

РАЗДЕЛ 3
УГОЛОК ПРАКТИКА

SECTION 3
PRACTITIONER'S
CORNER



BOARD COMMITTEE PRACTICES IN UKRAINE

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International board practice concerning establishing committees on the board is still not spread in the Ukraine. The state obliged Ukrainian joint stock companies to establish an audit commission. But the commission is not on the supervisory board. It is not an integral part of the board. Members of the audit commission are prohibited to be members of the supervisory board at the same time. Although the audit commission reports to the supervisory board, objectives of the audit commission are narrowed only to controlling financial transactions executed by the management board. Therefore, it is worth of establishing an audit committee on the supervisory board with a broader spectrum of functions and equipped with the deepest knowledge on corporate governance mechanisms.

Compensation committees are established on the supervisory boards at 10 percent of researched Ukrainian joint stock companies¹. These are

companies mainly under control of foreign institutional investors. About 58 percent of companies, controlled by foreign institutional shareholders have compensation committees on the supervisory boards. It is worth of mentioning that this number is even higher than an average number for Germany, France and Italy.

Lord Cadbury mentioned that executive directors should play no part in decision making on their own compensation (Cadbury, 1992: para 4.42). Taking into account that executives are not members of the supervisory board in Ukraine, i.e. it is prohibited by legislation, we should broaden a term "executive" to a term "independent". Almost all members of compensation committees (85 percent) at the companies under control of foreign institutional shareholders are independent. That is a strong contribution to performance of the board.

It is interestingly, companies, controlled by employees, have not the compensation committee on the supervisory boards at all. Probably, it is because of very low number of independent directors on the boards and very stable stickiness of employees to

- annual reports of Ukrainian joint stock companies;
- annual reports of the State Securities and Exchanges Commission in Ukraine;
- annual reports of the First Stock Trade System in Ukraine;
- stock market reports, developed by famous Ukrainian investment companies.

The period of investigation is from 1998 to 2003.

¹ Research was comprised of two stages. At the first stage, we delivered questionnaires to Heads of Supervisory Boards and Deputy-Heads of Supervisory Boards of 240 companies. Feedback on questionnaires was received from 53 companies. They belong to the most developed industries - metallurgy, machine-building, energy generating and energy distributing. Further, we selected the most completed questionnaires (50) to conduct research and process questionnaires. At the second stage of research we used observation. We observed 50 companies whose directors had provided us with questionnaires completed. The following data sources were used to observe corporations:

"fixed" compensation contracts to sign with executives that reduces an importance of the compensation committee on the supervisory board. Under such circumstances, executives are free to influence decisions on the size and structure of their compensation through forcing a personnel department that is subordinated to executives and responsible to developing contracts for executives.

Finance committees are on the boards at only 3 percent of researched companies. Motives to establish the finance committee on the supervisory board at companies, controlled by various groups of shareholders are different. Thus, financial-industrial groups want to have the finance committee on the board to control financial expenditures by executives. Foreign institutional shareholders establish the finance committee on the supervisory board to involve directors in strategic financial decision making. Generally, strategic financial decisions are made by executives at the companies, controlled by executives themselves, employees and Ukrainian financial-industrial groups.

Administration committees are not popular on the boards of Ukrainian companies too. About 4 percent of researched companies have an administration committee on the boards. The reason of so low popularity of the administration committee on the supervisory boards in Ukraine is contrasting very much to those conclusions, made previously. Ukrainian companies, whoever controlled them, want to have well-performing administrators on the supervisory boards. But the market for directors in Ukraine has the lack of directors, who may effectively administer the work of the board, from the point of view of its various roles, i.e. strategic, control and advise. A shareholder committee is not popular at Ukrainian joint stock companies. It is quite surprisingly because of frequent cases of violation of the minority shareholders' rights by majority shareholders and executives. This situation can be explained by two reasons. The first is unwillingness of majority shareholders to take into account interests of minority shareholders. The second factor is the very low degree of knowledge of minority shareholders on the major mechanisms of protecting their rights. One of these mechanisms is establishing and participation on the board's shareholder committee.

Only 4 percent of researched Ukrainian joint stock companies have a shareholder committee on the board. It is interesting that all these companies do not experience agent conflicts and are very transparent. About 90 percent of these companies are under control of foreign institutional shareholders. There are no shareholder committees at companies under control of employees and executives. Employees do not establish the shareholder committee on the boards of companies, controlled by them, because they are strongly concerned with responsibility of the company to employees (employment, wages, etc.) and weakly concerned with outside shareholders and institutions (stock market, capital structures, stock price, etc.). Executives do not prefer to establish shareholder committees because an absence of shareholders committee allows executives to absorb a total control of the company and follow their own interests without a threat to be discovered and executed by shareholders.

A policy committee is the most popular committee on the boards at Ukrainian companies. Almost 25 percent of researched companies have the policy committee on the board. Policy committee is the most spread on the boards of the companies under control of foreign institutional investors, Ukrainian financial-industrial groups and Ukrainian investment companies and funds. The higher concentration of ownership structure the higher likelihood of establishing the policy committee on the supervisory board. It is because controlling shareholders want to have a total control over the strategic directions of the companies development through a very simple mechanism to establish - the policy committee. As in the case of the finance committee, only foreign institutional shareholders establish the policy committee mainly to develop strategic directions, and only next to control its execution by executives, i.e. members of the executive board. Companies, controlled by Ukrainian financial-industrial groups, executives and employees, prefer to delegate a function to develop strategic decisions to executive board.

It is interestingly to know a mode of strategic involvement of the policy committee at Ukrainian companies.

Table 1. Mode of strategic involvement of the members of supervisory boards in Ukraine

Involvement in strategy	Frequency
Review	12
Discuss	12
Approve	10
Ratify	9
Decision-taking	9
Monitor	9
Define strategic framework	5
Guide	4
Help formulate	4

Number of respondents, i.e. members of policy committees - 12

The deepest mode of strategic involvement, i.e. helping formulating strategy, was demonstrated by policy committees of those companies under control of foreign institutional shareholders (3 replies) and with dispersed ownership (1 reply).

The deepest mode of strategic involvement of supervisory boards at companies, controlled by Ukrainian financial-industrial groups is monitoring (4 replies).

Supervisory boards at companies under control of executives are involved in strategic process only from the stage of strategy discussion (1 reply). This

proves that shareholder executives are inclined to absorb corporate control through preventing the establishing the policy committee or through delegating as least as possible involvement in strategy process to the policy committee.

Surprisingly, but we found that directors of those companies, where there are no policy committees are involved in strategy process too. They do this at the ordinary meetings of the supervisory boards or at the general annual meeting of shareholders.

Table 2. Roles of the supervisory boards in Ukraine

Roles	Number of respondents positively answered
Involvement in strategy	44
Hire, appraise and fire executives	4
Converse with shareholders/stakeholders	4
Development of corporate vision	7
Responsibility for ethical framework	2
Ensure corporate survival	3
Determine risk position	2
Lead strategic change	3
Review social responsibilities	2
Understand current and forthcoming legislation	4

number of respondents - 50

Regrettably, it is worth of mentioning that involvement in strategy is considered by most directors when meeting on the board, only as approving the strategy (38 respondents). 7 respondents consider their involvement in strategy through helping formulating the strategy, and 3 of them are not the policy committee members. Obviously, supervisory boards have a lack of organizational change to let all members apply their knowledge and motivation on committees of the board.

Reviewing social responsibility is the role of members of the board of those companies under control of foreign institutional shareholders. Besides this, reviewing social responsibility is undertaken by members inside of the policy committee. Companies, where there is the policy committee on the board,

review social responsibility in general way. Contacts and discussions on the topic of social responsibility with stakeholders, employees, minority shareholders are not undertaken by members of the policy committee. Social responsibility is considered rather as "environmental protection". Obviously, but reviewing social responsibility requires establishing a special committee on the supervisory board. In our sample companies, social responsibility is a role of policy committees, that are not familiar with its role in details.

Generally, we conclude that committees of the supervisory board are demanded more by foreign institutional shareholders. Thanks to this, boards are multi-role performers, i.e. strategy, control and advise.