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Corporate Governance Structures of Public Russian Companies

Survey by the Deloitte CIS Centre for Corporate Governance, 2012

Corporate Finance

Executive Summary

Weaknesses in corporate governance are frequently cited among the primary risk factors facing Russian companies, considerably affecting their performance and market valuations

We note, however, that there has been a growing awareness of the importance of corporate governance in Russia in recent years, and that at least two major drivers for improving governance have been present.

Firstly, the number of cross-listed and foreign-listed Russian companies has grown to about 70 in 2012. These companies were likely required to strengthen their corporate governance structures due to the rules surrounding foreign listings, or at least faced increased scrutiny by analysts and investors, including on governance issues.

Secondly, the Russian government has shown concern for the standard of governance at state-owned enterprises (SOEs), and has been seeking to appoint outside directors to companies under its control since 2008. According to data provided to us by Rosimushestvo, the government's asset management agency, the scope of companies involved in the programme has reached 847, with 2113 external appointments having taken place during the 2012 proxy season (including 612 independent directorships and 1512 professional attorney positions). Although not without controversy in terms of the independence criteria applied, it is encouraging to know that this programme, aimed at strengthening corporate governance at SOEs, is in motion.

Questions remain, however, as to how effectual these developments were, which of the two drivers was more impactful, and whether Russia is really on its track to close the corporate governance gap with respect to global financial hubs.

In this survey, we take stock of the recent years' progress by analysing the board compositions of 135 listed Russian companies. We found the average share of outside directors on Russian boards to be 33%. 98% of the surveyed companies had audit committees and 91% disclosed their compositions. 43% of those audit committees, for which the composition was known, enjoyed outside majorities or fully outside membership. In general, these results compare favourably to such figures from earlier surveys in Russia. In its 2006 survey, Standard & Poor's (S&P) reported that 23% of directors were outsiders according to our definition of the term. 76% of companies in that survey were found to have audit committees.

Despite the government's best efforts, the subset of SOEs showed only a marginal increase in the proportion of outsiders on boards over the six years. Our results showed that 20% of the directors on SOE boards were outsiders, up from 17% as determined by the S&P survey in 2006 (we adjusted the latter figure to reconcile the differences in criteria). At least among the large public SOEs covered by our survey, the magnitude of change is substantially less than the scale of the government's programme might suggest. This generally reflects the fact that many appointments under the programme involved individuals with links to the government, such as executives of other SOEs.

At privately owned companies, the share of outside directors was 38%, up from 27% (adjusted for criteria differences) found by S&P in 2006. This observation suggests that private businesses have considerably outpaced SOEs in strengthening the independence of their boards in recent years.

In international comparison, the board structures of Russian companies continue to lag behind the standards observed among more advanced economies. Heidrick & Struggles, for example, performed a survey of European boards in 2011 and found that the average share of independent members was 43%. The average for the UK was 61%, Finland's was 72%, and the Netherlands' was 75%. In the US, independent directors occupy 83% of board seats at the S&P 500 companies, according to the 2011 Spencer Stuart survey. It is also important to bear in mind that these figures are based on more stringent criteria for director independence than we used in identifying outside directors on Russian boards.

The ownership structures of listed Russian companies have seen little change in recent years, both in terms of concentration levels and government ownership. 61% of the companies in our sample had a single ultimate majority shareholder, and the market cap of such majority stakes corresponded to 38% of the aggregate market capitalisation. The average size of free float was 28%; we view this as a liberal estimate, based on potentially incomplete data on ownership concentration. The average size of a majority stake, where present, was 64%. We found 39 companies (30% of the sample) to be government-controlled, and 6 companies (4%) in which the government held a significant non-controlling stake. In total, these government-related companies accounted for 49% of the aggregate market cap of the sample.

Non-executive directors at Russian companies enjoy relatively high compensation levels, possibly caused by a short domestic supply of strong candidates, but also reflecting the perception of the risks involved. We found the average compensation for directors to be USD 112,900 per year, and such average within the subset of large cap firms, USD 265,100. According to the Heidrick & Struggle survey, the average for the largest European companies was USD 110,000, and for the 50 largest UK companies, USD 152,800 – considerably less than that offered by the largest Russian companies. Even in the US, the average non-executive director at large cap US firms was paid USD 225,000 in 2011 according to a survey by Frederick W. Cook & Co.

Russian companies are commonly viewed as reluctant dividend payers, and this is indeed what we observed in our sample. Only 44% announced dividends on common stock in 2012, and among those that did, the average pay-out ratio was 26% (of IFRS/US GAAP 2011 net income). The average dividend yield was a modest 1.4% for the entire sample, and 3.3% for those companies that did pay dividends on common stock.

Our analysis of market multiples resulted in some interesting observations. We found the median value of the trailing P/E ratio to be 7.9x, in line with the popular view that Russian stocks are considerably undervalued. Even in other emerging markets, P/E ratios between 12x and 15x are common, according to various index performance reports. Within our sample, multiples did not differ substantially between foreign-listed companies and those listed only in Russia, but these multiples were considerably higher for private companies than for SOEs (9.2 x vs. 6.7x).

Domestic trades accounted for 63% of trade volume for the entire sample, 44% for companies traded both inside and outside Russia, and 54% for dual-listed companies. A foreign listing was associated with substantial gains in liquidity, but also higher values of market beta, a measure of systemic volatility, suggesting that Russian companies tend to attract high-risk capital abroad, rather than conservative buy-and-hold investors.

We conclude that, at least among listed companies, the appeal of global equity markets continues to be a more important driver of governance improvement than the government policy. Although we believe that the impact may have been more profound with respect to smaller SOEs, in the case of listed SOEs, the government's programme of independent appointments has led to only a small gain in the role of outside directors. Private companies have shown more substantial improvements in their board structures, although a gap still exists in relation to some advanced jurisdictions.

These drawbacks, in conjunction with modest dividend pay-outs and limited free float, continue to constrain the appeal of Russian stocks in our view. Also, as trading patterns show, more substantial and systematic efforts may be needed to enable Russian companies to build a stable, high-quality investor base both domestically and globally.

Methods

Our survey covers 135 Russian companies that have common stock listed on either the Moscow Exchange or one of the leading international exchanges, such as the London Stock Exchange (directly or through depositary receipts), the NYSE and the NASDAQ.

These have traditionally been the exchanges of choice for foreign listings by Russian companies. Our analysis therefore covers virtually all listed Russian companies, with only a limited number of exceptions listed elsewhere (i.e. Stockholm, Frankfurt, etc.).

The clear advantage of this approach is that it allows us to perform a universal analysis of listed Russian companies. All of these companies have opted for a listing and have a distinct class of equity investors requiring protection from governance-related risks. The downside is that it did not allow us to include several large publicly traded non-listed Russian companies, such as TNK-BP Holding, which continue to represent an important part of the Russian equity market. Over 250 companies are traded on the unregulated "outside lists" segment of MICEX-RTS (Gazpromneft, Bashneft, MGTS, Bank Uralsib), for example, and over 800 companies are traded on the RTS Board over-the-counter market.

We also did not account for those companies that have preferred, but not common stock listed (e.g. Transneft) since we believe their governance fundamentals differ substantially from those of the companies included in our sample.

Our analysis was based only on publicly available information presented in annual reports for 2011 and on corporate websites. We accounted only for information published before 1 August 2012. Where such information was insufficient, particularly for our analysis of beneficial ownership, we relied on information presented in leading Russian business periodicals (Vedomosti, Kommersant, RBC and Expert). We used Bloomberg data on market capitalization and other stock characteristics.

Our survey addressed a number of observable governance attributes that can be meaningfully analysed on the basis of public information.

Sample Characteristics

Our study covers listed companies for which Russia is the primary operating environment, regardless of their country of incorporation and the presence of a domestic listing

As displayed in Chart 1, these included 99 companies listed on all markets of the Moscow Exchange MICEX-RTS, with the exception of investment companies/funds and companies traded on the "outside lists" segment. 30 of these 99 companies had cross-listings in the UK or the US, and one was cross-listed in Hong Kong.

In addition, we included in our sample 36 Russian companies listed only outside Russia, whether in the US (NASDAQ or NYSE) or the UK (Main market or AIM). Some of these companies had shares or Russian depositary receipts traded (but not listed) in Russia (e.g. Gazprom), while others were traded only outside Russia (e.g. Yandex NV, Evraz Holding plc, X5 Retail Group).

According to statistics presented on the London Stock Exchange website, 60 Russian companies were traded on the Main (48) and AIM (12) markets as of 1 August 2012. Of these 60 companies, 27 were cross-listed on MICEX-RTS. In the US, two Russian companies were listed on the NASDAQ and three on the NYSE. Two of the NYSE-listed companies had a domestic cross-listing, but neither of the NASDAQ-listed companies had. The only Russian company on the Hong Kong Stock Exchange, UC RUSAL, had Russian depositary receipts listed on MICEX-RTS.

Chart 1: Company breakdown by listings

All companies	135
MICEX-RTS	99
of which cross-listed in the US, UK and HK:	30
LSE (Main)	27
NYSE	2
HKSE	1
LSE (including cross-listed)	60
Main	48
AIM	12
US markets (including cross-listed)	5
NASDAQ	2
NYSE	3

In terms of size, 17 of the 135 companies in our survey fell into the Large cap category, as defined by the threshold of RUB 300 billion (about USD 10 billion). We used the average value of market capitalisations for mid-2012, smoothed over twelve weeks (six weeks before, and six after 1 July 2012). Where valuations in various markets differed (e.g. between local shares and depositary receipts), we used the highest available valuation for the company.

47 companies had capitalisation values over RUB 40 billion (USD 1.2 billion) and are considered Mid cap. The remaining 69 companies were considered Small cap, of which 18 have particularly small capitalisation, falling under the bracket of RUB 3 billion (USD 100 million)

Chart 2: Company breakdown by market capitalization

	All	Domestic listing only			UK (Main) and HK	UK (AIM)	US-listed
		All	A1, A2	B-I			
Number of companies	133*	67	24	43	49	12	5
Large cap, nr. of cos listed	17	4	3	1	11	0	2
Mid cap, nr. of cos listed	47	19	10	9	25	0	3
Small cap, nr. of cos listed	69	44	11	33	13	12	0
of which under USD 100 million	18	8	0	8	2	8	0
Average MC , USD billion	5.2	2.9	5.5	1.4	9.3	0.1	8.4
Median MC, USD billion	1.0	0.5	1.3	0.4	2.9	0.05	6.3
Min MC, USD million	8.1	32.2	208.3	32.2	38.9	8.1	1317.2
Max MC, USD billion	110.6	57.9	57.9	29.5	110.6	0.6	18.2

* Data on LSE (Main) and HKSE traded companies have been pooled due to relative similarity in listing requirements

Chart 3 presents the industry breakdown of our sample. Interestingly, "electric power utilities" is the most populated category, accounting for 25% the sample. These are followed by "metals & mining" (17%) and "oil & gas" (10%).

Chart 3: Industry breakdown

Industry	All		Domestic listing only			UK (Main) and HK	UK (AIM)	US-listed
	# of cos	%	All	A1, A2	B-I			
Electric power utilities	34	25%	45%	60%	36%	6%	0%	0%
Industrial metals & mining/ mining	23	17%	10%	12%	7%	22%	42%	20%
Oil & gas producers	13	10%	1%	0%	2%	14%	42%	0%
Manufacturing/industrial engineering/oil equipment & services/construction & materials	12	9%	10%	4%	14%	10%	0%	0%
Retailers/food/restaurant	12	9%	10%	0%	16%	10%	0%	0%
Transportation/industrial transportation	9	7%	6%	8%	5%	8%	8%	0%
Chemicals/pharmaceuticals	9	7%	7%	4%	9%	8%	0%	0%
Telecommunications/ computer services	8	6%	3%	4%	2%	6%	0%	60%
Banks	6	4%	6%	8%	5%	4%	0%	0%
Real estate investment & services	6	4%	1%	0%	2%	8%	8%	0%
Media	3	2%	1%	0%	2%	2%	0%	20%

Ownership structures

When carrying out this study we accounted for information about shareholder structure presented on company websites, annual and financial reports.

Where such information was not disclosed by companies (as was the case with 30 companies, or 22% of our sample), we accounted for the ownership information presented in leading Russian business periodicals (Vedomosti, Kommersant, RBC, and Expert). This approach allowed us to analyse the ownership structures of 132 companies. For only three companies, no information on ultimate ownership was available from either the companies themselves or the business media.

The ownership concentration of Russian companies has traditionally been seen as high, and this is manifest in our sample. We found the average size of the largest block holding to be 49.8% across all of the 132 companies for which we were able to obtain ownership data (chart 5). The level of ownership concentration at foreign-listed companies is only marginally lower; the average size of the single largest UK-listed block holding is 45%, and that of the single largest US-listed block holding is 44%.

91% of the companies in our sample, corresponding to 85% of the aggregate market cap, had at least one block holding exceeding 25% (Table 4). This is broadly similar to the figures presented in the 2010 Transparency & Disclosure survey by S&P, which covered the 90 largest public Russian companies (Table 4, figures in brackets). 60% of the companies in our sample had a single ultimate majority shareholder, and the market cap of these majority stakes corresponded to 38% of the total market capitalisation. 11 companies (8.3%) from our sample were joint ventures, with two or more block holders, each holding between 25% and 50%. Joint ventures accounted for 8% of the aggregate market cap, and the respective block holdings for 5%. 30 companies (23% of the sample) had a block holder with at least 25% of the shares. Other block holdings besides the largest stake may have been present at these companies, but each of these was smaller than 25%.

Hardly any of the companies analysed can be described as having dispersed ownership. 11 companies reported (or were described by the media as having) only a moderate ownership concentration, with the largest stake being below 25%. We suggest that these findings be treated with caution as they may not reflect the actual concentration of influence. In most cases we observed a number of significant minority stakes, held by founders or strategic investors. In our view, these shareholders are likely to coordinate their votes on strategic issues, even in the absence of a formal shareholder agreement. Also, in those few cases where no significant minority positions are reported (or only a few are, aggregating to a small share of votes), we would query the completeness of the information available to the public.

We found the average size of free float to be 28% for the entire sample, 32% for the UK-listed companies, and 29% for the US-listed. In value-weighted terms, these figures are 29%, 30% and 30% of the respective aggregate capitalisations. In estimating the size of free float, we accounted for all shareholdings individually not exceeding 5%.

Chart 4: Ownership concentration

	All (132)	LSE, HK (60)	NYSE/NASDAQ (5)
Single largest block holding, % of common	49%	44.5%	44.0%
Free-float	28% (31%)*	33% (34%)*	29% (39%)*

* Figures from the 2006 survey by Standard & Poor's

Chart 5: Ownership: breakdown by type

Companies, nr.	131	% companies in the sample	Companies in AMC,%	Stakes in AMC,%
widely-held largest stake < 25%	11	8 (13)	11 (13)	-
with at least one block-holder (>25%)	120	92 (87)	85 (87)	46 (52)
of which: majority-owned (>50%)	79	60 (60)	60 (64)	38 (43)
joint ventures (two or more blocks between 25 and 50%)	11	8 (n/a)	8 (n/a)	5 (n/a)
with controlling stakes (>50%) directly or indirectly owned by government	39	30 (33)	46 (50)	28 (33)
with large (>25%) private stakes	79	60 (51)	38 (35)	18 (21)
with private majority stakes	39	30 (27)	14 (14)	9 (10)

* – numbers in brackets represent the results of the S&P "Transparency and Disclosure by Russian companies 2010" report.

39 companies, representing 30% of our sample, were directly or indirectly controlled by the government, whose share in the aggregate market cap was substantially higher at 46%. This is largely due to the fact that the government controls the largest issuers, such as Gazprom, Rosneft, Sberbank and VTB, while privately owned companies are smaller on average. The average beneficial stake of the government in these companies was 63%. 9 out of the 39 government controlled companies in our sample were listed in the UK, and none of them had a US listing. 30 only had a domestic listing.

The government was also a significant non-controlling investor, with a stake between 25% and 50% in 6 companies, which accounted for about 3% of the aggregate market cap of the sample. Overall, government-related entities (including those where the government held significant non-controlling blocks) represented 49% of the aggregate market cap of the listed companies in our sample.

Board composition

We analysed the board composition of 132 companies included in our survey as of 1 August 2012. This analysis accounts for the outcomes of the 2012 proxy season

Director independence is a not an easy notion to tackle, and a director's bio often gives a poor indication of her independence of mind. We therefore refrain from making any judgment as to the independence of any individual director in our survey, or the general degree of independence of any board.

Instead, we divided the directors into two categories, inside and outside directors, defined as follows:

Inside directors

Insiders in our survey are those directors that met one or more of the following criteria:

- shareholder with ownership of more than 10%;
- executive/employee of such a shareholder or its affiliates, or a family member of such a shareholder;
- current or former employee of the issuer (unless their employment ended more than five years before our survey took place).

As a part of the second criterion, we treated executives of government-owned companies as insiders if they served on the boards of other government-controlled companies. Similarly, we treated as insiders those directors of private companies that served as executives at sister entities.

Our treatment of SOE executives as government insiders is in line with the recent comments by the Russian Ministry of Economic Development, pertaining to such director appointments.

Outside directors

We treated the following categories of directors as outsiders:

- minority shareholders with stakes below 10% and executives/employees of such shareholders;
- unaffiliated directors.

The unaffiliated cluster generally consisted of shareholder activists, former government officials, retired executives, finance professionals and academics.

It is worth a mention that we did not use a threshold for board tenure among our criteria, as some codes require. It should also be noted that we used only publicly available information in our categorisation, which limited our ability to account for certain less obvious links between directors and companies or their shareholders.

Finally, our categorisation of directors is close, but not identical to that used by Standard & Poor's in their 2006 survey. The main difference relates to the different treatment of minority representatives: directors affiliated with strategic minority investors were considered outsiders in the S&P survey, while we felt it more appropriate, on substantive grounds, to account for them as insiders. However, due to the very detailed presentation of data in the S&P report, in most cases we were able to reconcile their 2006 figures with our categorisation and to study the dynamics in board structures at Russian companies over the last six years.

Inside directors

The breakdown of outside and inside directors is displayed in chart 6.

Predictably, we found the Russian boards to be dominated by insiders, albeit not to the same extent as they were in 2006. Inside directors accounted for 67% of board seats in our sample, compared with 77% (a reconciled figure) in the 2006 S&P survey.

Despite the positive dynamic of recent years, our findings for Russian enterprises lack luster in comparison with overseas companies. The average proportion of inside directors on the boards of public European companies was 57% in the 2011 survey by Heidrick & Struggles, and was significantly lower than that in several countries.

Chart 6: Board compositions

	Entire sample		UK & HK listed	LSE Main only		US listed	
	2012 (132)	2006* (75)	2012 (60)	2012 (48)	2006** (17)	2012 (5)	2006** (7)
Inside directors	67%	77%	58%	57%	70%	48%	66%
Shareholders/representatives	44%	57%	28%	30%	52%	38%	54%
Management	23%	18%	30%	28%	14%	10%	8%
Outside directors	33%	23%	42%	42%	31%	52%	34%

* Data from the 2006 survey by S&P
(AIM traded companies were not covered; we do not cite the S&P data on certain other insider types here)

We also noted a significant difference between the average percentage of insiders on the boards of private (62%) and government-owned companies (80%), as illustrated in chart 7. This difference is largely due to the continuing presence of directors affiliated with the government on corporate boards, which on average accounted for 60% of board seats. Predictably, the share of insiders on the boards of foreign-listed or cross-listed companies is lower than for the entire sample (57% foreign-listed, 58% for cross-listed Russian firms).

Chart 7: Board compositions broken down by ownership types

	State-controlled (39 companies; 30% of the sample)	Privately-owned (94)
Inside directors	80%	62%
Representatives of all block holders	70%	33%
Government representatives	60%	-
Management	10%	29%
Outside directors	20%	38%

Shareholders and representatives

Within the category of insiders, shareholders and their representatives are the largest class, accounting for 44% of board seats overall (note that this figure does not account for individual shareholders involved in executive roles and accounted for as executives). This is much higher than the average for European companies (17%). Shareholders and affiliated directors are somewhat less prominent on the boards of Russian companies that have foreign listings or cross-listings, averaging 28% for LSE-listed companies (including AIM) and 38% for US-listed companies.

Directors affiliated with the government occupy 60% of board seats of government-controlled companies, which is nearly twice the figure of shareholders representatives (33%) at privately owned companies. Of these 60%, 10% are civil servants and 50% are executives of (other) state-owned enterprises.

Executives

Executive directors on average comprise 23% of the board, and this number has increased by 5% since the S&P survey in 2006. This is nearly twice the proportion found at European companies (12%) according to Heidrick & Struggles.

The proportion of companies where executive directors hold 25% or more of the seats is 37%, 9% more than in 2006 (28%). Meanwhile, 15% of companies do not have any executive directors on the board at all (chart 8). The share of executive directors on SOE boards is low, with an average of 10%. It is worth noting that it is common practice in some European countries (most notably, Germany) to appoint employee representatives to the board, and that they, on average, hold 10% of board seats in Europe.

Chart 8: Executive directors on Russian boards

	All (132)	LSE, HK (60)	NYSE/NASDAQ
% companies without executive directors	15% (21.3%)*	7%	40%
% companies with proportion of executives directors > 25%	37% (28%)*	47%	0

* Data from the 2006 survey by S&P (AIM traded companies not covered)

Outside directors

We found that about 88% of the analysed companies had outside directors on their boards, up from 77% in the 2006 survey by S&P. About 62% of Russian public companies have more than 25% of outside directors on their boards, as the Russian Corporate Governance Code recommends, and this proportion tends to be higher at companies with foreign listings (see Chart 9). Outside directors on average hold 33% of the board seats at the surveyed companies, up from 23% (reconciled figure) in the 2006 survey by S&P. Broken down by size, the average share of outside directors is 40% for Large cap, 35% for Mid cap and 29% for Small cap firms in our sample.

According to the survey by Heidrick & Struggles, the boards of European companies on average include 43% independent directors, 10% higher than the average in our sample. However, the average for the UK (50 largest FTSE firms) was 61%, Finland's was 72%, and the Netherlands' was 75%. According to the Spencer Stuart Board Index 2011 Survey, independent directors on average constitute 84% of the boards of S&P 500 companies. It is also important to bear in mind that these figures are based on more stringent director independence criteria than we used in identifying outside directors on Russian boards. Accordingly, even though the average figures in our survey are close to those from some European markets (e.g. Belgium, 32%, Spain, 33%, and Portugal, 30%), in reality Russian boards may still lag behind companies in thesemarkets in terms of independence.

Foreign-listed or cross-listed firms tend to have a higher proportion of outsiders on their boards. In the case of the LSE's Main market, that proportion is 42%, up from 31% in the 2006 survey by S&P. Government-controlled companies are noted for their relatively low number of outside directors: 20% (up from 17% in 2006) in comparison to 38% at privately owned companies (up from 27% in the 2006 survey by S&P).

Foreign (i.e. non-Russian) nationals account for 24% of board seats in our sample, and at least one foreign director is present on 60% of all boards surveyed (chart 10). This is close to the average European figure of 24% as reported by Heidrick & Struggles in 2011.

Government-controlled companies are considerably less likely to appoint foreign directors then private companies, with 38% of government controlled companies having appointed foreign directors compared to 70% of private companies.

Chart 9: Outside board members

	All (132)	LSE, HK (60)	NYSE/NASDAQ (5)
% companies with at least one outside director	88%	95%	100%
% companies with proportion of outside directors > 25%	61%	82%	100%

Chart 10: Foreign board members

	All (132)	LSE, HK (60)	NYSE/NASDAQ (5)
% companies with foreigners on the board	60%	80%	100%
Government-controlled	11%	8%	
Privately-owned	49%	72%	
Average percent of foreign directors	21%	35%	49%

Corporate governance structures

Board committees

This survey comprises a report on the pre-board election committee structures in 2012. The committee structures of Russian boards are renewed each year, as Russian law requires that the entire board slate stand for election annually. It is common for new committee compositions to be announced as late as September. In our survey, we chose to account for board committee structures created by the incumbent boards in 2012, since they were described in annual reports for 2011. Indeed, the alternative of waiting for companies to announce the new board compositions would have considerably delayed the release of this survey. 98.5% of the companies in our sample had board-level audit committees, up from 86% in the 2008 survey by the Independent Director Association and 76% in the 2006 survey by S&P. This is close to the European average of 98%, as shown in the 2011 survey by Heidrick & Struggles, and the predictable 100% of S&P 500 companies, as reported by Frederick W. Cook & Co. in 2011. Remuneration and nomination (or similarly named) committees were present at 88% of companies, up from 63% in 2006. These are followed by Strategy committees, present at 43% of companies. Corporate governance and risk committees are considerably less widespread, present at 13% and 8% companies respectively. In Europe, Corporate Governance committees were present at 21% of companies in the Heidrick & Struggles survey, and figures varied significantly among countries: in particular, about 60% of Portuguese and Swiss companies had Corporate Governance committees, whereas none were reported in Germany and Austria. In the Spencer Stuart US Survey of S&P 500 companies, 100% of companies had board-level compensation committees, 99% had nomination committees, 8% had risk committees, and 3% had strategy and planning committees.

Chart 11: Board committees

	Audit committee	Remuneration and Nomination committee	Strategy committee	Ethics/Corporate Governance committee	Risk committee
All (135)	98%	88%	43%	13%	8%
LSE, HK (61)	97%	92%	33%	15%	12%
NYSE/ NASDAQ (5)	100%	100%	40%	80%	0

Indeed, the establishment of a committee is not sufficient to ensure that its function is adequately met. The composition of a committee, both in terms of skill set and independence, is a crucial precondition for the committee to function effectively. The UK Corporate Governance Code suggests, for example, that the audit committee should include at least three independent directors (two for smaller companies). According to the Russian Corporate Governance Code the audit committee should comprise entirely of independent directors, and if this condition cannot be met due to objective circumstances the audit committee should be chaired by an independent director and consist of independent and non-executive directors.

Of those 123 companies that had board-level committees and reported their compositions, 23% had audit committees consisting exclusively of outside directors (Chart 12). Within the subset of foreign-listed companies, the percentage was higher: 36% for UK and HK-listed companies and 100% for US listed companies. A further 23% of audit committees, although not fully composed of outside directors, enjoyed outside majorities. On the other hand, 21% of the audit committees surveyed had no outside directors among their members.

Predictably, 100% of the audit committees of the US S&P 500 companies were fully independent, according to the Spencer Stuart Board Index 2011 survey.

Chart 12: Audit committee composition

	All (123)	LSE, HK (56)	NYSE/NASDAQ (5)
% “outside” audit committee	23%	36%	100%
% majority of outside directors at audit committee (including fully “outside)	43%	68%	100%
% chairman of audit committee – outside director	63%	86%	100%
% no outside directors at the audit committee	21%	7%	0

Disclosure of board procedures and board compensation

Disclosure standards on corporate governance practices are rising globally, and are tightly regulated in many advanced jurisdictions. While the Russian regulatory regime is relatively lax in this regard, and enforcement is often considered poor, voluntary disclosure by Russian companies (or those driven by foreign regulation) is gaining ground.

For example, 36% of companies in our sample disclosed information on board meeting attendance in their 2011 annual reports. While more companies presented some data to that effect, we accounted only for those attendance reports that presented individual statistics by director, including the form of participation (in person/ in absentia).

Within the subset of UK-listed firms, 54% provided disclosure to this standard, but only one out of the five US-listed Russian firms did so. According to Heidrick & Struggles, in a number of European countries (Austria, Denmark, Germany, the Netherlands and Norway) companies also provide very limited attendance information.

We further studied disclosure of director compensation, another important element of governance-related information. We found that 27% of the companies in our sample had presented a detailed board compensation report, which included a description of the principles and structure of compensation, as well as a pay breakdown by component (Chart 13). As a general observation, we note that fixed cash retainers and per-meeting fees were the most common forms of non-executive pay.

Chart 13:
Disclosure of board pay and director attendance

	Attendance report	Remuneration report
All (135)	36%	27%
UK and HK (61)	54%	30%
NYSE/NASDAQ (5)	20%	40%

Board and Executive Compensation

We further estimated the average director pay based on the figures in the annual reports for 2011. The results are displayed in Chart 14. Within our sample, the average annual director compensation was about RUB 3.4 million (USD 115.7 thousand). This result represents an approximation, obtained by dividing the aggregate director compensation pool by the number of board members (excluding government officials, which are not allowed to accept compensation for board service under Russian law, and also those board members that were reported not to receive compensation for their service).

Director pay was above average at companies listed in the UK and US, at USD 165,400 and 317,100 respectively. Russian SOEs tend to be relatively less generous to their directors, with an average of USD 80,500, despite these companies being considerably larger than our sample's average. According to Heidrick & Struggles, the average director compensation in Europe ranged from USD 30,600 in Austria to USD 246,000 in Switzerland, and the average for Europe was USD 107,000. The average director pay for Russian companies in 2011 was therefore slightly higher than the EU average.

It should be kept in mind, however, that the largest European companies (e.g. the largest 50 of the FTSE 350 index for the UK) are comparable in size to the Large cap firms in our sample, rather than the average. Also, in the case of Large cap US firms, the average total annual director compensation was USD 225,000 according to the Frederick W. Cook & Co. 2011 survey (USD 170,000 at Mid cap US firms).

We also collected data on compensation paid to key management personnel (including executive and board compensation) presented in IFRS footnotes, and used these figures in conjunction with director compensation data to estimate aggregate executive pay. Where IFRS reports were not available, we relied on executive compensation disclosure in annual reports. Our findings are presented in Chart 14. There is a significant disparity in terms of the average size of director remuneration and the compensation paid to key management personnel among companies with different market capitalisation.

Unlike our findings for non-executive director pay, we found no systematic differences with respect to executive pay levels between SOEs and private companies. Higher figures for executive pay at Large cap SOEs do not necessarily indicate pay excesses; they are likely to result from the massive size of the largest SOEs. No such trend is evident within the subset of Mid cap firms, where SOEs do not have advantage in size.

We were not able to find comparable international data on aggregate executive compensation and therefore cite figures for CEO remuneration in the US. According to GMI Ratings, average 2011 total realized CEO compensation at Russell 3000 companies was $5.8 million and for S&P 500, $12.1 million. Average compensation of US CEOs is about one third of the aggregate compensation of entire executive teams of Russian companies of market cap.

Chart 14: Average annual remuneration of a non-executive director

	Market capitalisation, $ billion	All (116)	LSE, HK (52)	NYSE/NASDAQ (4)	State-controlled (37)	Privately-owned (78)
	All	115.7	165.4	317.1	80.5	124.2
Average annual remuneration of director, $ thousand	Large (>10 bln $)	273.1 (266.5*)	282.4	397.8	284.3	267.5
	Mid (1.2-10 bln $)	141.5 (90.7*)	188.4	236.4	67.1	172.1
	Small (<1.2 bln $)	55.3 (55.0*)	55.3		34.2	65.1

* - using capitalization thresholds identical to Frederick W. Cook & Co. 2011 survey

Chart 15: Average annual pay of key executives

		All (103)	LSE, HK (48)	NYSE/NASDAQ (4)	State-controlled (34)	Privately-owned (69)
	All	15.9	24.5	17.7	20.3	13.6
Average aggregate annual payment to key management personnel, $ million	Large	43.4	46.9	32.3	81.2	29.1
	Mid	20.8	31.4	3.1	23.1	19.8
	Small	4.4	3.6		3.8	4.8

Dividend practices.

We analysed dividend announcements made by surveyed companies, following either the decisions of shareholder meetings or board decisions (for foreign-incorporated companies) to assess the dividend pay-out practices of listed Russian firms. 44% of the analysed companies announced dividends in 2012, including 56% of UK-listed companies (including AIM) and 60% of those listed in the US. Foreign-listed firms also have higher than average pay-out ratios.

Chart 16: Breakdown of dividend pay-out levels by ownership type

	All (135)	LSE, HK (61)	NYSE/NASDAQ (5)
% companies announced dividends	44%	55%	60%
Privately-owned	30%	43%	
State-controlled	15%	12%	
Average payout ratio (where announced)	26%	26%	80%

Predictably, Large-cap companies are more inclined to pay dividends, as was the case with 16 out of 17 Large cap companies. However, the average pay-out ratios (expressed as dividends announced in 2012 divided by IFRS earnings for FY 2011) were at their highest at Mid-cap companies.

Chart 17: Breakdown of dividend pay-put levels by market capitalisation

	Average (133)	Large cap (17)	Medium cap (46)	Small cap(51)
% companies announced dividends	44%	94%	57%	15%
Average payout ratio (where paid)	26%	23%	32%	19%

Market characteristics

We used Bloomberg data to analyse valuations, liquidity and volatility of Russian stocks. These data are displayed in Chart 18. We were able to collect valuation data on 100 companies (average price per share), trade volumes on 133 companies, and market betas (with the MICEX index as the market benchmark) on 91 companies.

Our analysis of market multiples resulted in some interesting observations. We found the median trailing P/E ratio to be 7.9x, in line with the popular view that Russian stocks are considerably undervalued: even in other emerging markets, P/E ratios between 12x and 15x are common. Within our sample, multiples did not differ substantially between foreign-listed companies and those listed only in Russia, yet they were considerably higher for private companies than for SOEs (median 9.2x vs. 6.7x) and for companies with foreign directors present on their boards (8.3 vs 7.9).

A foreign listing was associated with substantial gains in liquidity, but also higher median values of market beta. Taken together, and backed by anecdotal evidence, these observations suggest, in our view, that Russian companies tend to attract high-risk capital rather than conservative buy-and-hold investors. This is a reflection of both macroeconomic and governance risks, of which only the latter can be addressed by issuers, through creating strong corporate governance structures and sending a credible signal to that effect.

Chart 18: Market characteristics

	All	Domestic listing only			UK (Main) and HK	UK (AIM)	US-listed
		All	A1, A2	B-I			
Median P/E (100)	7.9	7.9	6.8	10.5	7.8	4.5	27.2
Large cap only	7.4	6.6	7.8	4.0	6.7	-	20.5
Mid cap only	12.3	12.1	6.1	15.4	11.9	-	27.2
Small cap only	6.5	7.1	5.8	7.9	5.3	4.5	-
Median MC turnover days (133 cos)	1270	3130	4458	3128	477	528	265
Large cap only	330	457	304	-	317		
Mid cap only	1060	3734	6434	3734	649		
Small cap only	1990	3137	4458	3128	874		
Median beta (91 cos)	0,93	0,92	0,92	0,92	0,96		1,07
Large cap only	1,00	0,97	0,92	1,03	1,02		0,69
Mid cap only	0,93	0,92	0,89	0,92	0,96		1,44
Small cap only	0,91	0,91	0,94	0,91	0,73		-

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The center builds strong relationships with governance leaders and organizations, such as the Millstein Center for Corporate Governance and Performance at the Yale School of Management. These relationships help Deloitte stay on top of research needs in the marketplace and to provide opportunities to contribute a point of view on issues that are relevant to clients, directors, and the broader corporate community.

The center collaborates with third-party policy groups and contributes to global research projects on strategy, economic development, and performance measurement.

The CIS Center for Corporate Governance, launched in May 2012 and led by Dr. Oleg Shvyrkov, comprises a team of governance specialists, based in Moscow, with extensive experience in governance analysis in the region and internationally. The team plays an active role in major corporate governance forums and policy-making initiatives, including the OECD Russian Corporate Governance Roundtable, the National Council for Corporate Governance, and the Workgroup for the Development of the International Financial Center in Moscow.

This team is fully dedicated to providing independent assessments of Corporate Governance and related research. The analytical products of the group are published on the website for the CIS branch of the Deloitte Center for Corporate Governance: www.corpgov.deloitte.ru.

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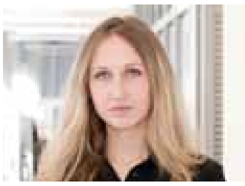

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