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Moscow, Russia

International expert council for the project:



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Foreword

The Survey was performed in Spring 2009 by the executive search firm Board Solutions, in partnership with the international law firm Allen & Overy and the Russian Independent Directors Association (IDA). It was based on a methodology developed by Board Solutions with the support of an international expert council created for the project.

The Survey was conducted in the form of personal interviews with Chairmen, CEOs and independent directors of 64 major companies with established Boards of directors doing business in Russia. Each interviewee was addressed with the same questions covering the following areas: new challenges, priorities for and expectations of the Board, required resources for the Board, and changes which need to be implemented to get more value from the Board and its members.

The Survey’s conclusions have been drawn from the opinions of the participants and through roundtable discussions with a select group of directors and CEOs. No specific actions were taken to verify the objectivity of the data provided by the Survey’s respondents.

This important study will help business leaders to evaluate how the credit crisis has affected the role and work of Russian companies. It provides an insight into governance and how Boards react to substantial changes in the business environment. The major findings and lessons could benefit the business community and be of interest to government agencies in Russia.



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The report is available at the Board Solutions, Allen & Overy and IDA websites:
www.boardsolutions.com, www.allenoverly.com
 and www.nand.ru respectively.

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1. Survey overview

The Survey was intended to review the impact of the financial crisis was having on the role, performance and perceived value of Boards of directors in Russian companies and to compare international experience. A key issue was whether improving corporate governance was seen as adding value to companies in a period of crisis or whether it was seen as an expensive and bureaucratic luxury of little relevance.

In times of economic turbulence, the general response is often to avoid all expenditure and cut out all processes that don't deliver immediately to the bottom line. As a result, R&D is often cut, staff training and development are put on hold, and Boards focus on the short term crisis. In particular, there are companies that see governance as a chore that takes too much time and adds little value.

In looking at examples around the world of how companies and Boards are reacting to the financial crisis, it was found that different models of governance made it difficult to find clear and simple answers to our queries. However, several themes and indicators of best practice have emerged as follows:

- Boards' agendas are re-shaped in difficult times to focus much more on managing cash and managing the risks in the business.
- Boards' agendas are re-ordered to deal with the important items of strategy or big decisions first and more routine business is given less time allocation.
- Reports to the Board are more timely and quicker to provide information on the critical variables and with a more comprehensive view of the business, as opposed to the normal situation.
- Boards tend to spend more time in special meetings where they are required to deal with critical issues.
- Boards with the right balance of skills and experience, from not only the company's own industry but also from other industries, are able to deal more effectively with their priorities than those with limited diversity. Balance on the Board is a key prerequisite for good decision-making and for good governance.

(Source: Institute of Directors UK)

These indicators are definitely relevant. However, we wanted to see first hand from discussions with top business leaders what the situation in Russia is. We believe that the information gathered through this Study will prove helpful to the business community. We not only intended to describe how companies have reacted in this difficult time, but also to draw some conclusions for consideration and, if thought appropriate, possible implementation to improve the efficiency and competitiveness of Russian companies.

2. Corporate Governance in Russia

Although much is yet to be done, for the last 15 years Russian business has demonstrated significant progress in developing corporate governance. The most significant achievement is perhaps the introduction of the Russian Corporate Governance Code by the Russian Federal Securities Commission. Despite being of recommendatory nature it nevertheless serves as a basis for development by Russian stock exchanges of corporate governance requirements in the listing rules which became mandatory for publicly traded companies.

Based on an IDA study completed in 2008, there were 359 directors holding 430 seats as independent directors in 159 major companies. 75% of these companies were publicly traded. That study reported that Board committees were established in 85% of the surveyed companies.

Recent developments also demonstrate the State's further willingness to strengthen the quality of corporate governance in Russia. The Government has recently announced plans to replace state officials on the Boards of the state-owned companies with independent directors. Draft legislation is also expected to clarify the rules on insider trading and market manipulation.

*The view that **corporate governance does not create value during a crisis** did not receive strong support from the participants of this Survey. 73% of the participants believe that corporate governance is important and half of them consider it to be even more important in a crisis, while 27% think that it is an unnecessary cost when valuations crash and the capital markets are closed.*

So far as our feedback was concerned, some doubts were expressed as to whether in a crisis typical Russian Board has sufficiently well-qualified professionals that can exercise independent judgment and make decisions in the best interests of all shareholders. On the other hand, practice shows that many Russian Boards are able to cope with the challenges and to focus on practical value creation rather than box-ticking. In our discussions, we heard a clear view that those companies whose Boards are focusing on the substance rather than the form of good governance will more likely emerge from the crisis as winners.

For more information on Russian corporate governance and its implications for Board practice see Appendix 1.

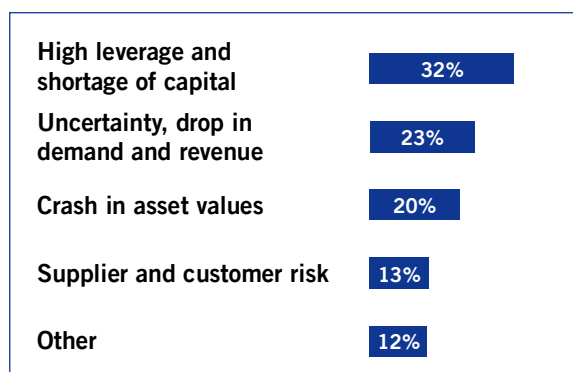
3. Survey findings by topic

3.1 Key market challenges

The majority of respondents believe that business faces an unprecedented situation where companies are mainly focusing on immediate survival measures and efficiency.

Only a few participants said that they met the crisis with their companies in good shape as the result of cautious investment and M&A policy in the past. A chairman of a consumer company said: “We were able to avoid many of the problems because the business has been very cash generative and, as a result of not paying dividends, has very low debt”.

The main challenges for business are high leverage costs and shortage of capital, a crash in asset values, market uncertainty, and supplier and customer risk. Other challenges were noted: lack of crisis management skills, altering the business model, and downsizing of the business (see the diagram).



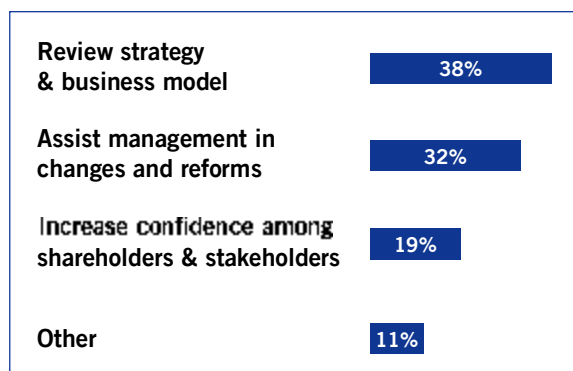
A few chairmen said that adapting products and services to a crisis situation was a key challenge for his company.

An undeveloped local capital market and banking sector led Russian companies to look for international financing. Exposure to international debt made Russia more vulnerable to the crisis because lenders were reluctant to refinance loans in emerging markets. As a result, Russian business was hit harder than western business.

One participant who has seen three previous financial crises said that this time, the effect had been much more rapid in emerging markets, partly because of the very rapid growth, financed by US dollar loans, of businesses with local currency revenues.

Board values and priorities for the Board

In general, the Survey revealed a positive attitude by business leaders towards the value that a Board can provide during a crisis. The survey showed that the Chairmen, CEOs and independent directors see Board leadership and value in the following areas (see the diagram):



Review strategy & business model

A CEO pointed out that the management team cannot cure itself because it lacks an objective perspective and has a natural tendency to do what has been approved before. It is obvious that a sick man needs an experienced doctor who can analyse the symptoms and the causes of a disease, give guidance and monitor recovery. In turbulent times, a good Board is able to play the role of doctor to the business.

Assist management in changes and reforms

A non-executive Chairman of a company stated that in turbulent times, the Board should provide leadership and assist management in making tough decisions such as reduction of the workforce. This is a painful process which no one likes, but unfortunately is necessary for adjusting to realities during a crisis. The Board has an important role to:

- (a) make sure that the realities of a crisis are acknowledged – which is not easy for the line management running operations;
- (b) ensure that the management builds “worst case scenarios” and understands the extent of the necessary pain; and
- (c) take leadership in going through pain – eg by reducing its own compensation and benefits. Of course the Board should not attempt to replace the management – rather, the Board should ensure that the management is leading change in the company.

Increase confidence among shareholders & stakeholders

As emphasised by an independent director who is serving on a number of Russian Boards: “A company should develop and maintain stronger relationships with analysts, investors and shareholders through regular and open dialogue. A crisis and crash in valuations cannot be an excuse to stop communicating. Once a company has accepted public money, it has to comply with stock exchange regulations and good corporate governance.”

The most popular view was that companies should strengthen communication with customers, government, suppliers and employees to ensure that they are informed about the company's position and demonstrate that the company is doing the right things and reacting appropriately to the crisis.

Additionally, there were views that the Board plays an important role in the protection of assets and ensuring liquidity. In listed companies, the Board reduces potential conflict between the dominant shareholder and minority shareholders. It was noted that the Board is the last line of defence for ethics, morality and maintaining a good reputation.

One of the directors interviewed said that key executives like the CFO and the CMO should have “Godfathers” – ie experienced non-executive directors to assist them in reviewing preliminary materials for Board meetings and providing guidance and professional support when necessary.

Along with these positive expectations a number of concerns were expressed. A Chairman who is a controlling shareholder pointed out: “Turbulent times require prompt decisions. The Board should be able to make a quick decision and provide more power and responsibility for the CEO. If the company is struggling for survival and the Board is not well-equipped, then it is too late to change it. We see examples when founders return to the CEO position and try to run the business in “manual mode” without a Board of directors.”

There was also a view that the role of the Board should be limited: it should merely find a CEO, agree on terms and oversee the CEO's performance. Other participants pointed out that such a narrow definition of the role of the Board would limit its ability to carry out its fiduciary duty of taking care of the interests of the company.

Monitoring of financial issues (cash flow, budgeting, investment programmes, working capital management and financial controls) together with survival measures (cost reduction, debt restructuring) were named as the main priorities for the Board now.

75% of the respondents said that, in a crisis, Boards' agendas focus more on operational issues and less on strategic ones. A Chairman of a large publicly traded company said: “In a crisis, survival is a strategic issue and accordingly, focusing on debt levels, cash and costs are all very important and currently more important than the issues normally regarded as strategic.”

3.2 Resources for the Board: composition, structure, diversity (skills and experience), committees

The results of the survey indicate a general view that the key to a successful, productive Board is a good balance. There should be a mix of independent directors and executive directors and more importantly the right mix of talent and a variety of skills and experience.

There is a general view that there is real value in having the right balance on the Board and utilising a nomination committee to ensure that those appointed have the skills and experience to provide the independent input.

In Russia, company law prescribes the way directors are appointed, and often sets a minimum and maximum number of directors.

Board size

The law requires that companies with more than 1,000 shareholders must have at least seven Board members, and those with more than 10,000 shareholders at least nine members.

The majority of the respondents see the optimal size of the Board as seven to nine members.

Board structure

There is a choice of Board structures for companies in Russia. It can be a one-tier (a single Board made up of executive management and non-executive directors) or a two-tier structure (a supervisory Board of outside directors with, perhaps, some management representatives and a separate management Board consisting only of executive directors).

In a two-tier structure the law requires that the members of the management Board occupy no more than 25% of the seats on the supervisory Board. There are no limitations with respect to the balance of executive and non-executive directors at the Board level in a one-tier structure. In both structures the CEO cannot be a chairman of the Board of directors.

The Russian Corporate Governance Code says that at least 25% of the Board members should be independent directors, but no less than three. This provision and criterion of independence for directors are much less strict than the international standard, where independent directors should exceed 50% of Board membership. The UK Combined Code, for example, requires that at least half the Board directors are independent, but there is provision with the “comply or explain” principle that any Board not being composed in this way should explain its reasons for the deviation. This is normally included in the Annual Report in the section on governance of the company. Communication with stakeholders on the governance principles in the company is an important part of a Board's responsibilities.

When we asked participants whether the CEO and other executives should be a Board member during a crisis, our interviewees were divided into two opposing camps: 45% of the participants believe that the CEO should not be on the Board, but should participate in meetings, and 55% believe that at least the CEO should be on the Board. UK/USA directors tend to prefer a unitary Board while continentals favour a supervisory Board concept.

The first camp believes that the CEO should not be a Board member in order to separate responsibilities between the Board and the executives. A concern that was expressed is that it creates conflicts of interests when the Board considers management performance, remuneration and other issues. It also means that the non-executive directors do not get the access to other executives in the organisation that would help the Board have a more balanced view of the whole executive.

The second camp asserts that the participation of the CEO and other key executives is important as it makes them feel more responsible for decisions; increases interaction, collaboration and involvement between directors and executives; and is a platform for executives' further development and an element of succession planning.

An alternative view was expressed that in fact the formal membership of the CEO is less relevant than a good spirit of co-operation and teamwork between the Board and the CEO.

Some CEOs said that they do not want to be a Board member when there is tension between the main groups of shareholders. Presumably they simply wanted to implement the strategy without being a party to the politicking that may take place in certain companies.

Independence

Although the most popular opinion was that the Board should have two to three independent directors, there was an interesting sentiment from a CEO that Boards should have a greater diversity of views and have at least four independent directors to hold a quality debate. Usually the CEO presents materials to the Board. At the Board meeting, representatives of the main groups of shareholders usually have a united position which has been discussed before. If one of only two independent directors cannot participate in Board meetings, this will not be enough to ensure an extensive and productive discussion.

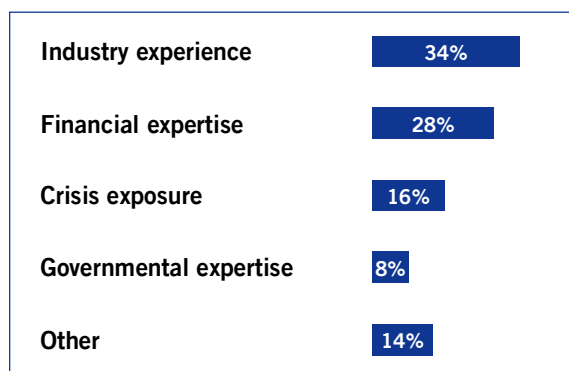
Another view was that state owned companies should have a majority of independent directors to ensure a balance between the interests of the government and other stakeholders.

A Chairman of a big private company noted that the presence of independent directors encourages management not to bring problems to the Board for fear of criticism and possible information leaks to the market. Therefore, independent directors should be limited in number and chosen carefully.

One of the ways to ensure Board efficiency and independence from the different groups of shareholders is to have an independent Chairman. Such a Chairman can develop a proper agenda, ensure the Board receives complete information and that each individual director is involved in discussions and decision-making. He/she also takes a leading role in determining the right composition of the Board and acts as a mentor to the CEO, providing input on key processes such as strategy, management development and succession planning.

Diversity

We asked respondents what skills and experience a director should have to be more valuable to a company's Board in a crisis. The largest number said “relevant industry experience” together with “financial expertise” (see diagram). Part of the reason lies in a desire to have candidates with specialist knowledge of relevant businesses and industries and the business environment in which the company functions who can provide insight regarding strategy and risk.



At the same time a few participants mentioned that, if they knew of an appropriate candidate, they would prefer to replace current foreign directors with Russians who understand the Russian market and are not linked with competitors.

16% of respondents felt that there was a lack of crisis management. This credit crisis has demonstrated the very real value of having independent directors who have had experience in similar conditions and are able to offer a balanced and informed view, using their experience and a cool head. Clearly, if a company hopes to respond to market uncertainty, its Board must be equipped with directors who know how to anticipate and react to a crisis.

Government expertise was noted by 8% of respondents as another important qualification. In the current business environment and credit crisis, the government and state-owned banks are perceived as the only source which can provide capital.

Independent Director: Important Attributes

To set the scene, the relatively low percentages for each of the attributes listed below is a reflection of the lack of agreement on the two or three really important things expected of non-executive directors. There is diversity in the responses.

Greater availability – 40%

Respondents expect directors to be more available to make fast decisions and participate in extraordinary meetings to consider urgent situations such as “credit tightening”, “a cash crunch”, “survival measures” or “breaching of covenants”. A director of a number of Boards including state-owned companies said: “Time availability of directors is even more important than their professional skills. If the company has a ‘star director’ who is too busy to be actively engaged in Board meetings he will have little value during a crisis.” A view was expressed that greater availability of directors is important, but the Board should be careful not to increase the burden on the management – by having more meetings and demanding more information simply because the Board feels insecure. The judgement of the Chairman and common sense is very important here.

Courage & independence – 21%

During a crisis, an independent director should have the courage to stand and say openly if he disagrees with controlling shareholders, to ask tough questions and play the devil's advocate role. All of this is in order to exercise his powers in the interests of the company as a whole.

Maturity and wisdom (keep a cool head) – 20%

Lack of crisis experience and crisis management skills requires the addition of mature and wise directors who will provide guidance to management with long-term goals and visions in mind. A chairman of a consumer company said: “The Board should keep a cool head and avoid panic. It does not help to have Board members who ‘get nervous’. It will be helpful to have lived through other crises – even if they weren't as severe as this one.”

Deeper understanding of the company's business – 19%

Management hopes to respond to market uncertainty and expects that the Board is staffed with directors who know how to react to a crisis. This includes a good understanding of the business and environment to assist management in identifying business problems and fixing them. There was a view that the management can have a short term view and propose to unnecessarily cut valuable business or sell assets which are important for the company's long term value. A chairman said: “Survival becomes both a strategic and a tactical issue in a crisis; the impact of events and decisions can be very immediate and so it is essential to be very ‘hands on’.”

Additionally there was a view that language skills are important. Bilingual directors might be more expensive but time and cost are also involved in dual-language documents and/or interpreters.

3.3 Boardroom practices in a crisis

Selected participants' responses:

1. No need to schedule more frequent and longer meetings in person. Circumstances may require more telephone meetings for urgent situations. Russian companies already have meetings on a near monthly basis.
2. The agenda is now more focused on operational issues rather than long term strategic ones.
3. Use management resources wisely and eliminate processes which are not important at the moment.
4. Better utilisation of the Board committees. Most respondents believe that there are two valuable committees: strategy and audit, and Boards should have both of these.

Strategy committee

Survival and efficiency were noted as being the key priorities of the committee.

A number of respondents said that they had a thorough strategy review at the end of 2008 or the beginning of 2009 and concluded that the usual way of strategic planning is not working anymore. Due to the high volatility of the market, previous assumptions are changing rapidly and becoming irrelevant to real strategic needs. The time horizon for strategic planning has reduced from 3-5 years to 6-12 months.

A Chairman said: “The strategy committee should check constantly that management understand the situation and adequately react to market changes”.

Some participants suggested that Boards should view the crisis as a new opportunity. The new strategy should consider how to take advantage of a bad situation. If life gives you lemons, make lemonade.

There are many examples in the Western world of successful companies with strong balance sheets using this as an opportunity to acquire companies that are a strategic fit at good value. In addition, with unemployment having risen significantly, those companies that truly value human talent are adding to the strength of their management teams through selective recruitment.

Audit committee

Some participants believe that the audit committee now has an even more important role than normal as transparency and probity have never been more important. There must be more frequent meetings and more time for the audit committee. Areas which were raised by directors:

1. *Review and monitor risk regularly*

In today's continuously changing business environment, factors affecting the likelihood and consequences of a risk are very likely also to change. Today's minor issue could be tomorrow's major concern. This is why monitoring and reviewing risks is an important part of the risk management process. The best Boards have reviewed their risk assessment and control process to see that it is effective and that the Board is clear about the high level risks affecting their company. Risk assessment is not an annual exercise that can be completed and set aside. It is continuously evolving and must be supported by the Board and embedded in the decision-making of the business.

2. *Alertness and early warning system*

It was noted that mapping of early warning indicators and conducting early warning exercises are vitally important in order to ensure preparedness and timely responses to the effects of a financial crisis.

3. *Assistance in the definition of issues in the financial system and identifying risk appetite*

The risk oversight function of the Board was seen as being even more critical today to make sure that risk management is in line with the company's strategy and is functioning properly.

Remuneration committee

The role of the remuneration committee received relatively little comment from interviewees.

There were really three issues raised during interview.

Firstly, interviewees were asked whether a remuneration committee should review salaries – ie for Board members and senior executives.

Secondly, some interviewees went on to talk about remuneration for executives generally and that there was no longer any upward pressure on salaries. As some participants said, the best bonus for 2008 is to have a job in 2009.

Thirdly, some interviewees focused on the remuneration of independent directors.

Remuneration of independent directors

Usually the remuneration committee would have independent directors making up the majority of the committee. Therefore, the remuneration of independent directors is a matter for the Board as a whole and is reliant upon the independent directors absenting themselves from discussions and decisions on their remuneration.

Our participants were divided on remuneration. Some believed that the company should continue to pay the same rate in times of financial challenge as this money was insignificant compared to the value of the directors and within the scale of the company.

Others said remuneration should be reviewed and if the company is in a difficult situation, the directors should set an example for management by reducing their pay. A number of participants said that directors should forego payment until the company gets through the difficult time.

We analysed the remuneration of the Board members of 15 Russian listing companies which comply with the Russian Corporate Governance Code whose revenues total more than \$1 billion. The average remuneration of Board members is around \$150,000 (the highest being \$500,000 and the lowest \$14,000).

The current AGM campaign of 2009 has revealed that several companies are cancelling payment for Board members. There are other examples where Boards reduced their own compensation and reduced benefits (such as business class flights), pre-empting cost-cutting measures to be carried out by the management.

This is unlikely to persuade the professional non-executive director (whose income comes solely from the role of non-executive director) to devote the necessary time and support to the role. Indeed, if companies want the best independent directors and want them to give additional time when there are significant challenges to be overcome, they must be appropriately paid in a professional way.

Remuneration structure of independent directors

Stock option plans are not widely supported, even where the company lacks cash. One of the CEOs said that the Board members should work in the interest of all stakeholders, not only shareholders, and should be compensated for their time with cash.

The idea of deferred payment was supported by some of the participants.

Nomination committee

The survey participants no longer see the nomination committee as an important part of the Board. Only a few publicly traded companies have a separate nomination committee. However, as can be seen from the earlier content in this report, this may well be due to the undervaluing of the role of the independent director and the historical way in which Russian companies appoint their nominees to act in their best interests on the Board of the company they are investing in.

Crisis programmes

Many Boards considered crisis plans. The interviewed directors shared some interesting practical experience on how to deal with unforeseen emergency situations. We have summarised some of them:

- For a turbulent time, the Board should have a financial crisis rescue plan and a communication plan on file in the event of possible bankruptcy, breach of important financial covenants, etc.
- Anticrisis score cards – some respondents suggested that the Board would find it useful to ask management for a monthly one page report tracking progress on anti-crisis measures and specific goals (eg free cash flow, debt position, cost cutting, capacity reduction etc.) approved by the Board. Such a report is different from usual KPI-based performance reporting. Monitor cash position and covenants at least monthly and have contingency plans. It is important for the Board to review the agenda regularly and to keep a careful eye on financial covenants and to ensure that they were stress-tested frequently.

While some respondents thought that the establishment of a Crisis Committee was a good idea, this was not fully supported by the majority of the respondents.

4. General conclusions and suggestions for Russian Boards

1. In a time of crisis, the Board should review areas for improvement and optimisation in order to become a real strategic asset for the company and create competitive advantage. The Board evaluation exercise is an essential tool to examine how it is currently operating and to find ways to improve performance. This need not be a costly or time-consuming task. It is meant to add real value.
 2. Numerous key processes need to receive the proper inputs from appropriately skilled directors. Risk assessment, control and management development and succession planning are key areas which, along with the strategy review and plan, are cornerstones for the Board.
 3. Companies need to have clear, concise communication plans both for outward facing information and for internal use amongst all employees. Failure to communicate in stressful times is a cardinal sin and will simply damage the company through rumour and assumptions made by others in the absence of information.
 4. Companies that responded more effectively to the credit crisis were those who were able to ensure that their Board agendas were altered so that sufficient time was allocated to reviewing and discussing major strategic decisions, rather than spending Board time on administrative exercises. The Board should review their agenda on an ongoing basis, especially in times of turbulent changes. Further it is of tantamount importance to establish a clear separation between management meetings and Board agendas.
5. Directors must carefully examine the information that they receive in terms of appropriateness and timeliness. In times of crisis, there is a need for more timely information, more focused to the short term and to the current needs of the business. Cash control and clarity of current and forward projections of borrowings against covenants are key weekly indicators.
 6. The Board should utilise the Board committees and management resources more effectively and comprehensively, possibly delegating increased powers while freeing itself for strategic and big decisions.
 7. The composition and structure of the Board must guarantee a broad variety of views and secure diversity of skills and experience. The Survey clearly demonstrated that a number of Boards are too limited and lack the right balance, skills or challenge from genuine independent directors.
 8. Board Committees:
 - a. The **audit committee** is key. It must be appropriately staffed with the proper balance of competences. At the foundation of an effective audit committee is the risk assessment and control process. This is a core process. The Board should view it as a value adding exercise to avoid unnecessary costs and resources.
 - b. The **remuneration committee**: in spite of too little attention being paid to this committee by the participants, the committee has a major role to play in monitoring the market situation with respect to executives' compensation practices and in compensating management fairly to ensure maximum motivation. Talent is essential for the business. Therefore reducing or cancelling the payments of independent directors would be counter-productive. It will send the wrong signal to shareholders, dilute the motivation of Board members, and will make it difficult to attract professional directors in the future.
 - c. The **nomination committee**: There is a strong case for Russian Boards to look at the ideal composition of the Board and to re-think the way directors are appointed by actively using the nomination committee. The appointment of directors through the active lead of a nomination committee can secure a wide range of candidates who meet the expected qualification requirements and experience as well as ensuring that recommendations are made to the Board only after a rigorous selection process. This process should, among other things, increase the quality of Board members, shareholder confidence and the Board's competitive advantage.

Appendix 1

Russian corporate governance and its implications for Board practice

Russia is a country with a highly concentrated ownership where the combination of ownership and management is common practice. Most companies are governed by a founder/dominant shareholder of the “first generation”. In turbulent times, this structure increases the conflict between the company and its founder/dominant shareholder, particularly in stress situations when the dominant shareholder tends to support his other businesses which have been heavily hit by the crisis.

A Forbes Magazine poll in 2008 demonstrated that the average age of the richest people in Russia, the “Golden 100”, is 46 and 50% of them are between 40 and 50 years old.

The S&P report “Transparency & Disclosure by Russian Companies 2007” states that the average share of controlling stakes in the aggregate market capitalisation was 49%. An aggregate share of controlling stakes was 44% of aggregate market capitalisation. The share of blocking (>25%) stakes in aggregated market capitalisation of the 2007 sample was 62%.

The lack of domestic capital led companies to look for international financing, forcing the adoption of corporate governance (the value of corporate governance and independent directors is not always appreciated and is seen as merely “window dressing”).

Out of 21 Russian IPOs in 2007-2008 which raised a total of about \$20 billion, nine were in the domestic market, raising an aggregate of only \$2.5 billion, while 12 were in foreign or foreign and Russian markets, raising an aggregate of \$17.5 billion, based on RBC data.

In 2003 to 2008, the external corporate debt of Russian companies almost doubled and made up 31.8 per cent. of GDP. By the beginning of 2009, external corporate debt reached \$500 billion, with \$130 billion to be repaid or refinanced in 2009.

Corporate governance listing rules on the Russian stock exchanges are much “softer” than the Sarbanes-Oxley (SOX) or UK Combined Code requirements. Out of 150 Russian listed companies only top 15 A1 listed companies fully comply with the Russian Corporate Governance Code.

An increasing government role as a big shareholder in business through new acquisitions of private companies will have ramifications for the level of corporate governance in Russia.

The growing influence of the federal government is the latest trend that has become apparent in the last four years. It is expressed both in the expansion of the state’s share in the capital of major companies and in the establishment of holding companies with a controlling state interest (in aeronautics, shipbuilding, atomic machinery and arms manufacturing).

During the crisis, this trend in Russia has become more apparent due to active government involvement in the economy. The State started to buy out problem assets and support the banking sector, as has been the case elsewhere in the world, during this credit crunch. From October 2008 to April 2009, \$ 11 billion was directly given to support major Russian companies and even more cash was pumped into the banking sector to support liquidity in the economy, according to the reports of the Russian Government.

The lack of legislation or comprehensive codes of practice, together with a misunderstanding of the important contribution from independent directors, limits Board effectiveness.

Under Russian legislation, shareholders owning at least 2% of the shares can nominate candidates for the Board. The Board nominates candidates where shareholders do not submit nominations. Having a nominations committee is not a common practice.

As a result, Russian Board members are still largely selected by the main shareholders and therefore the Board consists of representatives of the group that nominated them. This means that often, non-executive directors see themselves representing different shareholder blocks rather than acting solely in the best interests of the company. A Board constructed in this way misses out on the wider challenge of good independent directors. In order to get the best available, it seems sensible to have a Board nominations committee that will consider the balance of skills and experience that would make the Board more effective.

Appendix 2

List of companies participating in the Survey

We interviewed Chairmen, CEOs and independent directors from 64 companies.

AK Bars Bank	MDM-Bank	Raspadskaya
Baltika	Mechel	ROLF Group
Bank St. Petersburg	Megafon	Rossiya Bank
Bank Trust	Metallinvest	Russian Railways (RZhD)
City Mortgage Bank	MICEX	SeverStal
CTC Media	Miel	Sheremetevo International Airport
Derzhava Bank	Mobile TeleSystems	SUEK
EM-Alliance	MRSK Holding	Sviaz-Bank
EuroChem	Nezavisimost Group	SvyazInvest
GAZ Group	NOMOS-BANK	Synergy Group
Gazprom	Norilsk Nickel	The Agency for Housing Mortgage Lending
Genser	North-West Telecom	The National Depository Center
IBS	NOVATEK	Troika Dialog
Interros	OJSC Amtel Vredestein	Unimilk
Investbank	OTKRITIE Financial Corporation	United Metallurgical Company (OMK)
Kapital Investment Group	Ozon.ru	URALCHEM
Kirovski Zavod	Pharmacy Chain 36.6	UralKali
Lenta Retail	PhosAgro	VimpelCom
LUKOIL	Polymetal	VTB
M.video	Prof-Media	VTB Capital
Magnitogorsk Iron and Steel Works OJSC (MMK)	PromSvyazBank	Wimm-Bill-Dann
	Rambler Media	

