

Russia's corporate sector, disclosure regulation and practice

Russia's corporate sector

The Russian corporate sector is only 30 years old. Its emergence and active development dates back to the early 1990s, when the country embarked on a massive privatization program, which in less than a decade transformed the majority of state-owned enterprises into private firms (see e.g., [Hare, Muravyev, 2003]). The Russian privatization also provided impetus for the rapid development of the national stock market. The main milestones in this process were the establishment in 1995 of the Russian Trading System, the first organized over-the-counter market in the country with a considerable volume of trading (later transformed into the RTS stock exchange), the start of stock trading on the Moscow Interbank Currency Exchange (MICEX), and the merger of the RTS and the MICEX in December 2011, which created the Moscow Exchange (MOEX). As of 2016, the MOEX was one of the largest stock exchanges in the emerging markets and the eighth stock exchange in Europe¹.

The emergence of the corporate sector and organized stock market required a far-reaching legal reform, which had to be implemented virtually from scratch. The main milestones in this process were the passage of the law on joint-stock companies in 1995 (Federal law N 208-FZ), the enactment of the law on the securities market in 1996 (Federal law N 39-FZ) and the introduction of the law on the protection of the rights and legitimate interests of investors on the stock market in 1999 (Federal law N 46-FZ). These laws, which have been revised many times during the last two and a half decades, as well as numerous by-laws and regulations, filled in most of the legal lacunas that were widely discussed in the 1990s [OECD, 2002], and laid down a foundation for a functioning system of corporate governance. Despite that, many issues remained high on the agenda even in the 2000s, including corporate transparency and disclosure (see e.g., [Fox, 2014]).

Importantly, the Russian privatization created many open-joint stock companies that would not have emerged as public companies in a normal market environment. Many of these firms were relatively small, had very concentrated ownership structures, were not listed on the stock market, but the law required their governance bodies, procedures and reporting being patterned after the classic public widely held company. This gave rise to a massive non-compliance with regulations, including disclosure rules.

¹ Visual Capitalist. All of the World's Stock Exchanges by Size. URL: <http://www.visualcapitalist.com/all-of-the-worlds-stock-exchanges-by-size/> (accessed: 30.04.2023).

Corporate disclosure regulations

In terms of disclosure, the legal framework initially consisted of the first two aforementioned laws, by-laws issued by the regulator of the stock market² and regulations by stock exchanges (see [Vavulin, 2012; Nikitina, 2014] for details). The late 1990s were characterized by numerous by-laws, which often contradicted each other. Corporate disclosure occurred in several forms: regular quarterly reports, financial reports, reports by the issuer of stocks, and reports on material events and actions affecting the firm. In October 2003, most of the numerous by-laws passed in the late 1990s and early 2000s were integrated into a single document, the Regulation on the disclosing of information by the issuers of emission securities³. This regulation provided more detailed guidelines regarding the structure of information to be disclosed, the ways of disseminating it, and the timing of disclosure. In 2004, with the help of the Regulation on activities on the organization of trading on the stock market, the Federal Commission allocated some of the enforcement functions to the stock exchanges⁴. In particular, the stock exchanges were empowered to monitor the compliance of the listed companies with the mandatory disclosure regulations. Violations of the mandatory disclosure (as well as of corporate governance standards) were fraught with delisting of the firm from the market.

At the same time, the regulator also empowered the stock exchanges to monitor the compliance of listed companies with certain norms contained in the 2002 Code of corporate conduct [FCSM, 2002], for example, the presence of independent directors and an audit committee. While the norms of the Code were a mere recommendation for most companies, for publicly traded firms they became mandatory.

Since the mid-2000s, both the legislators and the regulators adopted numerous additional measures to improve the disclosure environment for public companies. For example, government introduced tougher requirements for listed companies to publish consolidated financial reporting in accordance with the IFRS. The regulations issued by the Central Bank of Russia, which from 2013 on plays the role of the regulator, further streamlined and strengthened disclosure requirements for Russian companies⁵.

In 2014, the country saw a legal reform that reclassified all joint stock companies into two categories: public companies and non-public ones. Now, detailed disclosure regulations only applied to the minority of companies, namely those choosing the public status.

² The Federal Commission on Securities Market (1996–2004), the Federal Financial Markets Service (2004–2013), and the Central Bank of Russia (since 2013).

³ Endorsed by the Decision of the Federal Commission for Securities Market No. 03-32/ps of July 2, 2003.

⁴ Endorsed by the Decision of the Federal Commission for Securities Market No. 03-54/ps of December 26, 2003.

⁵ Bank of Russia Regulations No. 454-P and 714-P “On disclosure of information by issuers of equity securities” issued in 2014 and 2020, respectively.

Importantly, some of the mandatory disclosure rules were relaxed after the imposition of economic sanctions on Russia following the 2014 crisis in Ukraine. The pendulum moved even further in 2022, when government provided companies with the right not to disclose essential information about their operations in order to protect them from additional sanctions imposed by the West. In the early 2023, the idea of dropping IFRS accounting was announced in Russia for the first time.

Disclosure practice

Despite the substantial progress, especially in terms of “law on the books”, enforcement of financial and business disclosure requirements has long remained one of the most important issues in the Russian corporate sector [Fox, 2014]. Compliance with even basic disclosure rules has been modest, with massive violations of the existing regulations being common. The reason is seen in poor enforcement of the regulations, and in particular, in immaterial sanctions for not obeying the rules. Indeed, as pointed out by some observers, until 2009, the maximum fine for violating disclosure provisions was a mere 40,000 Rub. (about 1,000 Euro) and the limitation period was two months only. Since April 2009, these numbers were raised to one million Rub. (25,000 Euro) and one year. As a result, compliance with the formal rules on disclosure (regardless of the quality of information provided) improved by 44% in 2010 relative to 2009 [National council on corporate governance, 2011].

Still, even in 2012, only 6000 out of 42 000 (or 14%) of joint-stock companies had their quarterly reports and material facts properly disclosed [National council on corporate governance, 2011]. Even when the formal rules were obeyed, there was no guarantee that the information disclosed was meaningful and complete. A case in point discussed in [Chernykh, 2008] is the non-transparency of company ownership, even for public companies. The main mechanism that allowed companies to hide owner identity while complying with formal disclosure requirements was “the transfer of shares in the name of a nominee or private company registered in a foreign offshore center” [Chernykh, 2008, p. 172].

However, in terms of obeying the formal rules (types of documents, their timing, and to a lesser extent, their content), the situation was substantially better for companies whose shares were listed/traded on the national market. This is due to additional oversight on the part of the Russian stock exchanges, which took effect in 2004–2005. Nevertheless, even in these cases, significant room for non-disclosure of important aspects of the firm’s operations remained, despite formal compliance with the rules.

Following the imposition of sanctions on Russia in 2014 and especially 2022, Russian government relaxed the disclosure requirements⁶. As a result, Russian companies are now facing considerable freedom in choosing the level and quality of disclosure provided to investors and therefore operate in a disclosure environment that is similar to what they faced two decades ago. As a result, some have already hidden essential information about their officers and owners in publicly disseminated reports.

⁶ Decrees of the Government of the Russian Federation No 400 of April 4, 2019 and No 351 of March 12, 2022 “On the specifics of disclosure and provision of information subject to disclosure”.

Standard and Poor's Transparency and Disclosure survey in Russia

The Russian transparency and disclosure survey was launched by the Standard & Poor's in 2002 to supplement the data on 13 Russian companies that were included in the S&P/IFCI 1200 (Emerging Markets) index. The survey used only publicly available information (from annual reports, corporate websites and reports to the regulator) and therefore, a company's transparency score is different from its corporate governance score and cannot be interpreted as a measure of governance standards. The transparency score is just one of the key factors affecting a firm's attractiveness to investors and an important element of corporate governance.

The survey was run from 2002 to 2010. The number of companies studied varied from 42 in 2002 to 90 in 2010. These were mostly Russian blue-chips from the non-financial sector. The majority of them were traded on the Russian stock market or simultaneously in Russia and abroad. Only a handful of firms were only traded abroad (those registered abroad, but whose operations were predominantly in Russia). The main criteria used by the S&P to select the companies in the study were size and liquidity of stocks. Some companies with relatively illiquid stocks, but fluid market for corporate bonds were also included in the early waves of the study⁷.

The S&P compiled an overall transparency and disclosure index as well as three sub-indices based on information about individual disclosures, whose number varied somewhat between the waves due to methodological refinements⁸. The three sub-indices were:

- T&D ownership structure and shareholders rights;
- T&D financial and operational information;
- T&D board and management structure.

The methods of data collection and processing were similar across the waves of the study, albeit a minor change in the methodology occurred in 2004.

Because some of the items were irrelevant for certain companies (for example, single class stock companies cannot disclose the rights attached to preferred (non-voting) shares), these items were excluded from calculation of the overall index and its sub-indices for the respective companies with the appropriate adjustment of the weights for the remaining items.

⁷ In particular, the 2004 companion book tells that the survey includes "17 companies in the S&P/IFCG Index, as well as 33 of the other largest companies in Russia (List 1). We also included 10 companies with illiquid or closely held stocks, which have their Rouble-denominated bonds first-tier listed on the Moscow Interbank Currency Exchange".

⁸ In particular, the 2004 companion to S&P data tells: "As noted above, as a result of methodological adjustments, the direct comparison of scores from 2003 and 2004 surveys is not robust in the scientific sense".

Additional information about identification of key governance variables

Executive, grey, and independent directors

Our approach is similar to the algorithm described in [Muravyev, Berezinets, Ilina, 2014]. We primarily rely on quarterly reports of the sampled companies and use additional sources, such as business newspapers and the Internet, whenever necessary. Although quarterly reports do not directly identify executive, grey and independent directors, they provide a wealth of information regarding directors' current and past positions within the firm and outside, including in its affiliated organizations, as well as regarding their ownership stake in the firm.

Based on this information, we first classify a director as an executive if she currently holds a managerial position in the firm. This can be seen in the quarterly reports, which list all current positions of the board members. All the other directors are regarded as non-executive.

Identification of independent directors is less straightforward. We rely on the definition in the 2014 Corporate Governance Code [Central Bank of Russia, 2014], with several key criteria that an independent director should meet. For example, an independent director cannot be a manager or an employee of the company; she also cannot be an affiliated person of the company or its affiliates; and she cannot be a representative of the state.

To split non-executive directors into truly independent and grey ones, we check, based on quarterly and annual reports, if a director (a) has an ownership stake in the company exceeding 1%; (b) is a public servant; (c) has sat on the company's board for longer than seven years; (d) holds a managerial position in any of the company's affiliated firms; and (e) is affiliated with the managing organization (where relevant). A positive answer to any of these items implies that the director cannot be regarded as independent and should be classified as grey. Finally, in a few uncertain cases, we resort to additional sources such as leading business newspapers (in particular, *Kommersant* and *Vedomosti*) and the Internet.

Female and foreign directors

We rely on the approach adopted in [Garanina, Muravyev, 2021]. The gender of board members is not explicitly marked in our data sources. Therefore, we use a specific structure of Russian full names, which contain patronymics with gender-specific endings (typically “-vich” for men and “-vna” for women). For example, Aleksey (name) Anatolyevich (patronymic) Ivanov (surname) and Irina (name) Aleksandrovna (patronymic) Smirnova (surname). This feature enables us to run a simple machine code to identify male and female directors, as well as foreign directors. The presence of a patronymic name (in about 85% of cases) indicates a Russian national and

immediately identifies a director's gender. Where patronymics are not available, manual checks are used to infer nationality and gender, occasionally with the help of additional information retrieved from the Internet. A final manual check reveals that our gender variable hardly has any errors while the variable for foreigners may have a negligible measurement error due to some "false Russians" — nationals of Belarus and Ukraine (rare among the members of board of directors) who have patronymic names indistinguishable from Russian ones and therefore classified as Russians.

Foreign ownership

Foreign ownership is identified based on the names of shareholders and their addresses. In SKRIN database, the names and addresses of foreign shareholders are normally given in Latin letters, as compared to Cyrillic letters for national shareholders. Foreign legal entities also have specific abbreviations such as Ltd., GmbH, AS, AB, etc. For example, the largest shareholder of company Mechel (MTLR) in 2010 is "Dalewave Limited" registered at "Themistokli Dervi, 3, Julia House, P.C. 1066, Nicosia, Cyprus" — all this is written in Latin letters. We take advantage of this feature of the data to screen foreign shareholders. We additionally check for country name in the addresses, which allows us to recover the country of origin for main shareholders. An interesting fact that emerges from this exercise is that most foreign shareholders are legal entities registered in Cyprus (e.g., among the largest shareholders, 81.3% are Russian legal and physical persons, 10.2% are shareholders with addresses in Cyprus, 1.9% — in the US, 1.7% — in Sweden and 1.3% — in the Netherlands).

Direct vs. indirect government ownership

These are identified in several steps. First, we look for matches between government structures and agencies that can have ownership stakes in firms according to Russian law (e.g., the Ministry of State Property, the Russian Federal Property Fund, regional governments and their agencies) and the list of shareholders of the companies sampled. Adding up the stakes of these entities in a given firm produces a measure of direct government ownership. Second, we look for matches between the main state-controlled holdings such as RAO UES, Svyazinvest and Gazprom and the list of shareholders in the companies sampled. Any matches add to our measure of indirect government ownership. Finally, we check the remaining shareholders in the sampled companies for their connection with the state via other firms. A shareholder is considered state-related (and its stake in the firm is added to indirect government ownership) if government structures and agencies have at least 25% stake in it.

For all intermediate links between the state and the shareholders of the firms sampled, we keep the 25% threshold. However, the measure of indirect government ownership is based on the final link between the shareholder and the company. For example, if the state owns 45% of company A, company A owns 30% of company B, which in turn owns 49% of company C included in our sample, indirect government ownership in company C is estimated at the level of 49%.

Main regression results, the fixed-effects models

Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
<i>Non_exec_share</i>	0.087* (0.051)				0.049 (0.042)			0.049 (0.037)
<i>Independ_share</i>		0.177** (0.079)	0.105 (0.067)	0.063 (0.057)		0.167** (0.077)	0.062 (0.057)	
<i>Grey_share</i>		0.089* (0.045)	0.082* (0.046)	0.050 (0.041)		0.084** (0.041)	0.050 (0.036)	
<i>Two_tier_board</i>	0.008 (1.661)	-0.313 (1.544)	0.352 (1.616)	0.483 (1.670)	0.512 (1.678)	-0.134 (1.567)	0.363 (1.663)	0.390 (1.671)
<i>No_directors</i>		0.271 (0.563)	0.376 (0.527)	0.464 (0.427)	0.458 (0.432)	0.305 (0.525)	0.499 (0.422)	0.492 (0.427)
<i>Gender_share</i>			0.054 (0.064)	0.055 (0.063)	0.055 (0.063)		0.045 (0.061)	0.045 (0.061)
<i>Foreign_share</i>			0.149** (0.064)	0.124** (0.057)	0.128** (0.057)		0.122** (0.057)	0.127** (0.058)
<i>Audit_committee</i>			4.668*** (1.717)	3.548** (1.493)	3.596** (1.474)		3.485** (1.491)	3.529** (1.470)
<i>State_ownership</i>	-0.003 (0.029)							
<i>State_direct</i>		-0.098** (0.046)	-0.109** (0.046)	-0.102** (0.042)	-0.103** (0.042)			
<i>State_indirect</i>		0.016 (0.034)	0.019 (0.033)	0.019 (0.036)	0.019 (0.035)			
<i>Foreign_ownersh</i>				0.103* (0.062)	0.103* (0.061)			
<i>Largest_owner</i>						-0.022 (0.041)	0.008 (0.033)	0.008 (0.033)
<i>Second_largest</i>						0.136** (0.063)	0.121** (0.057)	0.121** (0.056)
<i>Dual_class_stock</i>				-2.438 (2.973)	-2.485 (3.014)		-0.842 (2.823)	-0.894 (2.857)
<i>Cross_listing</i>				7.958*** (2.569)	7.998*** (2.558)		8.132*** (2.509)	8.165*** (2.490)
<i>Big-4_auditor</i>				2.675* (1.558)	2.659* (1.565)		2.782* (1.521)	2.767* (1.530)
<i>Log(sales)</i>	3.068*** (0.550)	2.995*** (0.535)	2.728*** (0.534)	2.396*** (0.625)	2.399*** (0.625)	2.981*** (0.563)	2.381*** (0.642)	2.383*** (0.642)
<i>Leverage</i>	0.011 (0.035)	0.008 (0.035)	0.002 (0.035)	-0.002 (0.034)	-0.002 (0.034)	0.012 (0.036)	0.002 (0.035)	0.003 (0.035)
<i>ROA</i>	-0.062 (0.077)	-0.060 (0.078)	-0.066 (0.076)	-0.039 (0.071)	-0.038 (0.070)	-0.060 (0.075)	-0.038 (0.066)	-0.038 (0.066)
<i>Industry dummies</i>	subsumed in firm fixed effects							
<i>Time dummies</i>	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
<i>R2_overall</i>	0.306	0.371	0.452	0.574	0.570	0.370	0.554	0.550
No obs.	559	559	559	559	559	559	559	559

Notes: the dependent variable is the S&P transparency and disclosure score that ranges from 0 to 100; cluster-robust standard errors in parentheses; * — $p < 0.10$; ** — $p < 0.05$; *** — $p < 0.01$.