



HOW TO ADDRESS THE SUPPLY SIDE OF CORRUPTION THROUGH CORPORATE GOVERNANCE

A. Ikonnikov

Executive Director

Investor Protection Association, Russia

October 8-9, 2001

Corruption is hard to cure, but can be prevented

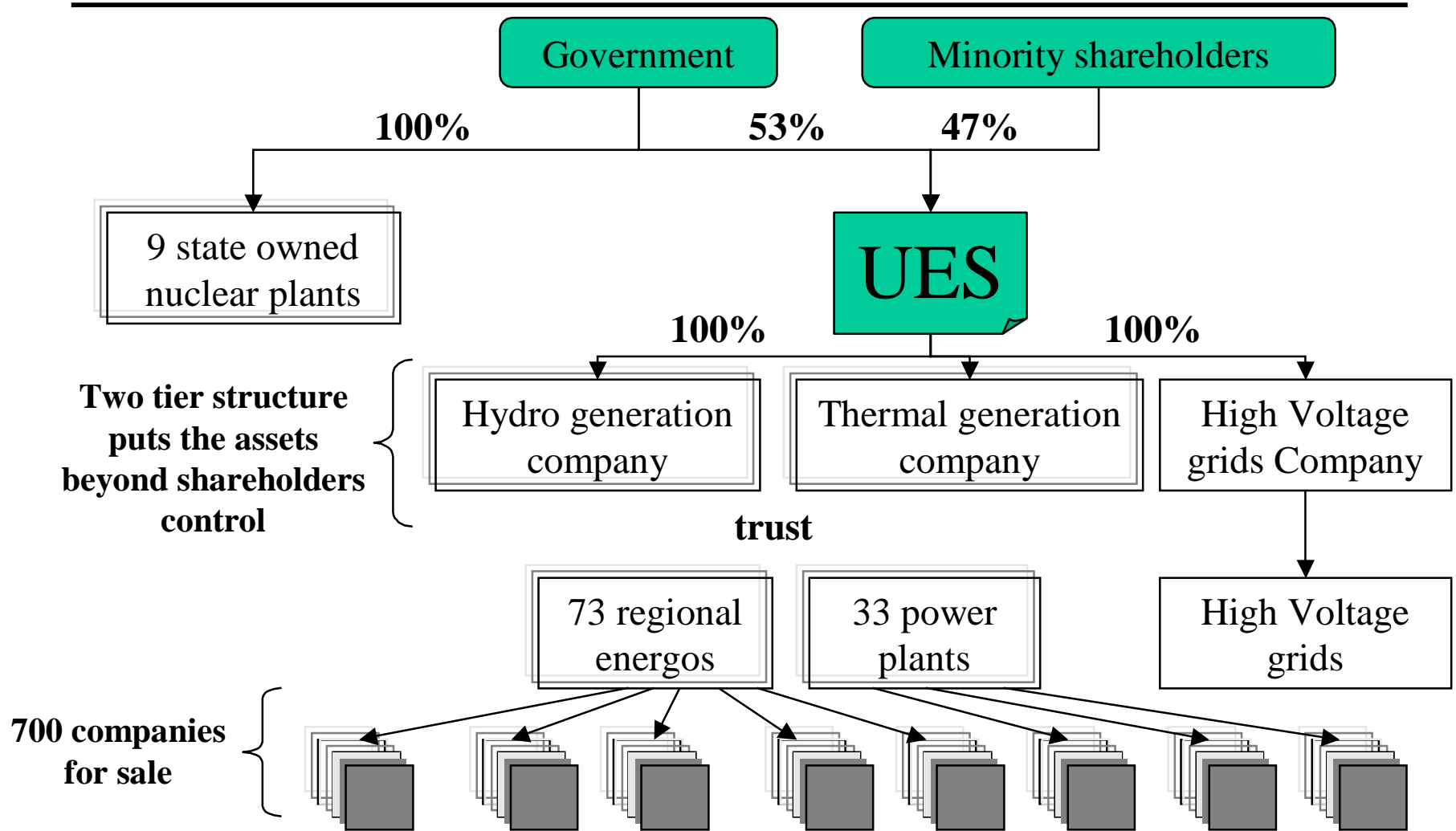
- It's not possible to eliminate corruption, but it can be deterred by good corporate governance, ensuring transparency of decisions making and effective shareholders control.
- Shareholders expect companies' managers to serve their best interests and to manage companies' resources properly on a daily basis.
- Management ethics and transparency are a prerequisite to public trust and a keystone of good corporate governance.

How corruption in emerging markets can be prevented by good corporate governance? (Case studies)

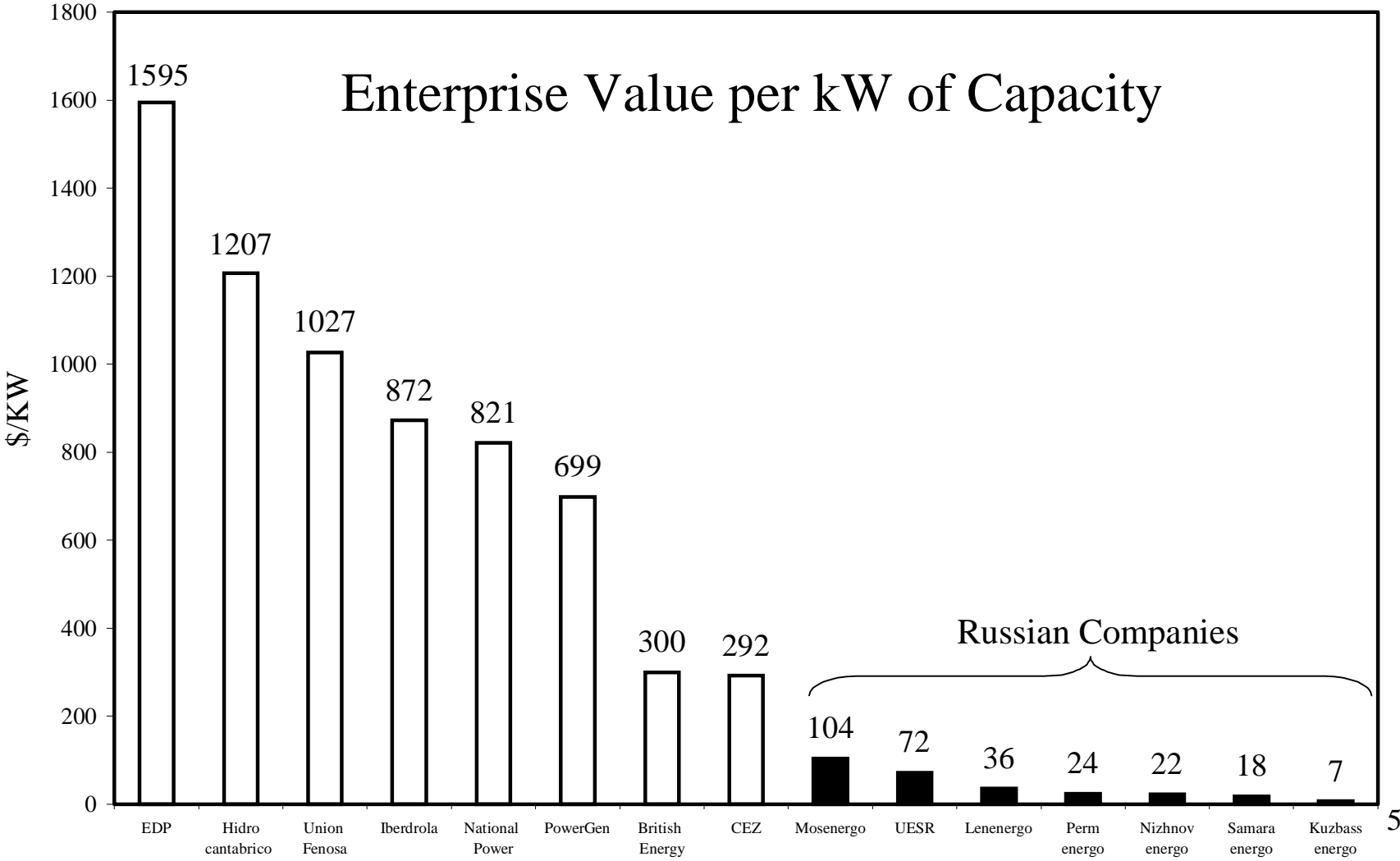
RAO UES Restructuring

- Management proposes complicated and non-transparent restructuring plan, developed without involvement of recognized outside experts.
- RAO UES complicated scheme puts the process of assets re-allocation beyond the control of shareholders and the Board.
- Failure to use civilized corporate procedures creates suspicion of corruption and assets stripping.

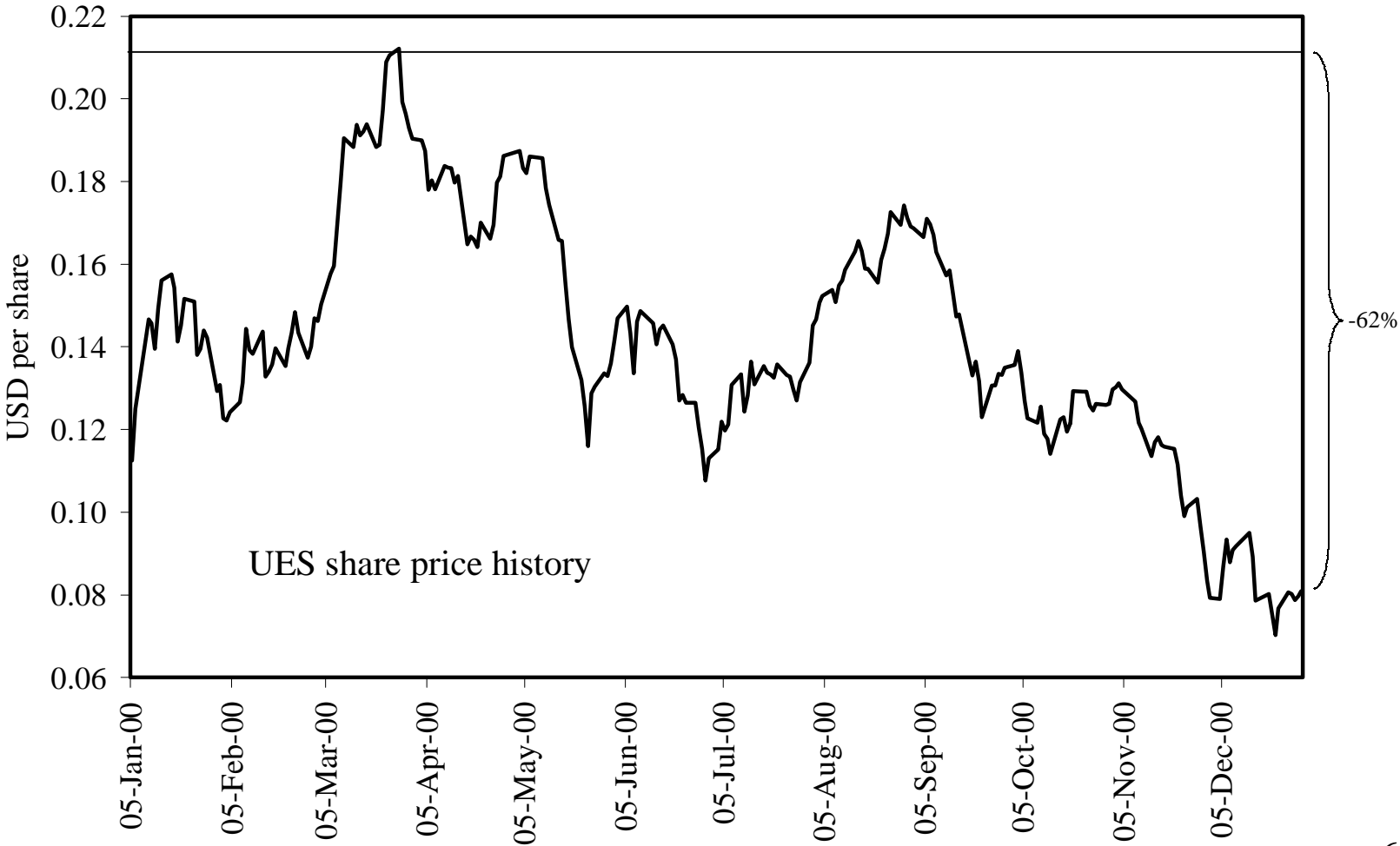
Example: Tiny generation, transmission and sales companies may have led to non-transparent deals with local industry and regional governments, corruption.



Any sales of assets were planned to be done at a very low price



Stock market has negatively reacted to the concept - the stock declined sharply



Preventing Potential Corruption

After active protests by UES Independent Directors and minority shareholders:

- Board of Directors banned all asset transactions until approval of the restructuring plan;
- President Putin announced a cancellation of the original restructuring plan and set up a commission including minority shareholders to devise new plan
- Government agreed negotiations with minority shareholders to change the Charter of the company to prevent asset sales.

Achieved success

- RAO UES hired international experts to devise the new restructuring plan and established the dialogue with shareholders
- The new Restructuring Plan, approved by the Government, is more transparent and provides much less room for corruption
- The Board of Directors plays a much more important role in restructuring. Asset sales are subject to its approval
- A Reforming Committee was created at RAO UES Board of Directors, chaired by an independent director

Conclusions: addressing corruption through corporate governance

- Board of Directors shall have more controlling powers over management
- Independent Directors prevent absolute concentration of corporate power, reducing potential corruption
- Use of outside independent expertise to evaluate management actions
- Maximum transparency of corporate actions for shareholders to prevent abuses and/or conflicts of interests

Conclusions: the market must take initiatives

- Introduce high ethical standards of corporate behavior
- Promote best practices of resolution of conflicts of interest
- Shareholders must exercise their rights

Disclaimer

The case study materials contained in this presentation are for information purposes only. The information is based on data obtained from publicly available sources, which have not been verified by the Investor Protection Association nor by any of its affiliates. We do not represent this information to be accurate or complete and therefore we do not accept any responsibility for the reasonableness of any conclusions based upon this information.