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Years of change for Russia
An interview with Andrea Di Segni, Head of Corporate Advisory in Sodali.

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From Igor Belikov, CEO of the Russian Institute of Directors – Russian Corporate Governance Journal

IB: What you think about the last two years in Russia in terms of Corporate Governance and GMs?

ADS: Despite the geo-political and geo-economic crisis, 2013 and 2014 have been years of change for the Russian market and Russian companies as well. The new Corporate Governance Code and the new voting requirements for GM participation are clear answers to foreign investors' expectations and requests for improvement which have been underlined for years.

The new Corporate Governance Code brought into the Russian context many best practices to protect shareholder rights and introduced the "comply-or-explain" principle which heading the majority of the developed financial markets nowadays. Recommendations over Board composition and independence level, more disclosure on the nomination process for directors, related party transactions and remuneration policies are in line with international best practices. These are very positive developments but is also true that the we need to wait and see the level of compliance to the code by top Russian companies to formulate a clear judgment.

On the other hand the new voting requirements – including the registration process and beneficial owners disclosure – even though may not have been fully welcomed by many foreign investors – is a big step towards a better disclosure environment between companies and investors. In my opinion, this represents a big discontinuity with the past and a further alignment with EU and other developed financial markets. Russian issuers can identify who voted in favor and who did not. This is an opportunity to finally understand why large investors as BlackRock, Capital, Vanguard or Dimensional have not supported Board proposal and develop a strategy to minimize such reputational risk.

IB: Do you think that all of these changes will impact the future GM seasons in Russia?

ADS: For sure! We are at the beginning and, from an international investors' perspective, we have just seen many positive changes at 2014 GMs. Comparing to 2013, this year the level of DR holders participation increase by 15% and for the first time the 42% level in the relative participation by this constituency has been reached. If we look back at 2012, the increase represents over 55%. Russia is not at UK, US or EU countries level, but foreign institutional investors started to be a strategic component of the GMs. Russian companies' ownership structure is still very effective but now Boards should look with more attention to supermajority resolutions. As happened in many markets where participation by foreign investors were not that high – Brazil, France, Spain, Italy and UK – a more active approach by those shareholders resulted in a more positive interaction model between Boards and shareholders.

Governance becomes not anymore a compliance exercise, disclosure should be assured to avoid risk of massive votes against, GM's outcome is no longer dependent to controlling shareholders only and a new approach to engagement with investors is necessary. These developments may not seem as a top priority for Russian Boards, but the international financial community tends to be very fast in adapting to the new environment and challenging companies in Governance-related matters.

IB: What does it mean in reality this new approach to engagement?

ADS: For years the relations between companies and investors have been based on financial matters only. The last financial crisis in US and Europe brought the necessity to re-visit such paradigm to minimize the excessive level of risks for the benefit of short time results. Investors had their responsibility in the crisis and they realized that a new form of active engagement was the only way to mitigate the risks of their investments over the long-term. All of that ended in a new approach by institutional investors to companies with the aim to understand how the governance practices and Board strategy are aligned with shareholders long-term value creation without excessive risks. This is the inner spirit of the engagement initiated through the UK Stewardship code in 2010, which has been recently implemented in many European and Asian countries. Russia should think about that development!

If we move into the Russian context, the climate is more difficult but many opportunities are there for the most proactive companies. In my opinion, many years of poor disclosure, unequal treatment of minorities shareholders together with the negative impact of the current crisis, determined a larger country discount on Russian shares and undermined the already low trust and confidence by foreign investors on corporations and Boards. Looking forward, to attract foreign capital Russian companies need not only rewarding financial metrics but restoring a consistent level of trust in Boards and their strategy to deliver in the long-term. In this sense, I see a fantastic window opportunity for Boards to engage with major foreign investors to explain their strategic view, differentiate the company from the country-driven Russian economic context, recall the discount gap and demonstrate to have a model of Corporate Governance that has been set to empower and drive the Management to deliver profits and long-term value creation for shareholders without excessive risks.

IB: Have you few suggestions on how Boards should engage their investors?

ADS: First of all a fundamental dogma, Boards should control the engagement proactively without being reactive and leave to investors the ball rolling. Engagement is not that different as a financial IR roadshow, different are the matters and the counterparts to deal with but it remains a process which requires an efficient step by step approach. Before thinking to the more effective target of foreign investors, Boards should identify and evaluate the company's positioning in terms of Corporate Governance through an extensive benchmarking against Peers and global best practices and a subsequent assessment performed by an independent expert to assure fresh eyes and avoid conflict of interests. Strengths should be the pillars of the selling story meanwhile weaknesses could be the "carrots" to demonstrate willingness to change and re-gain trust.

Boards should look at internal factors as culture, value, story and mission of the company and integrate them into a Governance story to be told to investors. Past, present and future changes to the company's Corporate governance model are the drivers for the engagement. Boards should be candid, genuine, listeners to investors' concerns and transparent in its communication but also firm to defend their peculiar aspects that make any company different from all the others. After all of that it will be a matter of define the right target, set one-to-

one meetings, report a collective feedback and discuss in the Boardroom what are the “must have” and “nice to have”, then create the road-map of the implementation and get back to the investors to sell the good story.
In US and Europe Governance engagement are part of the ordinary Board activity, General electric has a four seasons timetable every year, Total did a very extensive engagement to adopt a Chair/CEO combined position, Schneider Electric and UniCredit do engagements on remuneration to be front-runner on that matter. Even though topics can be very diverse, engagement programs are now fully integrated in the shareholder relations for Benchmark listed companies! We at Sodali started engagements early in 2009, many of our clients were facing reputational issues or content resolutions at GM and we supported them into the new relations with shareholders. Today, all of them including many other new clients from different countries, perform every year engagement programs to collect new expectations from foreign investors, present their new implementations and reinforce the trust in the Board. Sooner or later, Russian companies will get back to financial markets to attract capital, a trusted and supportive institutional international investors community – reinforced through a newly approach to governance – may be one the driver for a lower cost of capital.
As many other activities, engagement programs should be seen as a process which entails many preliminary analysis – what the investors named “home-work” – in order to be effective. Benchmarking the Governance model vs. a challenging Peers group, define the Governance story with a forward-looking stance, define the appropriate target of institutional investors, prepare a Governance presentation and a Q&A, create a Governance team are few examples of the necessary steps toward an effective Governance engagement.

IB: What is the relation between the engagement and the AGM?
ADS: The AGM is the place where shareholders scrutiny Board & Management results, how much they were aligned with both the interests of the company and long-term value creation for shareholders. Lower support to Board resolutions is a strong signal which should not be undermined, next time it could be larger and may have a different impact. The AGM is where Board and Management put their credibility on the table as simple as that!
Engaging with investors to sound their sentiment, listen their expectations, record their suggestions is a perfect tool to evaluate how the Board and Management are running the company from an external consistent perspective. If this exercise results in an effective dialogue, an alignment of the interests and a better governance implemented by the Board year to year, participation and support by international investors at the AGM will increase substantially.
Similar to the Governance engagement programs, the AGM should be considered a process where shareholders are the main counterparts to deal with. Comprehensive documentation, clear explanation including rationale related to deviations, enhanced disclosure, forward-looking statements, timely publication and information to investors, support in the voting process and Proxy solicitation are nowadays the bread-and-butter of any Top listed company’s AGM. A proactive approach to investors in conjunction to AGM brought the shareholders relation to a level-playing-field which is the key to ensure a real long-term support to the Board functioning.

IB: One last question, in this geo-economic and geo-political situation what Boards should do to ensure trust and confidence by investors?
ADS: Unfortunately a dramatic crisis is affecting Russia and perhaps even more Russian corporations. In my opinion Russian Boards should demonstrate that a clear distinction exists between a nation/Government and its corporate environment. A company is made by employees, culture, values, entrepreneurships, investments and Managers that should act in the interest of both the stakeholders and the shareholders. Boards should speak to

investors to assure the Board is on top of all of these aspects, driving the strategic vision, empowering Management to deliver long-term and sustainable results, implement all the checks-and-balances to ensure this delivery is made without excessive risks and attract long-term investors to sustain that road-map. Silence is not the more appropriate answer in situation as the one Russian companies and Boards are facing.
In crisis time, companies continue to inform their shareholders about their profits, business plan objectives, financial performances, best and worst case scenarios. This approach should be integrated with the Governance matters. In the last three months we have seen an eager interest from Board to understand much better what does it mean engagement, what is the value of that, what could be the returns. In my personal experience, when this matters came to Board level means that a re-think of the shareholder relations is coming and this could only benefit Russian companies and their investors in the long-term.

« … award-winning research co-authored by London Business School Professor Elroy Dimson analyzed investor engagement with US companies over 10 years to 2009 and found that *share prices rose by an average of 4.4 per cent in the year after an engagement was concluded.* The research found that companies tended to experience improvements in operating performance, profitability, efficiency and governance following shareholder engagements. «

Active ownership offers win-win strategy, 2013
Financial Times

« Engagement is essentially communicating with companies to enhance our mutual understanding and, where there are concerns, to seek changes in company practice. We believe that the most effective engagement is usually done privately and directly with companies. The Corporate Governance and Responsible Investment team works closely with the portfolio managers on individual company engagements to ensure an integrated approach is taken and a consistent message is delivered to companies. «

Michelle Edkins, Head of Corporate Governance, BlackRock

Andrea Di Segni
Head of Corporate Advisory **Sodali**