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BENCHMARKING CORPORATE GOVERNANCE FOR EMERGING MARKETS

The article investigates the benchmarking application in corporate governance for developing corporate relations, thereby improving business processes quickly and with the least possible costs, also enhancing the competitiveness of a company basing on the assessment of advanced experience and benchmark comparison.

Keywords: corporate governance; stakeholders; benchmarking; business ethics; Russia.

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БЕНЧМАРКІНГ КОРПОРАТИВНОГО УПРАВЛІННЯ ДЛЯ РИНКІВ, ЩО РОЗВИВАЮТЬСЯ

У статті розглянуто застосування бенчмаркінгу в галузі корпоративного управління, що дозволяє на основі оцінювання провідного досвіду та еталонного порівняння покращити корпоративні відносини, швидко та з найменшими витратами покращити бізнес-процеси, підвищити конкурентоспроможність компанії.

Ключові слова: корпоративне управління; стейкхолдери; бенчмаркінг; бізнес-етика; Росія.
Рис. 3. Табл. 1. Літ. 15.

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БЕНЧМАРКІНГ КОРПОРАТИВНОГО УПРАВЛІННЯ ДЛЯ РОЗВИВАЮЩИХСЯ РЫНКОВ

В статье рассмотрено применение бенчмаркинга в области корпоративного управления, что позволяет на основе оценки передового опыта и эталонного сравнения совершенствовать корпоративные отношения, быстро и с наименьшими затратами улучшать бизнес-процессы, повышать конкурентоспособность компании.

Ключевые слова: корпоративное управление; стейкхолдеры; бенчмаркинг; бизнес-этика; Россия.

Introduction. Effective corporate governance is an essential element of market economy. Fair practice of corporate governance guarantees that the companies following it consider the interests of a wide range of interested persons, that their governance is accountable to shareholders. It facilitates trust of investors and attraction of long-term capital (OECD, 2004). In a number of interviews with investors the drawbacks of corporate governance were named among the main obstacles for investment into Russian companies (Analysis of corporate governance, 2011).

Problem statement. Contemporary studies of corporate governance practice are aimed at the transformation of understanding and implementation of due principles of corporate governance. The need for companies to explore the issues of corporate governance is associated with investments attraction through public offer of its shares at exchange markets.

The best practices of corporate governance include compliance with corporate laws following the wide scope of recommendations developed by the associations of investors, international organizations and financial institutions, and consulting companies. The number of recommendations grows every year touching the new sides of company's activity related to corporate governance. There are the following demands

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and requirements to the practice of corporate governance: recommendations of the international best practice of corporate governance, best practice of corporate governance in similar companies; requirements of laws; listing rules of exchange markets; requirements and recommendations of investors etc.

Quality enhancement of corporate governance is facilitated by the use of benchmarking procedures which represent the art of using work experience of the best companies for one's own benefit. The study of the best practice of corporate governance of leading companies chosen as a benchmark allows to improve quality and effectiveness.

Traditionally, benchmarking is understood as a continuous process of studying the companies recognized as the leaders in their fields, as the search for the best methods leading to improvement of activities (Camp, 1989). Companies practicing benchmarking achieve success which allows them improve the results of their activity and enhance competitiveness (Zairi, 1992).

But the global financial turmoil resulted in the sharpening of problems, revealing the structural defects in corporate governance of the leading companies as well. Besides, at the period of worsening of the situation at the world stock markets the influence of international financial markets, which are an important factor of corporate governance practice development, reduced. The implementation of benchmarking in Russian companies during the crisis was impeded by low efficiency of legal and regulatory mechanisms for protecting minority investors, limitation for offering the shares of Russian issuers at international markets motivated by the development of Russian stock market etc.

The purpose of the study is to provide reasoning of benchmarking use in corporate governance based on the evaluation of best practices of corporate governance to improve corporate relations between stakeholders.

Methods of the study: comparative analysis, system approach, structural analysis.

Results of the study. In a broad sense, the process of benchmarking includes the following functions: planning, search, monitoring, analysis, and adaptation. Studying the analogues of the leading companies helps in building a system of corporate governance, determining the development priorities, choosing the model of corporate governance. Benchmarking technology implies control comparisons which include the phases shown in Figure 1.

The practice of corporate governance makes wide use of such instruments of evaluating its quality as audit and rating of corporate governance included in benchmarking procedures. The audit of corporate governance implies evaluating by an outside consultant the conformance of corporate governance procedures set forth in the Charter and internal documents of a company to the requirements of regulatory legal acts. Audit shall be done for the structure of the authorized capital and shareholders' rights, organization and activity of management and supervisory bodies, disclosure of information by a company etc. Audit results are primarily oriented at the company, its top executive staff and shareholders.

Standards of corporate conduct practice. The ratings of corporate governance are used for a wide circle of stakeholders. Though there is no unified model of corporate governance, there are certain standards of corporate conduct. Organization for Economic Cooperation and Development (OECD) worded a scope of fundamental principles in this field (Principles of Corporate Governance) which apply to different

models of corporate governance: honesty, transparency, subordination, responsibility. The principles of corporate governance worded by the OECD cover shareholders' rights, equal attitude to shareholders, the role of stakeholders in company's management, information disclosure and transparency, and obligations of the board of directors (OECD, 2004). Table 1 shows the international principles of corporate governance.

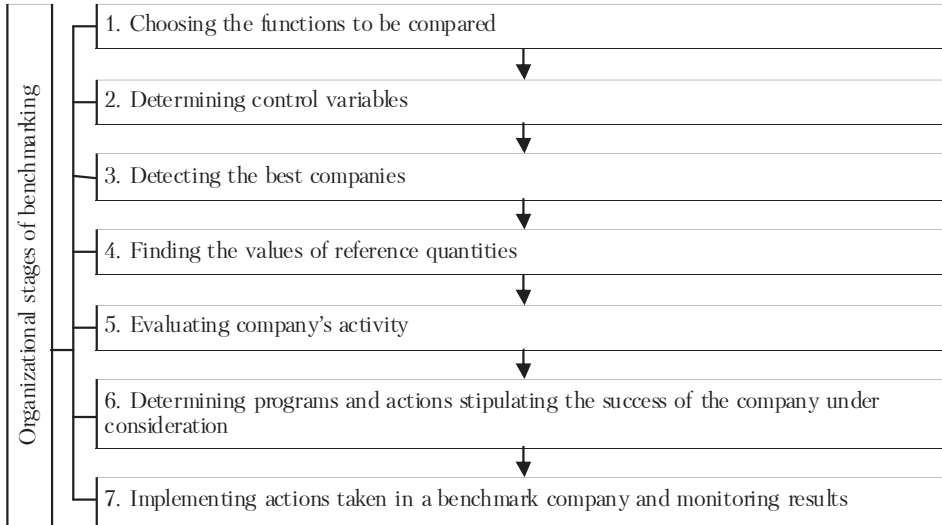


Figure 1. Organizational phases of benchmarking, own study

Table 1. International Principles of Corporate Governance

Principles of Corporate Governance	Organization	Year of adoption
OECD Principles of Corporate Governance	Organization for Economic Co-operation and Development (OECD)	1999
Euroshareholders Corporate Governance Guidelines	European Shareholders Group	2000
The Sarbanes-Oxley Act	US Congress	2002
ICGN Statement on Global Corporate Governance Principles	International Corporate Governance Network	2005

Source: National Council on corporate governance (www.nccg.ru).

The standards of the best corporate conduct are reflected in the codes of corporate governance which represent a collection of voluntarily adopted standards and internal regulations that establish and govern corporate relations. They are developed by exchange markets, corporations, institutional investors, associations of directors and corporate managers, associations for protecting investors' rights. The first codes of corporate governance were "Cadbury Report" (Great Britain), "General Motors Board of Directors Guidelines" (USA), and "Dey Report" (Canada). At present, the codes of corporate governance developed at the initiative of non-governmental professional associations exist in most of developed countries, e.g. in Australia there is the "Corporate Practices and Conduct standard", in Belgium – "Principles du gouvernement des entreprises" ("Principles of Corporate Governance"), in Great Britain – "The Combined Code on Corporate Governance" etc.

In the countries of emerging markets codes pay the biggest attention to the basic principles of corporate governance (fair attitude to shareholders, information disclosure about owners, financial indicators, and the procedure of annual meeting of shareholders). In developed countries these aspects are usually set forth in laws. In general, the codes of corporate governance recommend paying special attention to the issues of: preparing and holding the general meeting of shareholders, electing and assuring effective activity of the board of directors, operation of the executive body, information disclosure of company's activity as well as preparation and holding of large corporate events.

The Russian Code of Corporate Conduct (2002) is based on the best practice (FCSM, 2002). It is a national standard of corporate governance and is of advisory nature. The Code of Corporate Conduct includes the principles in accordance with which the practice of corporate governance shall ensure:

- A real opportunity for shareholders to exercise their rights.
- Equal attitude to shareholders holding equal amount of shares of the same type.
- Exercise of strategic management of the company by the board of directors and effective control by the latter over the activity of executive bodies etc.

In 2003, the Russian Union of Industrialists and Entrepreneurs adopted the Charter of Corporate and Business Ethics which contained the standards of the best practice of corporate governance.

Evaluation of corporate governance practice of Russian companies.

Implementation of the best practice of corporate governance is an additional resource of companies which facilitates the enhancement of functioning efficiency. This process was studied in the course of studying the practice of corporate governance in the regions of Ukraine, held at the initiative of the International Finance Corporation (IFC), which also included interviewing the representatives of 307 Russian companies. The participants of the research specified the following major goals achieved by means of improving corporate governance: 66% – improvement of strategic decision-making; 54% – attraction of financial resources; 40% – improvement of companies' interaction with public authorities; 37% – improvement of interaction between managers and shareholders; 25% – prevention of corporate conflicts. Among the obstacles hindering the implementation of the best practice of corporate governance, they named the following ones: lack of knowledge and information (63%), lack of qualified specialists (50%), inefficiency of Russian laws on companies (27%), low rate of return on improvement of corporate governance (20%), possible risk occurrence (17%), and possibility to use confidential information by the competitors (16%) (The practice of corporate governance, 2003).

Modern studies emphasize that, if compared to other countries, Russian laws provide shareholders with wide voting rights (Analysis of corporate governance, 2011). They particularly include the following: low limit of shares possession required to submit the candidates to the board of directors; the time of directors' stay at the position of the board members within one year; application of the procedures of cumulative voting while electing the board of directors; mechanisms of protection from merger; limitation on the combination of positions of the director general and the chairman of the board of directors; the presence of the representatives of minor-

ity shareholders in the board of directors which is a considerable disciplinary factor. But the quality of the corporate governance practice is complicated by the consistent implementation of laws and low level of law enforcement. It is this field that requires benchmarking technologies oriented at the involvement of the best benchmarking mechanisms of corporate governance.

Analyzing the most urgent for national companies' areas of best practice of corporate governance and evaluating their importance, foreign businessmen, managers, and experts related to Russian business named the following ones:

- further improvement of transparency and information disclosure, 73% of interviewed respondents;
- improvement of qualification and accountability of the board members, 55%;
- precise delimitation of powers between the president of the company and the chairman of the board of directors, between top managers and the board of directors, 55%;
- connection between remuneration of executive directors and the results of company's activity, 27%;
- raising the role and increasing the number of independent directors, 27%;
- expanding the rights of minority shareholders, 23%;
- expanding the powers and influence of the board of directors, 23%;
- increasing the interaction between the board of directors and minority shareholders, 18% etc. (Modern corporate governance, 2010).

For the purpose of improving the practice of corporate governance, the following actions have been singled out among the actions planned by companies to improve corporate governance: consulting on corporate governance issues (56% of the interviewed); implementation of IFRS (43%); training of the members of the board of directors on the principles of corporate governance (38%); implementing the system of remuneration of the members of the board of directors (25%); introduction of the position of corporate secretary (23%); introducing independent directors to the board of directors (11%) (The practice of corporate governance, 2003).

While providing benchmarking in the field of corporate governance, it would be reasonable to take into consideration the evaluation of the state of one's own practice of corporate governance, and implementation of the system that would make a rational balance between the recommendations on standards on the one hand and demands of company's development, the costs of creating such a system on the other.

Corporate governance ratings. In today's market economy, under huge volumes of information, even the largest companies do not have enough resources for its processing. That is why, independent risk assessments for the companies and securities play a special role. The main instrument of regulatory expert examination is ratings.

Corporate governance ratings (CGR) imply ranging the level of corporate governance in accordance with the implementation of the principles of corporate governance, compliance with legislative requirements in the field of corporate governance, recommendations on the Code of Corporate Conduct.

CGR are intended both for a wide circle of potential investors willing to determine the level of risks, and for the company itself while choosing the areas of improvement of corporate governance practice (Gulyayev and Korotetsky, 2007). Rating plays a function of transformation of huge volumes of information into public

opinion on the classification group the subject is related to. Ratings act as prediction instruments and as a kind of specific licensing upon admitting companies to certain services and projects. Typical peculiarities of ratings are shown in Figure 2.

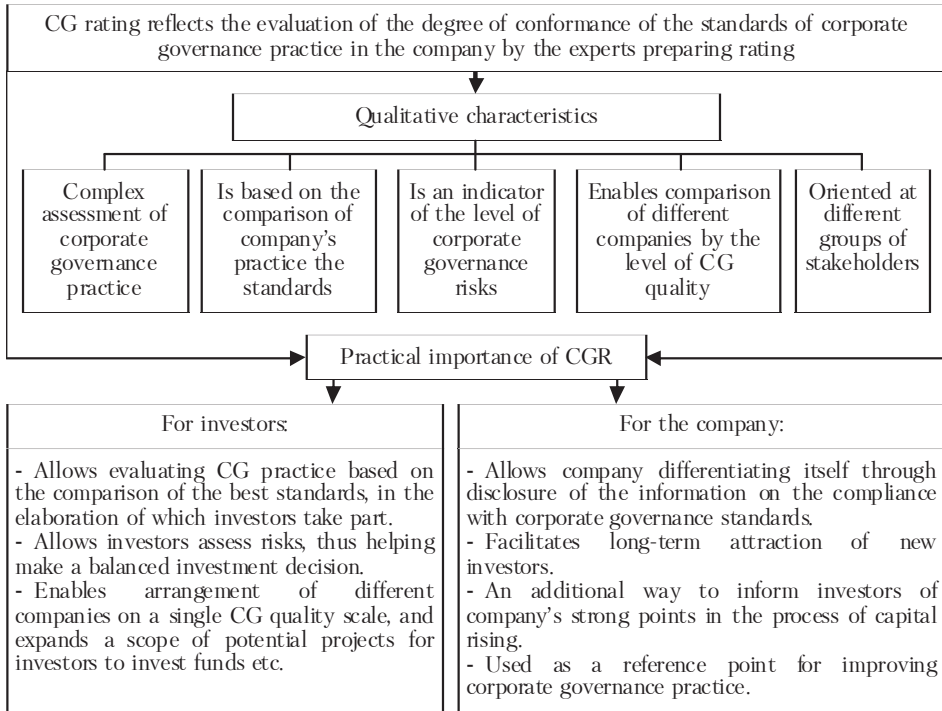


Figure 2. Rating of corporate governance (CG) and its practical importance, developed by the author

There are international and national ratings of corporate governance. The guides for determining leading companies in the field of the best corporate governance are considered to be the ratings assigned by agencies with international reputation considering different criteria, e.g. the evaluation of performance efficiency of the board of directors, bonuses established by professional community etc.

The evaluation criteria are oriented at the parameters being verified, e.g. such as "representation of majority shareholder and the management in the board of directors does not exceed their shares in the equity of the company", or "most places in the committee for appointments and remunerations belong to outside directors". An example of the rating that corresponds to the best requirements is the corporate governance rating by "Standard & Poor's". A of criteria in their research work includes a number of indicators (The rating methodology, 2012). A number of Russian companies, including "Kalina", "Lebedyansky", "Norilsk Nickel", "Seventh Continent" and "TMK" were rated high, because their internal policy contains additional provisions in addition to mandatory rules and procedures stipulated by laws.

A wide range of the questions concerned in the research works of S&P covers political, external, cash and credit factors, activity of funds, financial institutions, and companies. Thus, in December 2011, the "Standard & Poor's" credit rating service

placed long-term sovereign ratings of 15 countries of European and currency union in the CreditWatch list ("ratings under revision") with negative forecast (The rating methodology, 2012). The reason of the crisis of trust was worsening of crediting conditions in the Eurozone, including Germany and France, high level of debts of states, households, and the increased risk of industrial decay in 2012.

Besides the international rating agency "Standard & Poor's", the most popular ratings include the corporate governance rating by "Governance Metrics International" (GMI), "Moody's", "Fitch" etc.

There is a number of ratings evaluating corporate governance practice established in the companies in Russia that have their own methodology basis. An example of the national rating of corporate governance (NRCG) is the rating assigned by "Expert RA", investment company "Troyka Dialogue", the National Rating Agency (NRA) and others.

Thus, the NRCG by "Expert RA" implies complex evaluation of corporate governance practice in a specific company, divided into the following components: shareholders' rights, scope and performance efficiency of management and supervisory bodies, information disclosure, activity for the benefit of other stakeholders, and corporate social responsibility. NRCG is assigned according to the scale from NRCG 1 (the lowest rating) to NRCG 10 (the highest rating). The higher is the rating, the lower are the risks of corporate governance in the evaluated company.

At present, the Ministry of Finance disclosed a list of duly accredited rating agencies which included "Fitch", "Standard & Poor's", "Moody's", the National Rating Agency (NRA), "Rus-Rating", "AK&M" and "Expert RA". The absence of a unified methodology of rating agencies complicates the comparison of ratings. Ratings of international agencies do not take into consideration national peculiarities. There is no rating environment and the agency certification institute in Russia. Ratings are often hard to be compared and are even in conflict. That is why, it is reasonable to develop the national system of rating agencies forming a national rating environment.

Reformation of the operation standards of rating agencies in the result of economic crisis. Ratings evaluating the operation of corporations can produce considerable impact on the formation of public expectations, investment climate, and the general standing of a company. As estimated by specialists, unsatisfactory work of rating agencies was one of the reasons of economic crisis, when rating agencies were "irrational", "did not disclose risks as they should", and "became too close to their customers". Agencies used to assign ratings of the highest reliability to mortgage securities that lost their value rapidly. That is why, a set of measures to toughen the supervision over the rating agencies has been elaborated (Kotov, 2009). The US Securities & Exchange Commission (SEC) paid attention to the reformation of standards in agencies' activity, including such leading agencies as "Standard & Poor's", "Fitch Ratings", "Moody's" and others. One of the ways of reformation and changing the way of agencies' financing is to make them receive money from investors, but not from issuers. The cyclical nature of their activity is disturbing: in the period of growth ratings are raised without sufficient grounds, in the period of decay they are reduced. E.g., in March 2009, "Moody's" placed for revision 3,600 tranches of bonds secured by loans (CLO) for a sum of 100 bln USD. In February the agency raised the probability of defaults on loans making the basis of CLO by 30%.

The EU members suggested introducing mandatory registration and licensing of agencies on their territory and establishing their own system of supervision. For example, they suggested rating agencies should be obliged to submit information that would make it clear whether or not they truly realize the risks they have to assess.

The problem resolution implies the reformation of traditional agencies and creation of new ones. For example, a quasi-state-owned National Association of Institutional Investors established a Chinese rating agency "China Credit Rating Co" (CCRC). Another Chinese agency "Dugong Global Credit Rating" is also willing to replace its offshore competitors "Moody's", "Fitch" and "Standard & Poor's" (Shakhov, 2010).

A new business model is created in the EU – a rating agency organized on the basis of the French insurer "Coface". It is called to assign credit ratings only to the companies that have concluded insurance contracts with it, and to charge payments from the users of ratings, financial institutions.

A growing number of alternatives to traditional rating agencies represented by new players improves corporate governance practices, enhances quality and transparency of ratings, resolves the problem of the conflict of interests, which is actually impossible, when the issuers of securities pay for the services of agencies themselves.

Ranging is also done by other international organizations. According to the research done by the World Bank and the International Financial Corporation (IFC) "Doing Business 2012" (Business Conduct – 2012), Russia went up from 124th to 120th place in the table of ranges for 183 states. But it is still a low result. In the norms under analysis special attention shall be paid to the indicator "protection of investors". According to the rating by "Doing Business", Russia is at the 111th place by this parameter together with Austria, Argentina, the Bahamas, Moldova, Panama, the Slovak Republic, the Syrian Arab Republic, Tonga, and Ukraine. The leaders of the rating were New Zealand (1st both), Singapore (2nd), Hong Kong, China (3rd), Malaysia (4th), Israel, Columbia (5th) (Doing Business, 2012).

The quality of corporate governance is also reflected in the financial development index of the countries (FDI) by the World Economic Forum. Among 57 evaluated states and regions, the rank of Russia in 2010 was 40. The highest ranks belonged to the USA (1 of 57), Great Britain (2), Hong Kong (3). The following indicators were used to evaluate this index: institutional environment (Russia's range – 53), business environment (34), financial stability (42), financial services of banks (57), non-bank financial services (5), financial markets (33), access to financial services (54) (The Financial Development Report, 2010). In its turn, the parameter "corporate governance" is one of the composite parts of the indicator "institutional environment". The rank of Russia by this parameter is 53. Low range confirms the need to apply the best practice of corporate government.

Under contemporary conditions of global competition the quality of corporate governance is an importance resource of successful functioning of companies. Adoption of international best practice, looking up to the companies with the reference corporate conduct, implementation of the best practice of corporate governance ensure its improvement and development. From this perspective benchmarking as a technology of reference to the benchmark facilitates business development, increases companies' cost, favors the implementation of stakeholders' interests. In general,

enhancement of corporate governance quality is favored by a number of areas (Bocharova, 2012) as shown in Figure 3.

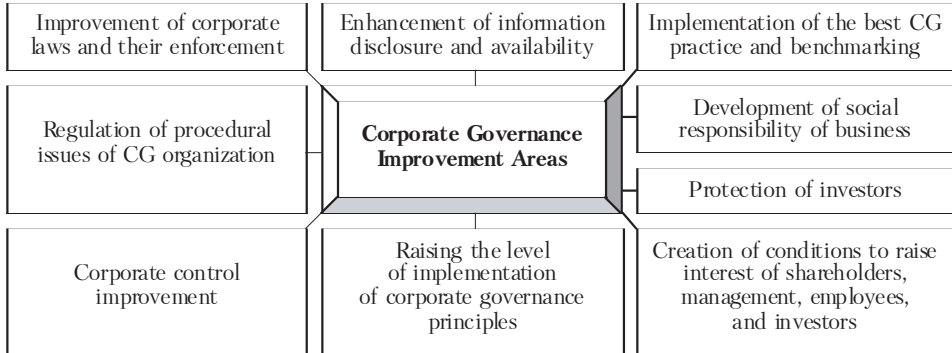


Figure 3. Corporate governance (CG) improvement areas, developed by the author

Conclusion. At present, more and more companies from different sectors enter public markets, investors pay more attention to the level of corporate governance and are ready to pay a company that has done a serious work in this direction and achieved the results corresponding to actual standards. An effective approach to formation and development of corporate governance implies the determination of the scope and consistency of this work on the basis of owners' idea of companies' strategies and their interests. Benchmarking makes an important instrument in the implementation of company's goals in accordance with market requirements.

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