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THE ESSENCE AND STRUCTURE OF CORPORATE GOVERNANCE

СУЩНОСТЬ И СТРУКТУРА КОРПОРАТИВНОГО УПРАВЛЕНИЯ

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Abstract. The article discusses establishment of market relations and increasing welfare of citizens are led to understand the importance of the corporate governance that is inevitably associated with the transition to market-based economy. In the modern countries, the corporate governance is one of the most essential factors that indicates the countries' economic development indicator, investment climate and social developments.

Аннотация. В статье обсуждается учреждение рыночных отношений и увеличивающееся благосостояние граждан ведут понять важность корпоративного управления, которое неизбежно связано с переходом к рыночной экономике. В современных странах корпоративное управление — один из самых существенных факторов, который указывает на индикатор экономического развития стран, инвестиционный климат и социальное развитие.

Keywords: corporate governance, market relations, economy, Uzbekistan.

Ключевые слова: корпоративное управление, рыночные отношения, экономика, Узбекистан.

If we glance history pages of corporate governance, the system evolved over centuries in the result of failures and crisis of companies' management systems. In the 1700s, the United Kingdoms have been approved the rules of corporate governance, but the system had called differently. It was the beginning of the corporate governance with functions. In the beginning, XIX century is initiated the next step of development of the system. Particularly, 1929–1930s on the stage of “great depression” the USA law adopted the corporate governance. The administration introduced fixed methods of governance of companies. Afterwards, the system was named “American model of corporate governance”. While the American model had been developed the Japan and German models also were not laid behind, the models developed and seemed to match to countries that had similarities. Moreover, Latin America and Middle East countries also had started to implement their models.

The role of corporate governance has been grown by failures of well-known companies. In the 1990s, the corporate failures of Bearings Bank (UK), Mirror Group (UK), Enron Corporation

(USA), Parmalat (Italy) and Vivendi Universal (France) happened because of incompetence or fraud of governance systems [1]. As consequences, the new governance frameworks adopted.

In Uzbekistan case, after getting independence the Uzbek authorities have been created the legal framework conducive to further development and progress of market of information technologies. In particular, in 1992 the law “On telecommunications” was adopted that covered the general principles. In 2002, “On further development of computerization and introduction of information and communication technologies”, in 2003, the law “On information” focused on the legal regulations in order to develop and overthrow the issues at these times. In 2012, “On measures for further implementation and development of modern information and communication technologies”. In 2013, the first President’s Resolution, the Complex program of development of National information and communication system of the Republic of Uzbekistan for 2013–2020 is being implemented (1).

In 2015, an enlarged meeting of the Cabinet of Ministers was dedicated to “the socio-economic development and the most important priorities of economic program for 2016”. At the first President, Islam Karimov noted that in today’s conditions in the era of Internet and electronics, the widespread introduction of information and communication technologies in the fields of economy, radical acceleration of creation of system “Electronic government” are of priority significance (2).

The corporate governance regime in Uzbekistan has emerged primarily through privatization and institution building: economic assets have been defined and distributed through privatization, which was complemented by as defining and enforcing legal and social frameworks that govern business transactions and firms engaged in them. However, the mismanagement of privatization and institution building contributed to an underdeveloped capital market, high unemployment rate and insufficient technological and managerial upgrading of companies, which results in their weak competitive position in the product/service markets.

Many of the local manufacturers are re-launched based on the principles of corporate governance in order to improve the efficiency of joint-stock company operations and to create favourable conditions for investment environment. There are regulations, Decree by the first President of the Republic of Uzbekistan on April 24, 2015, is focused on the measures to improve the modern corporate governance. The following of the outline points are (3): 1) to learn the international practices of companies operating based on the principles of corporate governance, 2) to establish joint-stock companies based on foreign direct investment and to improve the conditions of operations in order to attract the attention of investors, 3) to implement strategic management of joint stock companies, to establish an effective monitoring system for the personnel of the corporation, and 4) to educate young specialists on effective measures of strategic management in close cooperation with leading international universities.

Theoretical aspects

What is the corporate governance? This concept is enough difficult, rather new and continuing to develop. There are set of definitions of it. While looking the definitions by academic and practitioners, they have provided their individual with each conception. For example, the Organization for Economic Co-operation and Development (OECD) gives the following definition: “the corporate governance is to help build an environment of trust, transparency and accountability necessary for fostering long-term investment, financial stability and business integrity, thereby supporting stronger growth and more inclusive societies” (4). In a board meaning, the corporate governance is accepted as the process of implementation of the power by economic entities, decision-making within the property relations on the basis of the developed production, human and

social capital... is defined by the character of purposes of activity of the enterprise and its management, types of control, interests and property.

The scholars like Peter Crow (independent advisor, facilitator and speaker on corporate purpose, strategy and corporate governance) defined it as “the act of steering, guiding and piloting — describes what boards do when in session” (5). In some points, his definition came to same as Richard Leblanc (Associate Professor of Governance, Law, and Ethics, York University), “the corporate governance is the control of management in the best interests of the company, including accountability to shareholders who elect directors and auditors and vote on say on pay” (6).

The conceptions from practitioners hold widely, for example, Alston & Bird’s Corporate Transactions and Securities Group staffs like David Brown, Ted Schroeder and Val Del “is gathering together a group of smart, accomplished people around a board table to make good decisions on behalf of the company and its stakeholders” (7), and another example goes to the International Chamber of Commerce (ICC — world business organization, helping businesses of all sizes and in all countries to operate both internationally and responsibly), according to the ICC, corporate governance is the relationship between corporate managers, directors and the providers of equity, people and institutions who save and invest their capital to earn a return. It ensures that the board of directors is accountable for the pursuit of corporate objectives and that the corporation itself conforms to the law and regulations.

Above-mentioned definitions of corporate governance are led to three main directions: to governance property, governance output affairs and governance of financial flows of the company. Therefore, the corporate governance is the system of interaction between governing bodies, shareholders, and stakeholders of the company, which reflects on the balance of interests and gain the maximum profit. In a narrow sense, corporate governance is a system of rules and incentives that motivate company managers to act in the interests of shareholders. In a broad sense, corporate governance is a system of organizational, economic, legal and managerial relations between subjects of economic relations, whose interests are related to the company’s activities. In other words, the subjects of economic relations are meant managers, shareholders, and stakeholder (creditors, employees, partners of the company, and local authorities)s. All of these subjects have common goals such as:

- creation of the viable and profitable company providing release of high-quality goods, jobs and high prestige and faultless reputation;
- increase the price of material and intangible assets of the company, growth of share, and ensuring payment of dividends;
- gaining access to external financing markets such as capital markets;
- gaining access to a workforce sources such as managers and other workers;
- increasing job places and general growth of economy.

Moreover, each participant of the corporate relations possess interests, and this variety among them can lead to the development of the corporate conflicts. In the result, the corporate managers promote appropriately conflict resolutions, and at emergence, the charters of organizations might solve conflicts. Such processes and conflict resolutions are formation and functioning of various governing bodies, regulation of relations, providing equal relations to all participants and disclosure of appropriate information as shown in Figure 1.

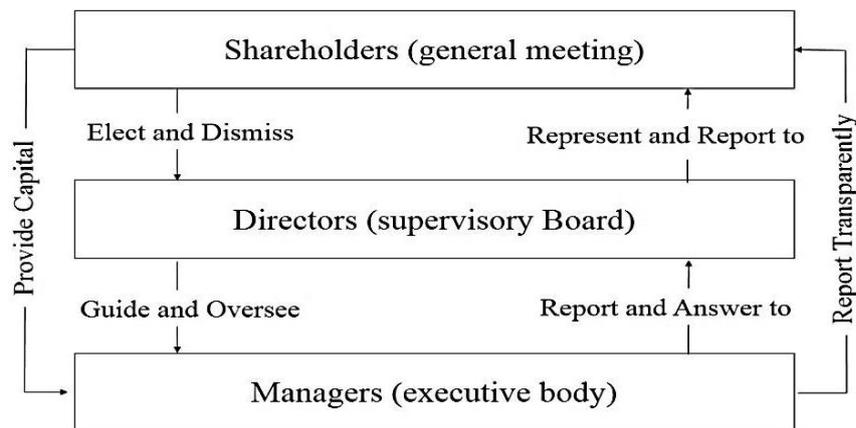


Figure 1. The system of corporate governance. Source: (8)

The scope of corporate governance

It is important to note the international aspects of realization of corporate governance. The corporation that is realizing effective corporate governance system promotes accounting of interests of a wide range of interested persons and accountability of bodies of its governance of company and its shareholders. In turn, corporation are promoted effectively attraction by foreign and domestic investments.

Due to the increasing role of corporate governance in sphere of investments and efficiency of activity of the companies. In 1999, the Organization for Economic Cooperation and Development (OECD) presented set of principles of corporate governance, which are accepted as the cornerstone of formation, functioning and improvement of a corporate governance system. These principles became a basis of realization of corporate governance in the countries of OECD members and non-members. Further, the Forum of financial stability has accepted the principles of OECD as one of standards of stability of financial systems. In 2004, updated with some important and additional amendments of principles of corporate governance system have been published by OECD.

There are many codes of the best practices and corporate governance principles have been developed over decades. Most of these codes point on the role of Supervisory Board in company. Only, the OECD Principles focus on policy makers, businesses and entire governance framework. The principles are gained worldwide acceptance as a framework and reference. There are main for core values of the OECD corporate governance, namely 1) fairness, 2) responsibility, 3) transparency, and 4) accountability.

What are the interests of the subjects in corporate governance?

The managers earn the main part of the reward as salary. They are interested in secure of their job and stability of company. In the process development and implementation of the strategy of company, it inclined to the stabile of risk and profits. Managers depend on shareholders who are presented by the board of directors and stakeholders. They also need to interact with other group of employees such as creditors, clients, suppliers, regional and local authorities. Moreover, the managers should take care all these groups' interests.

The shareholders can gain income from activity of the company only form dividends and sale of shares in case of the high level of their quotations. Respectively, they are interested in high profits of the company and a high rate of stocks. In this context, the shareholders take the highest

risks such situations if the company does not make profit and in the case of bankruptcy they could receive compensation only after all groups requirement are fitted.

Shareholders are inclined to support of decisions, which lead to receive high profits. As modern experience, the many shareholders prefer to invest their money to many companies as increase income sources. The shareholders are able to influence to the management of the company in two ways: 1) meeting of shareholders through elected member of board of directors by approving or disapproving activities of management of company, 2) by selling the shares, influencing to the price of share and creating to the absorption company with shares (8). Shareholders do not interact directly with management of the company and other interested groups.

There is one more group of participants of the corporate governance is stakeholders, which are (Table):

Table.

THE GROUP OF STAKEHOLDERS (10)

<p>Creditors –get profit, the contract is recorded between them and the company. Respectively, the creditors are interested in stability of the company and guarantees of return of their funds. They do not incline to support the decisions providing high profit, but connected with high risks; –diversify the investments between a large number of the companies.</p>	<p>Company employees –firstly, they are interested in stability of the company, preservation of the jobs and for them company is the main source of income; –interact directly with the management, depend on it and have very limited opportunities of impact on the management.</p>
<p>Partners of the company (customers of production, suppliers etc.) –Partners are interested in stability of the company and company’ solvency; –interact directly with management.</p>	<p>Local authorities –stability of the company due to ability to pay taxes, to create jobs, to realize social programs; –interact directly with management; –have an opportunity to influence activity of the company through local taxes.</p>

Apparently, the participants of the corporate governance interact differently among themselves, and the sphere of a discrepancy of their interests is very considerable. The right constructed the corporate governance system is to minimize possible negative impacts on the company affairs. The system of corporate governance is formed and aligned interests of shareholders, makes out them in the form of strategic objectives of the company and controls process of achievement of these purposes corporate. Basis of a corporate governance system is process of forming and effective implementation of internal control of activity of managers of the company on behalf of its owners (investors).

The above-mentioned patterns allow making conclusion that corporate governance has two aspects: internal and externals. The external aspect is focused on the relations of social and economic environment of the company such as state, creditors, brokers, local communities and other interested people. While the internal aspect is concentrated on the relationships inside of the company between shareholders, members of supervisory, executive and control bodies.

According to the Russian scholars, O. G. Aranovich and E. E. Stepanenko mentioned that the establishment of the corporate governance system orientates for three main solutions: 1) ensuring company’s maximum efficiency, 2) attraction of investments and 3) implementation of juridical and social obligations [2].

Besides, many companies face limitation of internal financial resources and impossibility of prolonging the debt burden. Therefore, it is better to be engaged in realization of the principles of effective corporate governance in advance. It will provide a future for competitive advantages of the company and give the chance to be ahead of rivals.

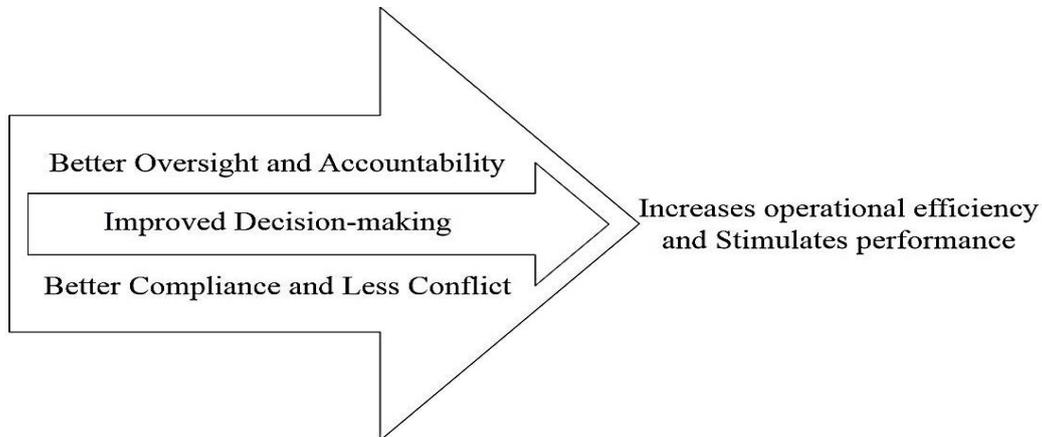


Figure 2. Advantages of corporate governance. Source: (8)

The Figure 2 shows the advantages of corporate governance leads improvement in the company's governance practices such as accountability, compliance and decision-making processes. On other hand, it reduces the conflicts. Corporate governance improves the management and oversight of executive performances by linking executive remuneration to the company's financial results. This creates favorable conditions not only for planning the smooth succession and continuity of the company's executives, but also for sustaining the company's long-term development. In the decision-making process managers, directors and shareholders are all likely to make more informed, quicker and better decisions when the company's governance structure allows them to clearly understand their respective roles and responsibilities, as well as when communication processes are regulated in an effective manner.

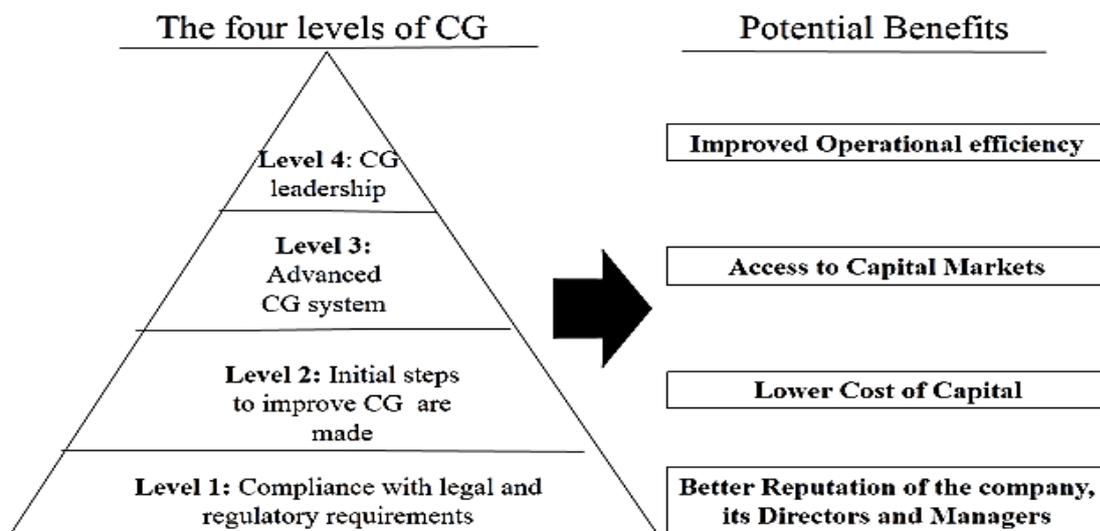


Figure 3. Level and potential benefits of Corporate Governance. Source: (8)

According to the International Finance Corporation (IFC) group members, namely, Dr. Davit Karapetyan and Sebastian Molineus (2004) have been conducted research for Russian Federation corporations and named the research “the Russia Corporate Governance Manual” program (11). There they have explored the levels and benefits in order to encourage fairness for at well-governed companies care to have cheaper and better access to the capital. The program encourages accountability, fairness, and transparency in corporate governance system. According to them, there are four levels and potential benefits of corporate governance are depicted in Figure 3.

The first level is named “compliance with legal and regulatory requirements” and its potential benefits better reputation of the company, its directors and manages. The second level goes to steps of initial to develop corporate governance have made in order to lower the cost of capital. The third level is about developed system corporate governance and it lead to access to capital market. The last level is being leader in corporate governance due to improved operational efficiency.

According to the corporate governance standards focuses to improve the decision-making process. In other words, the company’s directors, managers and shareholders would be informed deeply in affairs of the company, therefore they are able to make better decisions.

It is better to be engaged in realization of the principles of effective corporate governance beforehand: it provides future competitive advantages of the company and gives chance to be ahead of rivals.

The elements of corporate governance should be considered necessarily that increase the effectiveness of it. These elements are [3]:

1. Shareholders’ rights: the corporate governance system has to protect the rights of shareholders and provide the equal attitude towards all shareholders, including small and foreign shareholders.

2. The board of directors’ activity: the board of directors is obliged to provide the strategic leadership in business, control effectively over work of managers and report to shareholders.

3. Disclosure of information and transparency: the corporate governance has to provide timely disclosure of reliable information about all essential aspects of functioning of corporation, including data on financial circumstances, financial incomes, perspectives in managing affairs, the list of owners and structure of management.

The mechanism of corporate governance system is to protect of interests of all economic agents including creditors. If corporate governance system of the company is inefficient, then it generates fight for control between various interested parties: shareholders, managers and creditors. The worst-case scenario of fight might to lead to the bankruptcy. As the procedure of bankruptcy means a default of all obligations of the enterprise, the external creditors become affected party in this fight. Moreover, the fight for control over the enterprise distracts management and shareholders from operating and investment affairs. As consequences of it, the company may lead to the most negative for a financial condition. In turn, effective corporate management gives to joint-stock companies the following advantages:

Firstly, access of capitals to the market is simplified. One of the main factors of corporate governance is to provide access to domestic and foreign market of capitals. Implementation the principles of corporate governance provide necessary level of protection of rights of investors. Therefore, the investors perceive effectively operating companies as capable in order to provide acceptable level of profitability of investments.

Secondly, depreciation of the capital. If companies adhere to high standards of corporate governance, they could achieve reduction of value of external financial resources. The value of the

capital depends on risk that appropriated to the company by investors. One of the risks is the risk of violation the rights of investors. When the rights of investors are protected well, the value of share and loan capitals would be decreased. It should be noted that the investors providing loan capitals in the terms of including the practice of corporate governance system. Therefore, the implementation of corporate governance may lower interest rate for loans.

Corporate governance plays a special role in emerging market countries, whereas there are no system of protection of the rights of shareholders as in developed market economy. The level of the risk and cost of the capital do not depend on only economy of the country. Joint stock companies that have reached small scaled improvements in corporate governance system, they could be seen as the essential advantaged companies in comparison with other companies.

Thirdly, assistance to growth of efficiency. Because of improvement of quality of corporate governance system, accountability of company might to be improved, as a result it could lead to minimize risk of fraud of officials of company and conducting contracts based on their interests. Moreover, the control over managers would be improved and awarding them on basis of endeavors.

In conclusion, the principles of corporate governance is based on the transparency, availability, efficiency, efficiency, regularity, completeness and reliability of information at all levels. If the transparency of joint-stock company increases, investors have an opportunity to get into an essence of business activities. Even if information proceeding from the company that has increased the transparency is negative, shareholders benefit from reduction of risk of uncertainty. Thus, incentives to carrying out by the board of directors the systematic analysis and assessment of risks are formed. The standards of corporate governance help to improve decision-making processes that are capable significant effect on financial and economic affairs of company.

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