for the companies with the highest transparency) for the "Siberian Generating Company" LLC [10].

The overwhelming majority of the above indicators refer to the BODs of the companies (marked with a diamond). They also include the indicators concerning independent directors that are especially significant. Such significance is caused by the high concentration of the ownership in the Russian power generation companies, and the absence of the effective external corporate control from banks and stock market. The studies indicate that the mean index of the independent directors in BODs of these companies was relatively low (under 27% as of 2016). This value is below the mean index in the Russian companies (36.7%) and the lowest among similar indices in the companies of Europe and the USA. The highest percentage of independent directors (according to Spencer Stuart) are noted in the BODs of the companies in the Netherlands, Finland, and Switzerland (84%), and the USA (85%) [9].

The other indicators are also indirectly related to BODs, because, within the delegated authorities, it is the BODs that are responsible for developing, approving, and implementing all the internal documents in the interests of shareholders.

3 Correlation of results with Russian Corporate Governance Index

The identified indicators of corporate governance quality in the Russian power generation companies showed a high correlation with the indicators of 2017 Russian Corporate Governance Index [25].

3.1 Russian Corporate Governance Index

Russian Corporate Governance Index (hereinafter - Index) was compiled twice (in 2016 and 2017) by the Association of Independent Directors in cooperation with the National Research University "Higher School of

Economics", Bank of Russia, Moscow Exchange, and Russian Union of Industrialists and Entrepreneurs [24-25].

The index was developed to understand, what, indeed, good corporate governance for the Russian companies is through the eyes of present-day investors.

The Index was based on the Good Governance Index international methodology that was developed by the British Institute of Directors and Cass Business School (2015), and adapted for the Russian conditions.

There was only one invariable basic principle of this international approach, namely, to analyze the compliance of the companies with the best practices of corporate governance by using:

- Objective signs (indicators) of corporate governance from reports and other open sources concerning the activities of the companies.
- Data on the quality of corporate governance in the companies from the online survey based on their perception by representatives of professional, investment, and expert communities.

The international partners compiling the Good Governance Index discovered which objective requirements of the corporate governance in the world practice should be met by a company for the investor to positively perceive it. In the world practice, these requirements concern audit, risks, and interactions with stakeholders. Estimates of the corporate governance objective signs within these areas highly correlated with the data of the online survey of the stakeholders.

The indicators from the complete final list of the 2017 Index indicators mainly reflected the areas of the corporate governance recommended by the British Institute of Directors: the BOD composition and activity; audit and risk assessment; remuneration; relations with shareholders and stakeholders. To reflect the Russian specificity, the indicators additionally considered changes in the listing rules of Moscow Exchange, adoption of the new Russian Code of Corporate Governance norms, and possibilities to obtain information from open sources.

The 2016 Index demonstrated high significance of the BOD membership balance and effective activity as an objective requirement for corporate governance that affects its positive perception by the investor in the Russian conditions [24]. In the 2017 Index, "… only one factor had a positive and relatively considerable correlation - and that was the Board of Directors." Investors "evaluate more positively the companies, whose BODs approach the best corporate practices, i.e. have independent chairmen, sufficient number of independent directors, who, in turn, head committees, etc." [25].

3.2 Correlation of results

3.2.1 Approach to the identification of indicators

The objective signs of corporate governance in the 2016 Index methodology were mainly related to the new Code [24]. In the 2017 Index, the developers «… managed to depart from excessive attention to the Code of Corporate Governance and - following the recommendations of the British Institute of Directors - to more widely use the corporate behavior indicators promoted by known analytical and news agencies» [25].

Such an approach to improve the list of corporate governance quality indicators completely correlates with the approach of forming the indicators in the research done.

3.2.2 Central role of the Boards of Directors

In our study, conducted for the Russian power generation companies, we obtained a comparable result reflecting the central role of the BOD in improving the quality of their corporate governance.

3.2.3 Importance of independent directors in the Boards of Directors

The conclusion made on the high significance of the presence of independent directors in these companies proved close to the 2017 Index results. More than 30% of the corporate governance quality indicators in that Index concerned independent directors.

3.2.4 The number of the corporate governance quality indicators

The study also indicated a high correlation between the results related to the number of the corporate governance quality indicators. The number of indicators in our study is 35 compared to 34 indicators in the 2017 Index.

3.2.5 Content of indicators

The coincidence in the content of these indicators was, practically, 80%. Non-coincidences concerned, mainly, the presence of additional corporate governance quality indicators (identified by the Transparency International criteria and not considered in the 2017 Index) for the Russian power generation companies.

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