Ward Howell

Talent Equity Newsletter #8

January 2015

Effective Corporate Governance

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In 1991-2002 Stanislav held positions of CEO, Alfa-Telecom, President and CEO, Millicom International Cellular, Russia and CIS, Chief Operating Officer of VimpelCom, Director of Human Resources, Central and Eastern Europe of Otis Elevator. He served as Chairman of SUEK, Vimpelcom-R and a board member of a number of Russian and international companies.

Dr. Shekshnia is the author, co-author, or editor of 7 books, including “Coaching: How to Manage Free People” (2010), “The New Russian Business Leaders” (2004 with M. Kets de Vries, K. Korotov, E. Florent-Treacy), Corporate Governance in Russia (2004, edit. with S. Puffer and D. McCarthy). His articles appeared in such journals as The Academy of Management Executive, The European Management Journal, Harvard Business Review Russia, Harvard Business Review Germany, Journal of West-East Business, Case Research Journal, California Management Review, Compensation and Benefits Review, Journal of Management Inquiry, The International Executive, L’Expansion Management Review, Russian business daily Vedomosty, Expert, Management, Personnel Management, Personnel Mix, Kariera and Kompania magazines.

INTRODUCTION

This edition is dedicated to the topic of corporate governance, which, for our traditional Talent Equity Newsletter audience, evokes a yawn or, at best, a polite smile. Whether appointed managers or company owners, the majority of Russian businessmen still regard corporate governance as a necessary evil, an extraneous expense, an irrelevant added bureaucracy. Oftentimes, their understanding isn’t far from reality – members of a Board of Directors languish in unproductive meetings, management prepares page after page of meaningless presentations, corporate secretaries tediously collect signatures from members voting in absentia.

However, this picture doesn’t need to be painted so dismally. In this edition, we’d like to talk about the bright side of corporate governance, which can be an effective tool for building and preserving the value of a business. About the companies that found a dynamic model of governance amidst complex legal requirements, leading to benefits like strategic decision-making, successful appointments, and effective risk mitigation. About the business owners who build these models using their goals, values, and rules for employees. About the chairmen, who turned their Boards of Directors into effective, collaborative, decision-making bodies. About the ideas and models that make corporate governance lively and successful.

All of the different approaches that transform corporate governance into an effective tool for business development have one thing in common, one defining quality – the presence of people who take initiative and responsibility for building and operating a system that works for them. These leaders – business owners, hired managers, or external directors – could see, within all of the legal requirements of corporate governance, not only the constraints, but also its potential to create effective bodies and positive relationships. Their vision, energy, progress, and perseverance led to what is still a rarity in Russia – a dazzling and effective system of corporate governance.

OVERVIEW OF CORPORATE GOVERNANCE DAY

On September 26th, 2014, in the Hotel Baltschug Kempinski, Ward Howell and the INSEAD international business school, along with the support of the state corporation Rostec, organized Corporate Governance Day. Corporate Governance Day was dedicated to discussing the current state of corporate governance in Russia. Owners, Board of Directors chairmen, and CEOs of businesses – those for whom improving the system of corporate governance is a relevant topic – were invited. The first part of the event was dedicated to three basic topics: Effective owners, Effective Boards of Directors, and CEO Succession. After lunch, the participants split up into separate themed sessions – for owners, chairmen, and CEOs – where they were given the opportunity to further the morning's presentations and their own challenges related to corporate governance.

The event was opened by Olga Dergunova, Deputy Minister for Economic Development, Head of the Federal Agency for State Property Management, who noted the importance of improving corporate governance for the Russian economy. Olga Dergunova briefly spoke about the current state of corporate governance in companies that are fully or partially state-owned. In her opinion, corporate governance operates effectively in public state-owned companies, while non-public companies with full or partial state ownership need to substantially improve their corporate standards. In addition, about 1400 joint-stock companies with the government as a minority shareholder should consider radical revision of their corporate governance models. Olga Dergunova noted the critically important role of an independent Board of Directors, and the state's desire to build upon their existing experience and knowledge.

Ludo Van der Heyden, INSEAD professor and Director of the Corporate Governance Initiative, presented on effective owners – an important, but little-discussed topic. Professor Van der Heyden discussed many of the problems inherent to business owners, such as a lack of vision, inconsistency, an inability to trust their management, and a focus on inconse-

Sergey Shapiguzov

Managing Partner, President of FBK

How do you manage to combine the roles of business owner, chairman of the Board of Directors, and managing partner?

A company can combine these roles up to a certain state of development. It all depends on the size of the business – when a company grows, it becomes necessary to separate these roles.

Group decisions are more conservative, which is why a Board of Directors is needed for a more stable business; meanwhile, innovation requires more risky and quick decision-making, which is why one person can combine all of these roles in such businesses.

Any business should support the balance between technical development and financial attractiveness. At the moment, financiers hold a winning position: sustainable performance is more important than investments in innovation and development. This is both good and bad, as stability in this case can somewhat restrict development.

Owners often successfully manage businesses. To manage a company, it's not enough to understand just one tool of management – you have to understand the product, the technology, you have to be a professional in what you're doing. In small and medium-sized businesses, the owner can successfully enough manage the business, but in large businesses, it's essential to introduce institutions, a proper system of corporate governance.

quential problems. He also criticized the predominant understanding of corporate governance, which is understood as a model for public companies with disintegrated systems of ownership – all the while ignoring private and family companies, for which corporate governance is no less effective. By using the most successful business owners as an example (Warren Buffett and the Mulliez family, among others), professor Van der Heyden concisely outlined traits of success exhibited by these effective owners, including the ability to focus on what's important, as well as understanding the difference between an owner's strategy and investment or business strategy. (*For more information, see Ludo Van der Heyden's article on page 9.*) ▸

Igor Malykhin (Mirrico)

Natalia Prokopieva (Evalar)

Dmitry Pleskonos (PIK, Qiwi), Sergey Shapiguzov (FBK), Andrey Baranov (Altimo), Pavel Ilichev (Russian Raliways)

George Abdushelishvili, Senior Partner and Head of the Corporate Governance practice at Ward Howell, continued the discussion on corporate governance with a presentation on effective Boards of Directors, and their challenges. He noted several topics which, in his opinion, are not given enough attention: agendas and meeting formats, the Board of Director's purpose, and the chairman's leadership. Abdushelishvili noted that while Boards of Directors frequently meet all formal requirements, they are often ineffective because they ignore the importance of group dynamics, shared values among members, and personalities. (*For more information, see George Abdushelishvili's article on page 14.*)

Stanislav Shekshnia, INSEAD professor and Senior Partner at Ward Howell, spoke to the auditorium about the research done by the Talent Equity Institute on CEO succession in leading Russian companies. An analysis of over 250 cases of succession unveiled both global trends (for example, how internal candidates are more effective than external candidates, as well as higher rates of replacements made during periods of economic instability), as well as characteristics specific to the Russian market (the exceptionally short, 3-year tenure of the average CEO; CEOs willing to be demoted instead of leaving the company; and more). You can find more information about the research findings in the 7th edition of the Talent Equity Newsletter.

Olga Dergunova (Federal Agency for State Property Management), Sergey Karataev (PGK), Stanislav Shekshnia (Ward Howell, INSEAD)

Stanislav Shekshnia (Ward Howell, INSEAD)

The second part of the event involved discussing the morning's presentations in groups. Guests could choose which panel they preferred to attend. Ludo Van der Heyden worked with business owners and representatives of investment funds to solve actual, concrete issues that arose in their businesses. For example, a representative from an investment fund discussed a problem affecting one of his assets, which has an overly charismatic owner-CEO who fails to develop a strong team of managers. With help from the audience, Ludo Van der Heyden suggested that the fund develop KPIs for owners on training successors, complete with strict timeframes, and monitoring progress at each Board meeting. One company owner shared that after being involved in the operations management of the company on and off for the last 20 years, he and his partner (the co-founder of the company) disagreed on what their visions of the company's future and were unsuccessful in finding a new CEO. After analyzing several possible scenarios with the help of his colleagues in the session, the owner decided to reform the company's system of corporate governance and strengthen the Board of Director's role, while incrementally moving out of operations management.

Victoria Semerikova

Head of Corporate Technology Management, Federal Agency for State Property Management

It's very important for the government to increase the investment attractiveness of a business, to increase the company's capitalization. This is why Federal Agency for State Property Management aims to create a transparent, open, and consistent system of corporate governance. What are our priorities? Firstly, increasing the predominant role of the Board of Directors. Secondly, attracting professional independent directors who can compensate for any lack of business expertise. Thirdly, improving the methodological framework. And, lastly, an account of objectives. At the moment, we already have a pool of strong independent directors who have introduced a new code of corporate governance, but we still have a ways to go.

George Abdushelishvili moderated a panel discussion about the effectiveness of Boards of Directors. During the discussion, he directed the audience's attention towards issues such as the role of the Board of Directors, the function of the chairman, and the Board's committees. The session participants (which included directors of private, public, and state companies) concluded that the role of the Board of Directors varies, depending on the situation. For example, state companies would prioritize social obligation and, consequently, the interests of society, while the Board at a public company should keep the shareholders' best interest in mind. In a discussion regarding the ideal strengths a Board of Directors chairman would have, participants articulated that it's more important for a chairman to have facilitating and moderating skills than expert knowledge or professional experience. Is it possible to become an effective chairman? The audience agreed that it's certainly possible, but one must have a predisposition towards this kind of role – that is, attention and the ability to listen and hear. These skills are difficult to learn. One session participant noted: "A chairman is the operational director of the Board, and 50% of his time in this role should be spent preparing for Board meetings".

For CEOs interested in issues surrounding succession, Stanislav Shekshnia discussed with his audience why the average CEO tenure is 3 years, and how a CEO could extend his tenure. According to one of the participants, the CEO of a large company, three years is the point at which the personal relationship between the company owners and the CEO solidifies – for that reason, the primary task of the CEO during his first three years is to hold the owners' interest. How does one do this? "Develop more quickly than the company or its owners." Another participant saw the silver lining in the intense turnover of CEOs on the Russian market: "It's why I work every year as if it's my last – I can't afford to hope that there will be many years in front of me to carry out my plans". ▸

Benjamin Wilkening

Investment Advisor, Elbrus Capital

Corporate governance in Russia, without question, has its idiosyncrasies. The owner's role in the Russian environment is more significant, he is more involved in the business's operations. If you're looking on the bright side, then yes, definitely, this makes the process quicker and more flexible, but, on the other hand, this is more "rock-n-roll," if you're using the terminology of Ludo Van der Heyden, which isn't always beneficial for a business and company.

During the event summary, the moderators and participants shared the main topics discussed during the panel session, noting the practicality of the conversations. Professor Ludo Van der Heyden thanked the audience for the interesting discussions, and expressed his confidence in this particular event format – a combination of theoretical material as well as discussions on current, everyday problems faced by business owners, chairmen, and CEOs. In turn, Stanislav Shekshnia and George Abdushelishvili confirmed that such meetings – organized by Ward Howell, and drawing the best international professionals in corporate governance, coaching, and consulting – will continue on a regular basis, with the goal of increasing the effectiveness of Ward Howell's clients' businesses. ■

Ludo Van der Heyden

Professor of Technology and Operations Management, The INSEAD Chaired Professor of Corporate Governance, Academic Director, INSEAD Corporate Governance Initiative

Ludo Van der Heyden has been Professor of Technology Management at INSEAD since 1988. He is actively teaching in the MBA, Executive, and PhD Programmes. He holds the INSEAD Chair in Corporate Governance. He is actively contributing to the MBA, Executive and PhD Programmes, and is the Academic Director of INSEAD's Corporate Governance Initiative and co-Director of the International Directors Programme, he is teaching the Value Creation for Owners & Directors. Ludo Van der Heyden was until recently the first holder of the Solvay Chair of Technological Innovation.

He also was the first holder of the Wendel Chair in the Large Family Firm at INSEAD, which initiated INSEAD's activities in family business. The Chair led to the creation of the Wendel international Centre for Family Enterprise at Insead. Family Business represents the second facet of his INSEAD academic contribution.

He has been awarded the Mercurius Award from the Fedis Association (Belgium) for his work with Professor Arnd Huchzermeier (WHU, Koblenz) on the introduction of the Euro. He received with M. Pich and N. Harlé the ECCH European Case Award 2003 for the "Marks & Spencer and Zara" case. At INSEAD, he has earned several Outstanding MBA Core Teacher Awards, as well as the Outstanding Service Award in Executive Education.

Ludo Van der Heyden has been co-Dean of INSEAD (1990-1995) and Director of the INSEAD Zentrum Leipzig (1994-1999). Before joining INSEAD, Ludo Van der Heyden was on the faculty of the School of Organization and Management at Yale University (1980-1988) and of the John F. Kennedy School of Government at Harvard University (1978-80).

He holds an Engineering Degree in Applied Mathematics from the Université Catholique de Louvain (1974) and a PhD Degree in Administrative Sciences from Yale University (1979). He is the first Honorary Professor of the Handelshochschule Leipzig, from which he also received the distinguished Service Medal in 2003, and also is an Honorary Alumnus of INSEAD (awarded 2000). He is since 1996 an Officer of the Order of Leopold, (Kingdom of Belgium).

He has published in journals such as the International Commerce Review, the Family Business Review, the Harvard Business Review, the Journal of Economic Theory, Mathematics of Operations Research, and the International Journal of Game Theory.

He is member of the Supervisory Board of Bencis Capital Partners (for Fund I) and a member of the Adivsory Board (for Funds II and III). He also is a member of the Supervisory Board of Seisquare. He is Vice-President of the Association Pôle Sud Paris which fosters economic development in the South Paris area and Secretary General of the Scientific Committee of the Comité pour la Langue du Droit Européen.

WHAT IS AN EFFECTIVE OWNER, AND HOW CAN I BECOME ONE?

In this article, I would like to discuss the role of an owner in corporate governance, what qualities an effective owner should have, and what the dividing lines are between the owner strategy, investment strategy, and business strategy, as well as about the primary mistakes that company leaders make.

Owners often find it difficult to define their role in the business: they mistakenly behave like executives, investors, and even managers. One of my clients regularly reminds his CEO that he's not interested in anything other than a 25% return on his investment. And yet, he eagerly starts new projects, pushes, prods, and dismisses employees for his CEO, even gives him direct instructions concerning to whom and at what price he should sell products. This businessman, just like many other business owners, is lost between trees – ownership, investment, and management. ▸

This article was prepared for presentation at the INSEAD-Ward Howell Corporate Governance Day in Moscow in September 2014

The main goal of an investor is to preserve and increase their capital (see Fig. 1). They specifically solve issues of fund allocation by determining timeline, risk appetite, and industry preferences based on the first two parameters. The goal of management is to ensure the stable and profitable growth of the company that they manage. Their efforts are aimed at a concrete organization or institution, while an investor is neutral to the institution.

So what is the role of the owner? Of course, all owners act as investors, and even managers. But I would argue that beyond that there is a distinct role for the owner of a business. If you ask appointed CEOs what they'd like from the owners in charge of their businesses, 95% of them will say "vision." Specifically, answers to the following questions – What do we want to receive from our asset? Why did we invest in it? What are the terms and conditions? (The remaining 5% of CEOs will say "I want more money"). The role of an owner is to provide an effective framework for developing the business and managing it on behalf of those people. This can vary, and include different sets of parameters, including vision, long-term goals, limitations. I like the GVR format – Goals, Values, Rules.

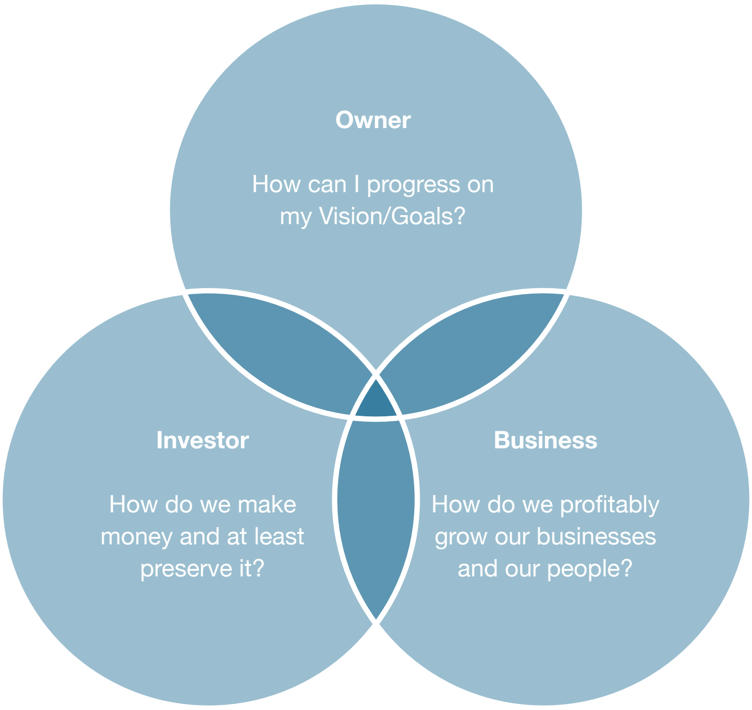

Fig. 1

With this in mind, an owner should concentrate only on his affairs. For example, one of the world's best business owners, **Warren Buffet**, founder of Berkshire Hathaway, doesn't sit on the board of directors at any of his portfolio companies. He only once agreed to chair the Board of Directors at Morgan Stanley, when the company was on the brink of bankruptcy. Warren interviewed three candidates, appointed a new CEO, and went back to Nebraska, with parting words of "if you have questions, call – but remember, you manage the company, I don't".

Another example of effective ownership is InBev's company history. When a new generation of owners joined the company's management, it was ranked 53rd in the world. The new owners asked themselves "**should we sell the company, or try to make it a global leader?**" The shareholders decided that they wanted to grow the business, which is why they broke up their monopoly on owning and attracting financial investment, which allowed them to purchase Anheuser-Busch and become one of the leading global beer producers. As a result, both the family owners and their shareholders won when the value of their reduced shares dramatically increased.

Let's look at another example, that of the company Peugeot-Citroen. Over the course of several decades, the conglomerate produced vehicles that were repeatedly recognized as "car of the year"; however, in recent years, they've been unable to escape the vicious cycle of market and financial strains. The root of their problems didn't have to do with their automobiles, but with their owners. First of all, the owners were completely unprepared to invest outside the borders of France: all of Peugeot-Citroen's foreign deals were unsuccessful. But you won't be successful in the automobile industry as just a national player. It's important to anticipate what's known as "**country risk**", which is a macro task that the owner, in particular, should work out. Secondly, the owners, brothers Robert and Thierry, did not get along. One was the chairman of the company's Board of Directors, and the other headed the holding's Board of Directors. As such, one managed the investment company, and the other, its largest asset, and the two couldn't agree on anything. The last two CEOs for the company could be considered a compromise between the two sides – they were financiers, without any experience in the industry, which speaks to how the owners cared more about money than their business.

All successful owners – **Bill Gates** (Microsoft), **Bernard Arnault** (LVMH), the **Mulliez family** (Auchan), and others – are examples of how long-term vision and innovation came from the owners, because they weren't focused on managing the business, but dealing with larger issues – country risks, choosing partners, etc. As an owner, you shouldn't be focusing on solving every problem, only the big ones!

American academic literature doesn't pay much attention to questions about owners' strategy or behavior – these issues simply remain outside the researchers' field of vision, but that does not mean that they do not exist. Why does this happen? The reason for the myth about the "normal" company, predominating Anglo-Saxon capitalism. The myth about the "normal" company, which is, of course, public. But it's completely not like that. In the US there are over 15 million companies, only 50,000 of which are public. Of course, those are the larger, leading businesses, but most companies are private and account for 50% of GDP, and provide 60% of employment. Business schools specifically talk about public companies more often because they have collected more information about them, and they tell these beautiful stories, but a huge number of successful companies are not public (for example Cargill, Mars, Dell).

So what is the problem with public companies? In this system shareholders don't speak – they only buy and sell shares. They don't talk about what they don't like, they "vote with their legs". Consequently, Anglo-Saxon capitalism, despite its alleged focus on defending the interests of business owners, actually reflects the interests of investors and traders. The ambiguous understanding of ownership in Anglo-Saxon capitalism has led to the increased role of management and the Board of Directors. In the US, legally, your responsibility as a Board member is to defend the interests of the company, not the owner. But the primary responsibility of the Board of Directors is to gather information about what the shareholder wants, and that he understands the value. Value is determined not by the market, but by the owner. In Japan, for example, the primary value is in maintaining employment. This is why Nissan practically went bankrupt in 2000: the company was putting off the inevitable reduction of half of its workforce, because they didn't want to betray the Japanese business ideology of working behalf of employees.

In summarizing everything above, I'll answer the questions posed at the beginning of the article.

WHAT DOES AN OWNER NEED TO COMPETE IN THE MODERN WORLD?

Long-term vision

■

Patience and dedication to the business

■

Reliable partners who share a common vision

■

Focus on hired managers who act effectively

WHAT ARE THE PRIMARY ACTIONS AND DECISIONS OF AN EFFECTIVE OWNER?

To determine the business's vision, and your ambitions as its owner.

■

To appoint managers and give them enough autonomy. Don't tell them exactly how to implement a concept, just give them the ability to exercise their creativity and feel responsible for the result.

■

To select Board members who can monitor progress and evaluate results.

■

To be prepared to re-evaluate your framework and vision, because you could be wrong. You don't have to know everything. Be open to changing people and partners.

WHAT ARE THE MOST COMMON MISTAKES MADE BY BUSINESS OWNERS?

A LACK OF VISION:

Some owners say "I have no vision, I just want to make a profit each year". That's not a vision. And a lack of vision, sooner or later, will lead to losing the business, or losing control over it.

■

A LACK OF YOUR OWN STORY:

Your company is your story that you're telling the world. It embodies your values, beliefs, perception, but there is a class of owners (I call them "rock-n-rollers") that don't have a distinct understanding of their own history, which is why they're constantly running around, wasting strength and resources.

■

INCORRECTLY CHOOSING PARTNERS:

This is largely a problem of money – they bring in people who are often useless or even harmful. But lacking partners is in and of itself a mistake, because you're depriving yourself of the opportunity to hear the opinions of others. Owners are often too focused on their own projects, therefore they are often biased and need an outsider's opinion.

To be an owner is a talent; it's an ability to create a vision and inspire others people to realize it. The ability to believe in other people is also its own sort of talent. Talent is the ability to recognize people who are trustworthy and dependable. ■

George Abdushelishvili

Senior Partner at Ward Howell, Head of Corporate Governance Practice

George is involved in executive search project for leading companies in the industrial, financial, and government sectors. He also leads projects related to corporate governance, leadership development, and succession in private companies.

The experience and perspective that George has amassed helps him consult corporate clients on a wide range of issues regarding leadership and organizational transformation, as well as increasing the value of businesses.

George is listed in The Global 200 Executive Recruiters Rating as one of the best executive search professionals in the world, and also serves on the Board of Directors for several commercial and educational institutions.

His educational background includes St. Petersburg State University, Emory Business School, and INSEAD.

WHAT MAKES THE WORK OF A BOARD OF DIRECTORS EFFECTIVE?

The history of collective management of a business goes back over 400 years. Starting at the beginning of the 17th century, when the first Board of Directors was recorded in Amsterdam, shareholders, consultants, bankers, and regulators developed an institution of collective supervision for effectively managing companies in the interest of the owners and general society.

Today, the practices of Boards of Directors are written in detail and tested in different countries, cultures, and socio-economic spheres. Has one single method for an effective Board of Directors been cultivated? No, and it's unlikely that one exists. We'll emphasize several areas, systemic work that can help maximize the functional effectiveness of your Board of Directors: its composition, agenda, the role of the chair, and the Board's purpose.

BOARD OF DIRECTORS COMPOSITION

This is probably the most thoroughly researched topic in academic literature – the research results displayed a significant correlation between the composition of a Board of Directors and their decisions (for example, a Board predominantly made up of investment bankers led to a growth in mergers and acquisitions and banking transactions – a growth in the volume of credit). Traditionally, the Board of Directors will be filled with industry experts, representatives from finance and the investment community, experts in law and regulatory activities, strategy and HR experts. This makes it possible to comprehensively review the issues on the agenda, and minimizes the risk of making the wrong decision. That said, in modern business, it is fundamentally important to have a variety of parameters that you use to choose a director: sex, location, industry, function – thanks to professionals with different backgrounds, the Board of Directors enjoys an expanded viewpoint and helps avoid tunnel vision.

But what if we want more? Specifically, to adopt the best and most innovative solutions to strategic issues, that maximize the value of the company. Ideally, the target result of the Board's work should be to make collective decisions that are better than those of the most intelligent Board member. For that, the composition of the Board of Directors should include members who are diverse in terms of discipline, and also work effectively as a team. Unfortunately, finding these skills when selecting directors is far more difficult than identifying professional competencies. A group of highly qualified professionals, gathered into one boardroom, could be useless if the directors' work styles don't complement each other (for example, if the Board of Directors consists exclusively of critics or pacifists).

Understanding group dynamics, familiarity with the role (or roles) that we assign during a Board meeting, and overcoming the so-called "traps" substantially increases the work effectiveness. Here are some examples of "traps":

Anchoring. A tendency to formulate a judgment based only on accessible and understandable information. It is important to comprehensively analyze diverse, contradictory, and not always easily accessible information. Board members should be able to find their own information, and not just rely on the information provided by management.

■

Confirmation. The involuntary attempt to confirm your own thoughts and conclusions. It is important to listen to the thoughts of others and, when necessary, change your opinion.

■

Self-righteousness, which develops in the overconfidence in oneself, and in hasty judgments about events and people.

■

Sunk Cost. The phenomenon of trying to justify past wrong decisions occurs often, which leads to additional and ineffective wasted spending.

AGENDA

Once you've attained the most effective composition of Board members, you then must address what keeps them busy, how they spend their time, and what are the meeting agendas.

An analysis of agendas allows you to determine what type of Board you have. Generally, all Boards of Directors can be divided into five types (See Fig. 1)

This isn't to say that one type of Board of Directors is better than another – depending on the context, it can and should serve different functions. However, for large companies that operate in the modern world, the Board of Directors should play a strategic role, not just be a supervisory body. It should move from analyzing the past to planning for the future, from monitoring abidance to procedures and standards to developing strategy and mitigating risk, from analyzing management's proposed decisions to developing them together, from confirming CEO candidates to actively engaging in succession planning. ▸

Cosmetic Board	Meet only to fulfill statutory requirements and rubber stamp for management prerogatives
Oversight Board	**Review policies, proposals, and performance**
Managing Board	Act like managers
Consulting Board	**A group of experts and advisors to Owner/Chairman**
Strategic Board	Set and authorize policy, management objectives, and implementation

Fig. 1

IN ORDER TO BE CONSIDERED "STRATEGIC," A BOARD OF DIRECTORS SHOULD, AT MINIMUM, PAY ATTENTION TO THE FOLLOWING:

Leadership: Who manages the company today, and who will manage the company in the future? How can we best motivate management?

■

Strategy: What will be done with the company in the future, and how? Or, more importantly, what shouldn't be done?

■

The structure or composition of the company: Which of the company's acquisitions are strong, and which ones should we get rid of?

■

Risks: What level of risk is acceptable for the company, and how can we realize our chosen strategy while taking risk into consideration?

■

Finances: How can we preserve the financial well-being of the company and its shareholders?

■

Stakeholders: Who influences the success of the company, and how do we interact with them?

Paying attention to strategically important questions, introducing them to the agenda, and preparing for their discussion ensures the effectiveness of a Board of Directors, and guarantees the well-being of the company.

CHAIRMAN OF THE BOARD OF DIRECTORS

In practice, this role is often filled by a shareholder, his representative, a prominent public official (unless the government is a shareholder), or an independent, but always publicly respected professional. Whether or not this person is accountable is frequently considered more often than whether he can be effective in his role.

In the modern world, the role of chairman of the Board of Directors is complex and important: he determines the agenda of meetings, manages conflicts and disagreements between members, summarizes ideas and statements that have been expressed and creates understandable and achievable solutions from them, provides support and feedback to the members of the Board, interacts with key stakeholders on behalf of the Board, determines and introduces codes of conduct and standards of behavior for the members of the Board, supports and, simultaneously, monitors the CEO. These responsibilities clearly require developed communication skills and a high level of emotional intelligence.

The chairman of a Board of Directors, first and foremost, should be an experienced facilitator, not a strict authoritarian leader. This role should be performed professionally, and must be learned. But I'd like to point out that this doesn't mean that a shareholder can't be the chairman. It means that when he crosses the threshold into the cabinet for Board meetings, he plays a different role, and should fulfill it effectively. ▸

WHAT ARE THE PRIMARY MISTAKES THAT A BOARD OF DIRECTORS CHAIRMAN MAKES?

Manages the work of the Board in the interests of a particular shareholder, forgetting that even if he representing that shareholder as a Board member, as chairman, he should ensure that the work of the Board is done in the interest of all shareholders.

■

Focuses on supervisory functions more than strategy.

■

Controls the loyalty of the CEO, instead of providing support for business challenges.

■

Interprets the role of chairman as a leading role, and not a facilitating one.

■

Sees members of the Board of Directors as narrow specialists and/or advisors, without motivating them or helping them develop.

PURPOSE OF THE BOARD OF DIRECTORS

Another important task of the chairman of the Board lies in ensuring that all directors are well aware of the Board's mission, and know the answers to questions such as "What are we working for? For whom are we working? What are we trying to achieve?" The chairman of the Board should determine the standards and codes of conduct of the Board of Directors, specifically – what level of risk to accept, certain things the Board of Directors will never do.

Frequently, members of the Board of Directors don't fully understand the difference between the purpose of the Board and that of management: the primary goal of the CEO and company management is to create value and maximize results. The Board of Directors should be accountable for maintaining value and minimizing loss. Only then will the interaction between management and the Board of Directors be balanced and beneficial for shareholders.

Every member of the Board of Directors should understand that he simultaneously fulfills five roles: that of an expert (that is, has professional knowledge in some kind of function and/or industry), that of a strategist (capable of long-term thinking), that of a mentor (capable of motivating and developing management and other directors), that of a team player (realizes, that the value of the Board is in their combined abilities). Most importantly, he must have the ability to put himself in the owner's place and make decisions, thinking "If I were in the owner's shoes, would this be beneficial for me?" ■

CORPORATE GOVERNANCE IN STATE COMPANIES

Within the Russian economy, where the proportion of companies with state participation is very high, the problem of corporate governance in such companies is particularly relevant. We spoke with **Alla Laletina**, Head of the corporate-legal department at the state corporation Rostec about the features and reforms of corporate governance in state corporations.

TEI: This year, Rostec began to reform its system of corporate governance. How did the corporation's concept of asset management change?

To answer how Rostec's asset management changed, I first have to start with why Rostec initiated these changes.

The reasons, or, better yet, the prerequisites for changing the system of corporate governance were objective factors: on the one hand, changing Rostec's legislation and formulation is a practice of corporate governance, and, on the other hand, it is the last stage of formulating a holding and a mature, objective necessity for transforming to a business model of management, or, in other words, a request from potential market investors for an understandable and transparent system of corporate decision-making. These prerequisites and conditions stimulated the reformation of our previous asset management rules. As such, this is objectively an evolutionary process.

Now I'll answer how. The primary changes of Rostec's system of corporate governance included introducing a differentiated approach to managing Rostec's assets, increasing the independence of their holdings and the transparency of decisions made by the Boards of Directors, updating the procedure for composing a Board of Directors, implementing of a system of support for the corporation's managers when making decisions (that being the members of the Board of Directors).

A differentiated approach to holding management lies in the selection of a several models of corporate governance. The models primarily differ in the level of authority of the Board and the holding company executives, as well as to what extend the corporate headquarters participates in making operational decisions.

Another model of corporate governance can be applied in cases where the equity capital of the organization includes private investors in addition to the government corporation. This form of corporate governance in accordance with legal shareholders agreements. For example, this model applies to the Kalashnikov Corporation.

TEI: What role does a holding's Board of Directors play, and how does one assess its effectiveness?

The role of a Board of Directors, when talking about corporate relations, is quite traditional and difficult to assess. The Board of Directors is responsible for protecting the rights and legitimate interests of the shareholders; for strategic (not operational) management of the holding; for formulating of an effective system of decision-making; for evaluating the organization and its key leaders.

These directives relevant to both the Board's work as a whole and that of its individual members, as well as reviewing the activities of nominated candidates. These tasks, which lie in front of the Board of Directors, are extremely valuable.

The Board's effectiveness depends on a variety of factors, including a professional and balanced composition, the motivation and engagement of corporate directors, the presence of specialist committees, quality methodology and procedure, and a qualified corporate secretary.

Rostec's holdings created committees within the Boards of Directors in the following areas: strategy, budget, audit, personnel, and remuneration. The work of these committees is used to make recommendations to the Board, which influence their decisions. We attract the most qualified and experienced experts from corporate headquarters and holdings, as well as external market experts, to work on our committees.

The Rostec corporate headquarters created a registry of corporate secretaries, all of whom guarantee the effective work of the holdings' Boards and committees and help maintain a consistent set of corporate standards.

Analyzing the work of the holdings' Boards of Directors over previous cycles has given us a reference point and plans for improvement. Now Rostec has a monitoring function to evaluate the effectiveness of collective management bodies. The results of the ongoing evaluation of the Boards' effectiveness will be used to create profiles of candidates and professional matrices of each holding's Board for the following corporate year, which helps to evaluate ongoing performance, especially regarding the above-mentioned reform changes.

TEI: How are internal and external members nominated for the Board of Directors?

As you know, in September of this year amendments to the Civil Code of the Russian Federation went into effect, which significantly increases the responsibility of Board members. In addition, due to the changes in legislation, potential actions by Board members could post more direct risks for the corporation. Consequently, starting from the current corporate year, the professional experience and reputation required to join a Rostec Board of Directors has increased significantly.

In this corporate year, the composition of all of the holdings' Boards of Directors have been formulated according to new principles. Each holding's Board now includes one executive director (the CEO of the holding), and the remainder are non-executive directors. Two places are reserved for independent directors, who will be representatives from the business community, relevant ministries, or agencies. Heads of key corporate departments overseeing finance, strategic planning, industrial planning, corporate governance, and investments are all eligible for election to the Board of Directors.

TEI: Do you see any advantages to the corporate governance system's development? What kind of direction will the remaining development take?

As mentioned before, the primary goal of the ongoing corporate governance reform is to help increase of effectiveness and investment attractiveness of the company's holdings and other Rostec organizations.

Without question, the introduction of a new system and the achievement of sustainable results is a time-consuming process, not least because cycles in the sphere of a corporate year are longer than those of the regular business processes of the organization. Obviously, steady growth in key performance indicators will be monitored for three years after each change in the system of corporate governance.

This means that the corporate governance system won't improve just once – the work in this area must be carried out continuously, taking into account the corporation's goals and objectives, as well as constantly changing external factors.

Our main efforts in our attempt to perfect our system of corporate governance will lead to the development and improvement of Board members' competence, an improvement in how the Board and organization management interact with one another (please don't implicate any members of the Board in operational activities), as well as to the development of a system of support for decision-making. ■

CORPORATE GOVERNANCE IN STARTUP COMPANIES

Problems related to corporate governance are relevant not only for public companies and large private businesses, but also for fast-growing entrepreneurial companies that frequently have neither time nor the necessary knowledge for solving such problems. We spoke with **Kamil Kurmakaev**, co-founder of Wikimart, which was founded in 2009 and became one of the top 30 Russian internet companies by 2012 (according to Forbes magazine).

TEI: Kamil, tell us, how did the system of corporate governance evolve at Wikimart?

The development of our system of corporate governance is still ongoing. It can conditionally be divided into a few stages. During the first two years at the company, there were two boards – an Advisory Board, something fairly common in fast-growing technology businesses, and a traditional Board of Directors. The Board of Directors includes the two founders of the company (myself and Maksim Faldin) and two representatives from the business angels that invested in Wikimart. We got together about once every four months to discuss what was happening in the company, what kind of progress we made. These discussions were informal, but key decisions were made there.

During the first stage, the Advisory Board was extremely beneficial for us. In particular, we managed to get together a reasonably large group (about 20 people) of highly-qualified professionals, primarily from the business angels. Almost all of them had experience in starting a business from scratch, so their expertise was critical for us, especially in the areas of technology, logistics, and sales. Early on we received such high-level expertise that we had the opportunity to establish many processes geared towards the long term.

TEI: How did you establish this process? How did you motivate members of the Advisory Board?

Many think of an Advisory Board as some room in which advisors sit and provide recommendations to management. It actually looks quite different. You call a specific person with a specific problem, and then develop a particular model of communication. For example, with one of our leading professionals, Michael van Swaaij (a former Ebay executive), we decided to talk over the phone monthly and discuss about the events of the previous month, as well as our thoughts on different matters and any concerns. Intercommunication didn't pan out with some angels – we talked once and understood that we don't have any mutual interests, which is totally normal. We gradually formed a group of people that we communicated well with, and set topics and timeframes for communication (once a month, once every three months).

Regarding remuneration for Advisory Board members: we didn't have a well-developed system of compensation. Several of them could hold shares, but many helped us for free. ▸

TEI: How and when did the second stage of the corporate governance system's development begin?

The second stage began in the second half of 2010, and continued until the beginning of 2012. The first venture capital investor, Tiger Global, joined the company, investing 5 million dollars and receiving 50% of shares. Together with the fund, we began to expand our corporate governance: the Board of Directors grew to 5 people, including Lee Fixel, a partner at Tiger Global. We also recruited two independent directors – Michael van Swaaij and D.J. Patil, a former LinkedIn executive. Beyond that, the Board of Directors operated at two levels: the first involved gathering the whole board every 3-4 months to talk about strategic issues, with presentations and metrics. The second level included only three people (myself, Maksim, and Lee Fixel from Tiger Global), and we made decisions about operational issues regarding debts, partnerships, etc. – all of the things that couldn't be put off for several months. At this time, the Advisory Board started to play a smaller role. Moreover, at this point we decided to limit the information that we presented to the Advisory Board to only the most general metrics so that we didn't put pressure on management. To explain to every advisor changes in this or that variable would have taken too much time.

Taras Polischuk

Talent Equity Ventures Investment Manager

Talent Equity Ventures (TEqV), is a venture capital fund affiliated with Ward Howell, focused on technology-intensive HR and Education technology startups in the US, Europe, and Russia.

In the last two years, we created an Advisory Board for a series of companies in TEqV's investment portfolio. Based on our experience, the optimal number of members in an Advisory Board is 6-10 people. On the one hand, this helps effectively manage and support communication with all advisors; on the other hand, it provides the opportunity to attract highly-qualified professionals from all the necessary backgrounds and qualifications.

I would divide advisors into two types: functional experts, who can contribute to the project team through key functions (marketing, technology, etc.) and industry experts, who have a broad network of contacts in the industry and are well-versed in the business of the company. For B2B companies, it's also important to have people who are actual consumers of the product or service in the Advisory Board, because their advice holds weight for other potential customers.

Along with expertise, one of the key functions of an advisor is introductions to relevant people: potential partners, investors and customers. That is why, when choosing an advisor, it's important to pay attention to his rolodex and network of contacts. And, of course, the most valuable advisors are those whose names are well-known in the industry or even outside of it.

Regarding remuneration, the most effective tool is options with 2-3 year vesting period, because, unlike straight compensation with cash or shares, they create the right motivation and help to build long lasting relationships with the advisors.

The new stage began in the beginning of 2012, and was also related to the addition of a new shareholder – Finprombank, which held 10% of shares. But the corporate governance system's reform involved not only to the addition of a new shareholder, but a change in the nature of the shareholders. Two less formalized outlines emerged: as before, all key financial decisions and issues related to approval of potential deals and partnerships were made with Lee. But we added to this a committee that included Russian investors, with whom we could meet and discuss problems and opportunities that were specifically Russian – for example, which distributors we needed to build relationships with. Such local questions might have been interesting to our international investors, but they wouldn't have been able to provide any meaningful, practical advice. At this point, the role of the Advisory Board diminished to nothing, but we still kept in touch with several advisors.

TEI: Why did the role of the Advisory Board diminish to nothing?

The company grew and certain issues that the experts from the Advisory Board helped us solve were delegated to a lower level, and were no longer on mine and Maksim's plate. For example, a former manager who consulted with us on logistics now spoke to our business process executives, not with us. Maksim and I could no longer spend so much time on individual conversations and deep analysis of each issue.

The fourth stage began at the end of 2012, at a time when Tiger Global had many portfolio companies. This meant that they couldn't be deeply involved in the numbers for each company, and by this point Wikimart already grown into a large company. Tiger Global formed a group of analysts, one of whom worked closely with our company. This was tremendously beneficial for the company, and helped us monitor general trends. In addition, we started to visit Tiger's portfolio companies (in the Middle East, India, and Germany) and interact with the founders and executives of these companies. In my opinion, this is a form of corporate governance, because company-level training, where there are general shareholders, is taking place.

TEI: What's happening with the company now?

2014 was a big year for the company in terms of events – the company has grown and has changed its share capital structure. Our Russian shareholder bought out a portion of shares from Tiger Global to become the majority shareholder. We've entered a new stage, which includes cooperating with companies that Tiger Global and Finprombank invest in. Not only e-commerce, but other closely-related business matters – financial service, loyalty programs – we found a lot of interesting overlaps. At the same time, we're establishing the Board of Directors' work, but it's too early to say what the new system will look like. The independent members of the Board haven't changed, but it's possible that there may be some changes in composition, such as adding Russian independent directors.

TEI: How do you motivate independent members of the Board of Directors?

In the early stages, businesses like ours don't usually have enough money to pay independent directors. One of our independent directors, Michael van Swaaij, had been an investor from the beginning, and was therefore interested in increasing the value of his shares. The second member of the Board of Directors was given an option at 0.5% of his work.

TEI: But from a legal standpoint, isn't Michael an independent director?

Yes, we look at him as an independent director because he's not affiliated with any major shareholder. Michael's minority share didn't have any impact on his ability to make an objective, independent judgment, though he wasn't formally an independent director.

TEI: Kamil, at the moment, serious discussions are ongoing about how having representatives from investment and venture capital funds on an entrepreneurial company's Board of Directors doesn't ensure a long-term vision for the business, because a primary goal for a fund is to sell their shares, to "withdraw" from the business. Did you ever have a situation where the representatives of funds were colliding with the independent directors because they had different timelines?

In this sense, everything was simple for us: e-commerce is a fairly capital-intensive business that only becomes profitable after 7-8 years of work. There aren't really any examples of companies in this industry that have been able to produce positive cash flow in the first few years of work. This means that there's always a choice in front of the company – attract additional funding, or die. This kind of situation makes any discussions on long-term perspective that omit consideration of current financial tasks pointless. We didn't have such conflicts on our Board of Directors because everyone understood that – both representatives of funds and independent directors. I think that what you're talking about is more relevant for companies that are in more mature stages of development, and are already self-sufficient. In those kind of companies, a situation where funds are "twisting arms" is possible, but that is more of an indication that the founders of the company haven't maintained a controlling position in management. In my experience, complete removal of company founders from management (or becoming less influential) happens rarely in technology businesses because these shares, in isolation from the people that started the company, dramatically lose value. ▸

TEI: What kind of advice would you give to growing businesses about forming their systems of corporate governance? Would you have done anything different?

I don't contest that there are other ways to do it. An employer can see the business as his own creation. If he has a distinct vision, then it's possible that communicating with funds and advisors will be harmful. In addition, this communication comes with a price – at a minimum, time. There's a purely financial price, for example, you give shares to certain funds. If the entrepreneur's style is very unique and personal, then communication could be harmful. But there are several living histories that show that business problems can be a result of not a root cause, not economic challenges, but because of managerial errors. When you're alone and there's no one to correct you, these situations can arise. In my opinion, to painstakingly build a system of corporate governance is the right way to go, despite the fact that it takes a lot of time and effort.

TEI: We often hear the opinion that there are certain specificities of Russian business (different forms of ownership, different external (environmental) conditions), which is why a western model of corporate governance isn't completely appropriate for us.

I would be interested to ask those who share this opinion what kind of car they drive. There are best international practices that have repeatedly proven their effectiveness, and to rely on these practices is just like driving a nice car. But, to continue the analogy, if a car is built for a country with a warm climate, then the cold Russian winter won't be easy for you. It is the same with corporate governance – a carbon copy of the western model doesn't always work. If you try to transfer it to a developing business in Russia, it will most likely fail. Certain issues will be solved too slowly, as there isn't always a month to wait and convene the Board of Directors. Therefore, any model needs practical adaptation, and I think our history illustrates this approach. ▪

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