

Course: Economics of Industry



Lecture 7: Best practices

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Best Practices: Election of Board Members

Shareholders should receive sufficient information to determine the ability of Supervisory Board nominees to fulfill their duties and, if applicable, to ascertain their independence. Some useful items of information include:

- The identity of the candidate;
- The identity of the shareholder (or the group of shareholders) that nominated the candidate;
- The age and educational background of the candidate;
- The positions held by the candidate during the last five years;
- The positions held by the candidate at the moment of his nomination;
- The nature of the relationship the candidate has with the company;

Best Practices: Election of Board Members continued

- Other Supervisory Board memberships or official positions held by the candidate;
- Other nominations of the candidate for a position on the Supervisory Board or official positions;
- The candidate's relationship with affiliated persons of the company;
- The candidate's relationship with major business partners of the company;
- Information related to the financial status of the candidate, and other circumstances that may affect the duties and independence of the candidate as a Board member; and
- The refusal of the candidate to respond to an information request of the company.

The Election of Directors

- All directors must be elected with cumulative voting.
- Cumulative voting is a system that helps minority shareholders pool their votes to elect a representative for the Supervisory Board. The election of directors cannot be done if a GMS is held by written consent.

The Election of Directors

- **How Cumulative Voting Works:**
 - Candidates for the Supervisory Board are voted on collectively, i.e. as a group;
 - Each shareholder has a maximum number of votes equal to the number of directors that must be elected (according to the charter or a decision of the GMS) multiplied by the number of voting shares held;
 - Shareholders can allocate their votes to one candidate or divide them among several candidates as they please;
 - The top X candidates with the most votes are considered elected, whereby X equals the number of Supervisory Board members to be elected as specified by the charter or the decision of the GMS.

Cumulative Voting: Minimum number of votes to elect one director

$$\frac{nS}{D + 1} + 1$$

where D — the number of directors to be elected, S — the number of outstanding voting shares and n — the total number of directors the majority shareholder wants to elect

Company Practices in Russia

- Representatives of major shareholders (35%), management and employees (30%) are the most common types of directors,

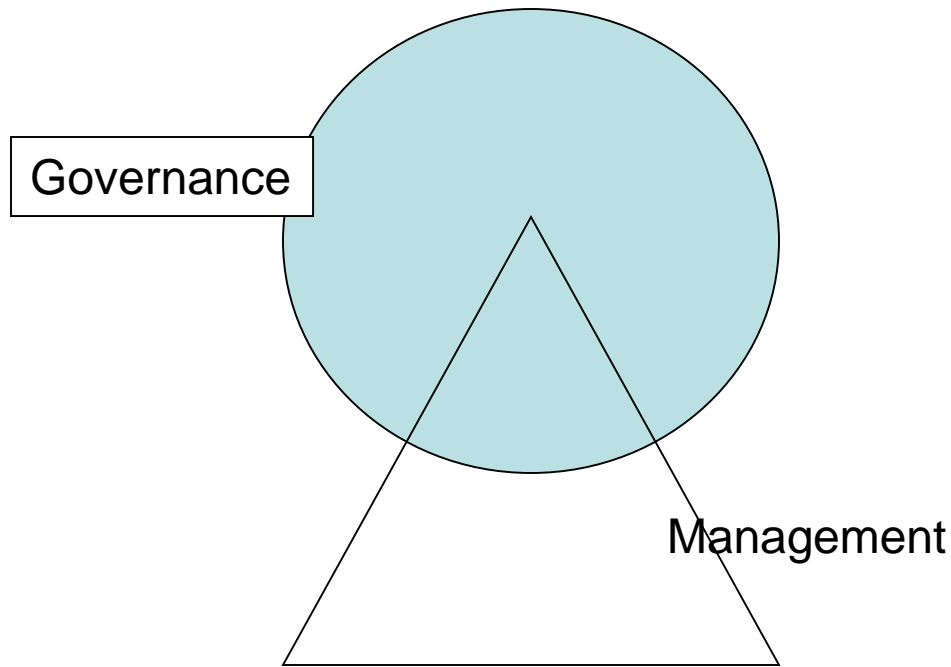
Company Practices in Russia

- Independent directors (18%) and minority shareholder representatives (9%) still constitute a minority on most Supervisory Boards.

Company Practices in Russia

- A positive correlation exists between the number of shareholders in a company and the number of representatives of majority shareholders on the Supervisory Board. Hence, Supervisory Boards of large companies with many shareholders tend to include more representatives of large shareholders.

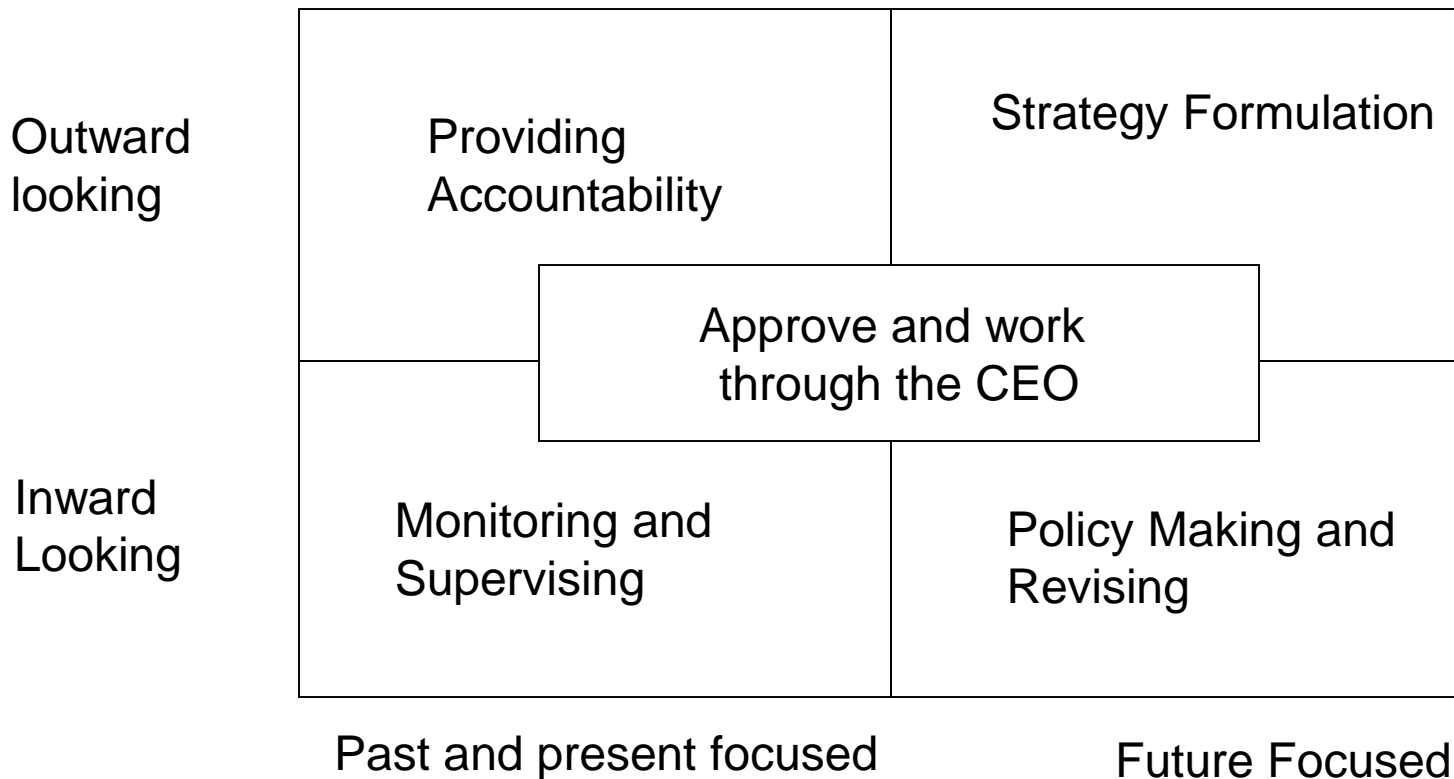
Governance is Different from Management



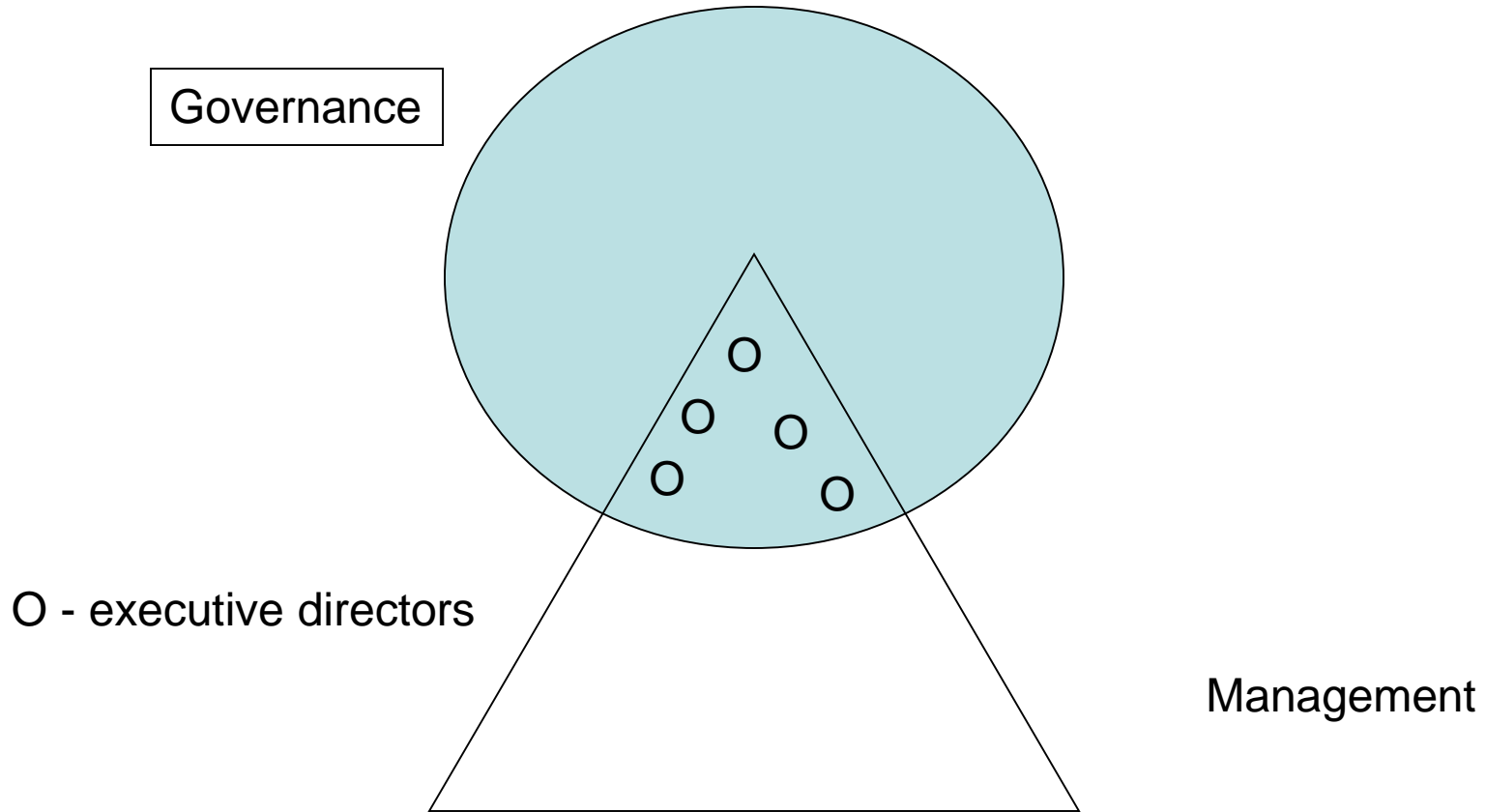
Governance and Management

- Management runs the business
- the board ensures that the business is well run and run in the right direction

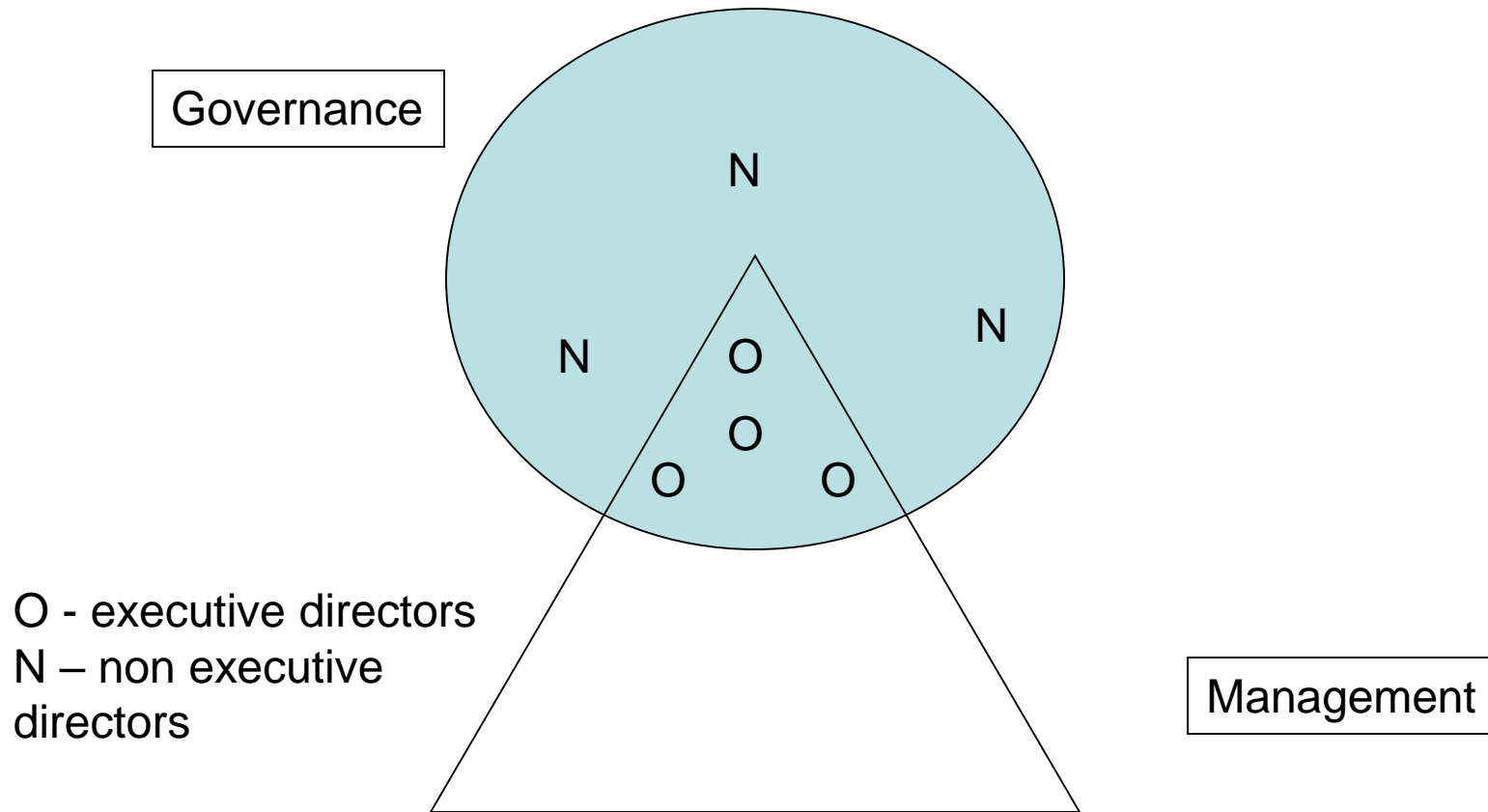
Functions of the board



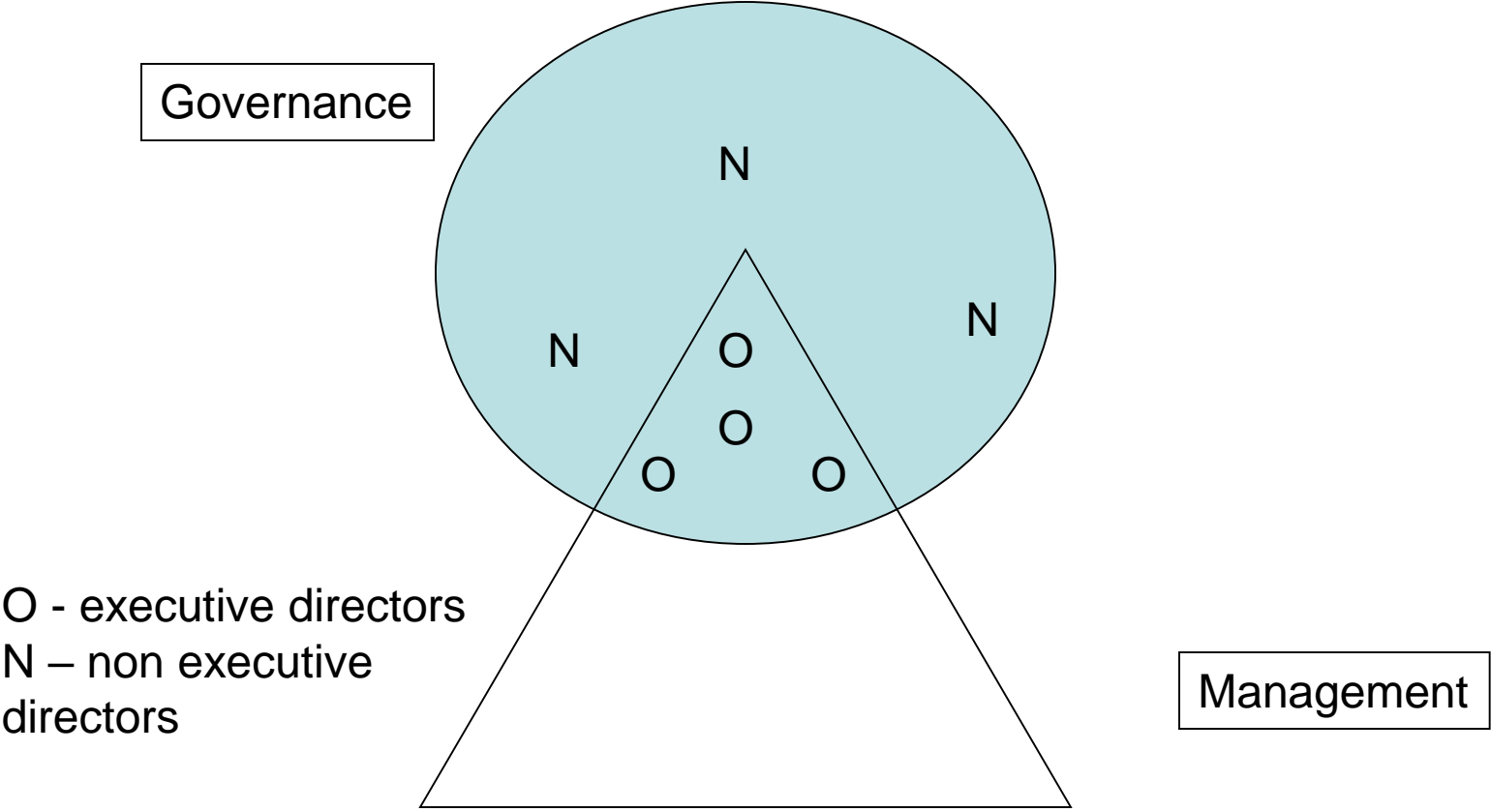
All Executive Board



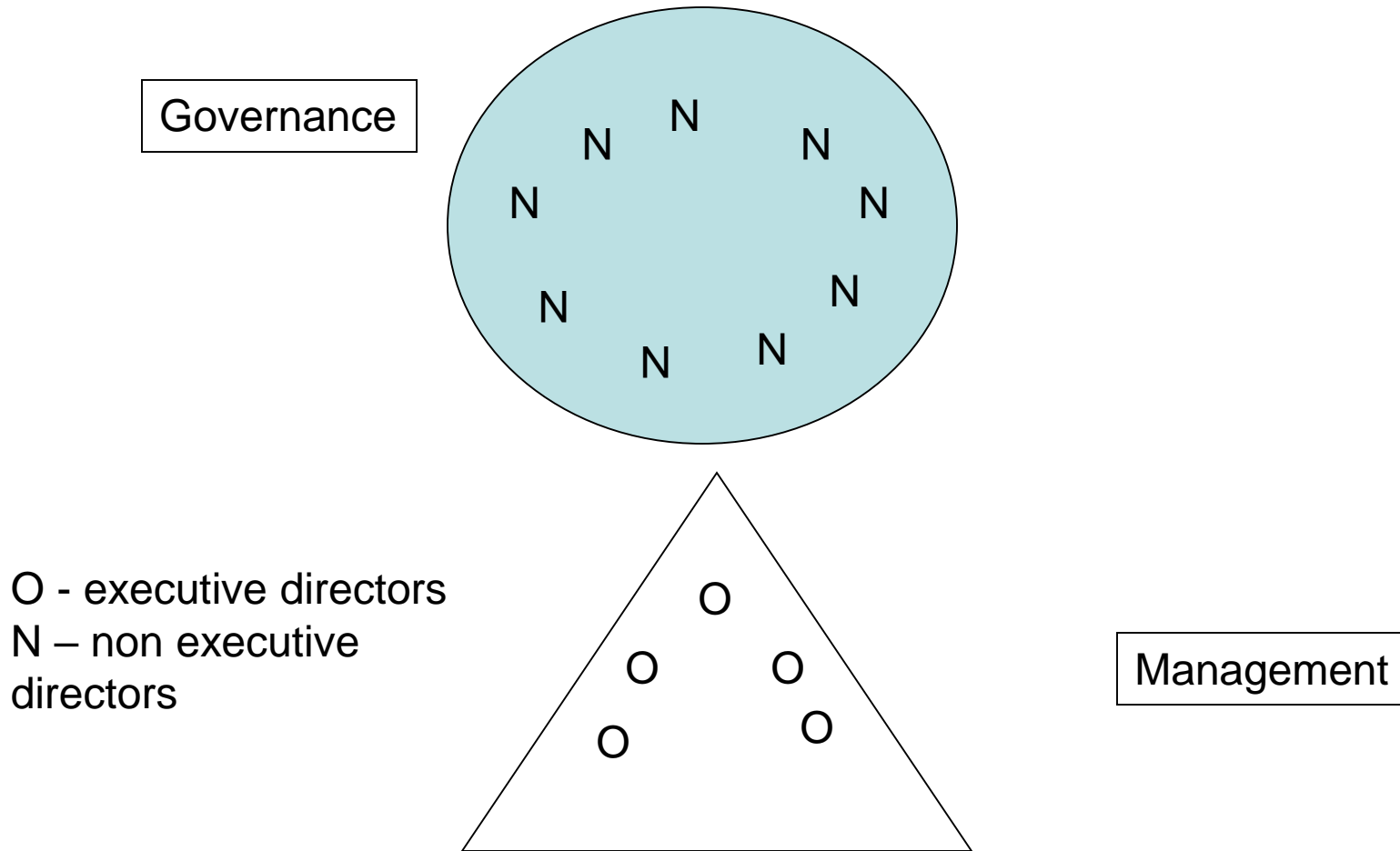
Majority – executive board



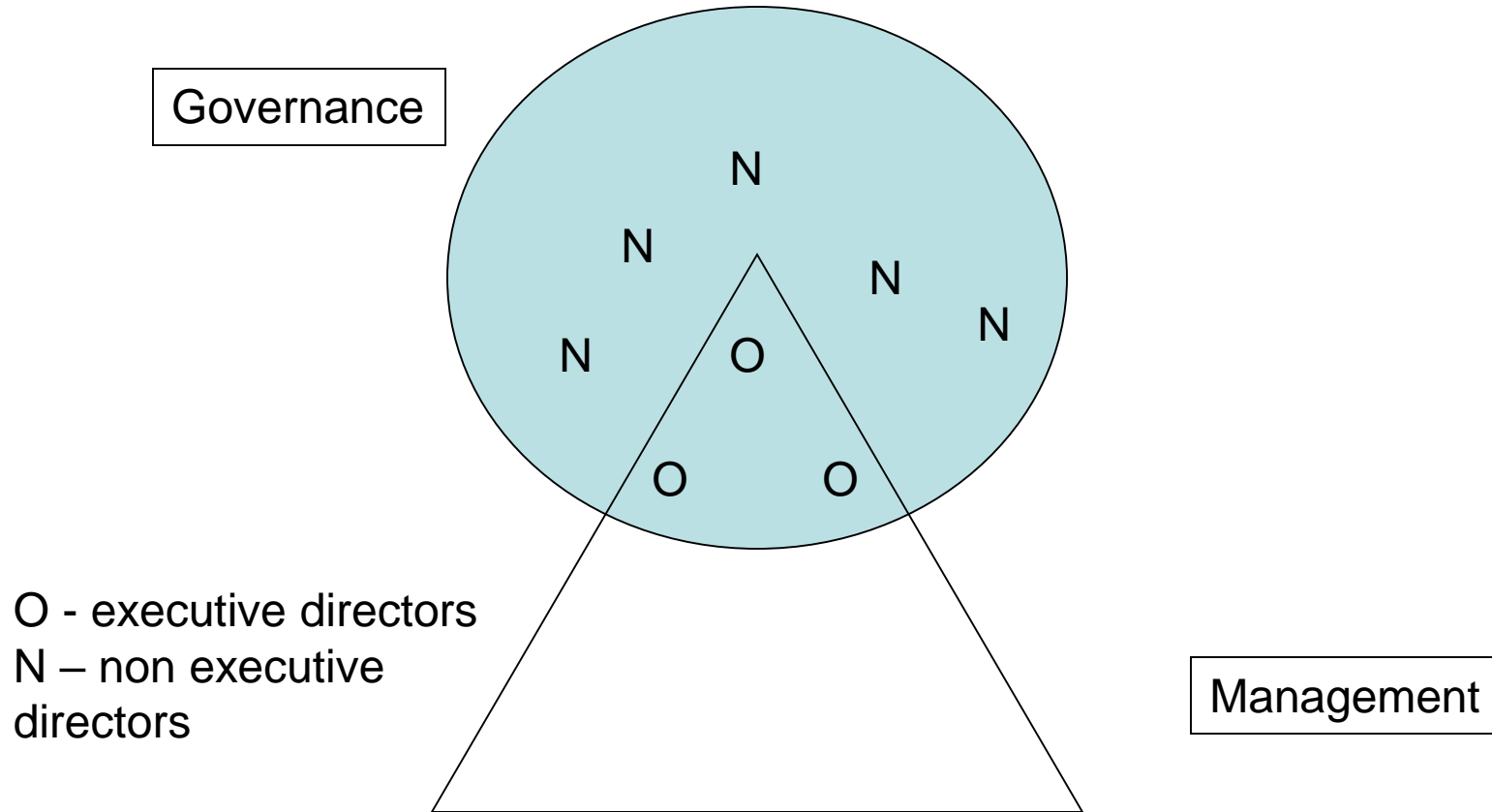
Majority – non executive board



Two – tier board



Majority – executive board



Corporate Governance and Initial Public Offerings

- Corporate Governance is a principle variable in evaluating risk / setting discount for IPOs
- Firms reaching the market make significant CG changes to their board structure and practices to conform to market expectations

Role of the Board in a Public Company IPO / Listing Experience

- The Board
 - Effectiveness
 - Talents and background of board members
 - Tying board remuneration closely to performance
- Strategic thinking by the Board
- Managing risk effectively

Role of the Board in Listing - IPO

- Developing a robust audit committee
- Taking corporate social responsibility on board
- Encouraging and active dialogue with shareholders

The Effective Board

- Clear strategy aligned to capabilities
- Vigorous implementation of strategy
- Key performance drivers monitored
- Effective risk management
- Sharp focus on views of the capital market and other key stakeholders
- Regular evaluation of board performance

What does the market look for in a board member?

- Asks the difficult questions
- Works well with others
- Has industry awareness
- Provides valuable input
- Is available when needed
- Is alert and inquisitive

What does the market look for in a board member?

- Has business knowledge
- Contributes to committee work
- Attends meetings
- Speaks out appropriately at board meetings
- Prepares for meetings
- Makes long-range planning contribution
- Provides overall contribution

Implementing effective strategy and change programs

- The blueprint for the strategy
- The business case
- The transformation program
- A mobilized organization
- A 'transformation map'

The audit committee's main responsibilities

- To monitor the integrity of the financial statements
- To review the company's internal financial controls, internal control and risk management systems.
- To monitor/review the effectiveness of the internal audit function.
- To make recommendations to the board on the appointment/removal of the external auditor

The audit committee's main responsibilities

- To monitor/review the external auditor's independence/objectivity and the effectiveness of the audit process.

The audit committee's main responsibilities

- To develop/implement policy on the engagement of the external auditor to supply non-audit services

The audit committee's main responsibilities

- To review arrangements by which staff may raise concerns about possible improprieties ('whistleblowing')

Flotation – who ends up steering the boat?



Reference

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Thanks