Guidance for Practical Corporate Governance: PhICS Model

Igor Belikov, Vladimir Verbitsky, and Ekaterina Nikitchanova

Abstract The international corporate governance best practices (CGBP) built up over the last decades present all-embracing set of recommendations covering all aspects of companies' corporate governance practices. Based on experience of publicly traded companies, CGBP recommendations are posed, in fact, as universal goal for all companies. Most of corporate governance rating, scoring and evaluation methods presume that the more CGBP recommendations are installed in a company the higher level of corporate governance practice it has. Lack of some components prescribed by CGBP recommendations or their more simple forms as compared with elaborated recommendations are considered as shortcomings to be corrected. In our view, PhICS model of corporate governance provides more effective and reasonable basis for improving corporate governance practices of most companies (primarily non-public). PhICS model is an evolving set of CGBP recommendations whose selection for a particular company is determined by key development factors whose specific combination usually stays relevant for this for the period of 3–5 years or even longer. These key development factors are: phase (stage) of corporate life cycle (Ph); predominant forms of investments (I) company primarily relies on; level of control the company's major owners want to have over the company, a leader style they exercise and their vision of company in their personal investment strategy (C); the company's strategy (S). Relevant model of corporate governance practice for a particular company (PhICS model) is a specific set of CGBP recommendations whose selection is determined by the above factors. Although PhICS model looks "imperfect" as compared to the "ideal corporate governance" model,

This article is based on years-long reflections of the authors as they studied how standards of corporate governance were being embedded in the Russian companies, and after they consulted with many large and midsized Russian companies about evaluation and synthesis of their corporate governance frameworks. It also relies on the authors' personal experience in the boards of Russian companies

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in terms of the number of recommendations and degree of their elaboration, it provides more effective framework for successful and sustainable company development for a certain period of its; life cycle. Yet, it is important for each company's owners to timely readjust specific parameters of its PhICS model to significant changes in key development factors. It is only at a very advanced stage of its development and life cycle the company's corporate governance model may take on many or even most of CGBP recommendations.

1 Introduction

Multinational organizations, financial institutions, professional associations, rating agencies, consulting firms and think tanks have over the past two decades drafted a set of recommendations about what companies should do to mitigate their risks related to violations of shareholder rights and to business failures due to decisions that had been taken by their governance and control bodies without due preparation and prudence. A wealth of these recommendations has not translated into statutory regulations but companies are urged to adopt them. Collectively, these recommendations are known as *corporate governance best practices (CGBP)*.

Indeed, the first systemic step in this direction was a report of a commission chaired by Adrian Cadbury, *Financial Aspects of Corporate Governance* (1992) that set recommendations about arrangement of company boards to ensure reliability of corporate financial reporting. This document was followed by many others that contained general recommendations as well as special-focus advice on various components of corporate governance practices, such as the composition of the board of directors, its procedures, criteria for treating board members as independent directors and their role in the boardroom, composition of the board committees, their authority and procedures, composition of financial and nonfinancial information that companies should disclose, independence criteria for the company's external auditor and many other recommendations.[1] Overall, descriptions of the existing CGBP recommendations take up thousands of pages, and their volume is increasing. One can be sure to foresee that the ongoing discussions of lessons learnt from the global financial crisis that began in 2008 will result in new recommendations about governance practices in companies and particularly in banks and financial institutions (one example is a 2,400-page Dodd-Frank Law on financial reforms that was passed in the USA in 2010).

[1] See, for example, OECD Principles of Corporate Governance. 2005; Report of the High-level Group of Company Law-Experts on a Modern Regulatory Framework for Company Law in Europe, 2002; Report of the High-level Group of Company Law-Experts on Issued Related to Takeover Bids, 2002; Combined Code on Corporate Governance 2003; Review of the role and effectiveness of non-executive directors. Derek Higgs, January 2003; Combined Code Guidance: report and proposed guidance by an FCR-appointed group chaired by Sir Robert Smith, 2003; Modernizing Company Law and Enhancing Corporate Governance in the European Union: a Plan to Move Forward, 2003;

A review of recommendations that were offered since CGBP was first introduced highlights several important problems that are worthy of discussion, in our view.

The development of corporate governance best practices in a company is typically understood as a linear and continuously bottom-up process of introducing the largest possible number of CGBP components (such as bodies, policies and procedures). The more components are in place and the larger their scope, the higher is evaluation of a company's governance practices by experts of various entities (multilateral organizations, financial companies, rating agencies, etc.).

The absence of any given component in a company's governance practice is explicitly treated as a weakness – as is the existence of this component in a simpler form than what is advised by extensive and detailed recommendations that have been drafted by experts and are in place in large public companies with heavily dispersed ownership (these recommendations were the basis for building an "ideal model" of corporate governance). Thus, it turns out that an ideal company in terms of proper governance is a company which has all components of international best practices, and each of these components has been introduced to the highest possible extent. This is not an official standpoint but this conclusion would be logically suggested if we look at the general focus of OECD recommendations or carefully read analytical reports and studies, as well as rating agencies' reports about levels of corporate governance in companies. Indeed, the highest corporate governance rating means the highest consistency with the corporate model of a certain "ideal" company. This ideal model effectively applies to any company regardless of the stage of its development and specific features of its ownership. In our view, one example of such approach was Standard & Poor's Corporate Governance Scoring that had been assigned from late 1990s until late 2000s to companies from Russia and some other emerging markets. It used a scale where "1" was the lowest level and "10" was the highest or, in fact, corresponded to the "ideal model."[2]

All academic and practical publications on corporate governance practices in Russia, appeared since mid-1990s, have been entirely focused on such issues as importance of corporate governance, impact of corporate governance on companies' market capitalization/valuation and correlation between corporate governance and market capitalization/valuation, protection of minority investors rights and forms of violation of their rights, various aspects of corporate governance regulations under the Russian law and Russian best corporate governance recommendations (Code of Corporate Governance).[3] We have failed to find publications

[2] See: Standard and Poor's Corporate Governance Scores. Criteria, Methodology and Definitions. July 2002; Standard and Poor's Governance Services Launches New GAMMA Score. Press release, April 2008; Marathon takes crown in Energy Intelligence Governance survey. – International Oil Daily. January 15 2004; Jane Kim. Free web-link offers corporate-governance scores. – Wall Street Journal. May 10, 2005

[3] See, for instance: Andrei Vernikov. Does corporate governance really predict firms' market values in emerging markets? The case of Russian banks. – SSRN Working Papers Series, No

dedicated to analysis of how CGBP recommendations should be applied to Russian companies, which factors determine and succession, scope the pace of this process.

We believe that the most adequate approach to the development of corporate government practices would be their evolution within a PhICS model of corporate governance. This model is based on a combination of components of corporate governance best practices (CGBP) that are consistent with objective needs of a company's successful progress. These objective needs, in turn, are determined by key development factors which are phase (stage) of corporate life cycle (Ph); predominant forms of investments (I) company primarily relies on; level of control the company's major owners want to have over the company, a leader style they exercise and their vision of company in their personal investment strategy (C); the company's strategy (S). These factors usually last for medium term (3–5 years) or even for a longer term (from 5 to 12–15 years). Sustainable and successful development of every company requires its specifically tailored PhICS model of corporate governance. We believe that PhICS model have may relevance for improving corporate governance in other emerging markets.

2 "Ideal model" of Corporate Governance

We cannot say that conventional CGBP approach pays no attention at all to the quality of implementing these components. There is understanding that this factor is important. But the quantitative approach to a set of components that constitute the best practices, and to their content in companies, obviously prevails. For example, one key indication of this abstract ideal is a board of directors where the majority (preferably all) members are independent regardless of such factors as the structure of the company's equity, the role of major founding shareholders in the governance process, their plans with respect to their role, share of minority shareholders in the company, time span of their interest, etc.

It should be noted that several recent publications challenge this "ideal model" which has been construed on the basis of CGBR recommendations. Martin Lipton, a well-known governance expert and a managing partner in Wachtell, Lipton, Rosen & Katz, writes, "A board need not, and should not, simply accede to every list of corporate governance "best practices" promulgated each year by governance

2274282. July 2013; Wei-Xuan Li, Clara Chia Sheng-Chen, Joseph J. French. The relationship between liquidity, corporate governance and firm valuation; evidence from Russia. – Emerging Markets Review 13 (2012);. Corporate Governance in Russia: An Investor Perspective. The Institute of International Finance, 2004; Entrepreneurial Ethics and Corporate Governance in Russia: Interviews with Western Executives Working in Russia. Expert Publication. Moscow 2004; Pajuste A. Do Good Governance Provisions Shelter Investors from Contagion? Evidence from the Russian Crisis. – Beyond Transition. October/November/December 2004, vo. 15, No 1; Guriev S. Lazareva O. Rachinsky A. Tsukhlo S. Corporate Governance in Russian Industry. Moscow 2003; Black B. The Corporate Governance Behavior and Market Valuation of Russian Firms. – Emerging Markets Review, 2001, vol. 2.

activists and proxy advisory firms. That said, a board should proactively consider how best to organize itself and its committees to meet the increasing demands and responsibilities being placed on the board."[4]

The question whether – and to what extent – the "ideal model" of corporate governance which has been build over the past two decades is universal and applicable to all companies (even non-listed ones), and to what extent it ensures effectiveness and viability of companies, deserves a thorough discussion in itself. But in this article we do not want to analyze the "ideal model" or corporate governance as the target for the development of governance practices for all companies. Our focus is on the process of introducing CGBP recommendations. This process is long and its nature is evolutionary, which makes it very important for ensuring steady and successful development of companies.

In our view, regardless of the type of this "ideal model" which real companies should seek to achieve, the approach stating that the "ideal model" of corporate governance framework should be the ultimate goal for companies (without very close attention to the *process* of putting governance standards in place) does underestimate very important qualitative differences in fundamental characteristics of companies and their operational environment. An approach to the development of a company's governance practices which is based on a simple direct comparison with the "ideal model" precludes a correct assessment of the existing governance practices in real companies and their consistency with a company's specific features. Its recommendations inadequately reflect the companies' objectives, give inadequate targets for improvement of their actual governance practices and do not factor in the evolutionary nature of implementation of governance standards.

3 PhICS Model of Corporate Governance

In our view, it would be more appropriate to use an approach based on a "*PhICS model of corporate governance*" for evaluation and development of governance practices in companies and for drafting recommendations on how to improve these practices.

A PhICS model of corporate governance (M cg) is a set of components of international corporate governance best practices (CGBP). The scope of this set is sufficiently consistent with objective medium-term needs of successful development of a given company that are driven by the key development factors.[5] In our view, a company's key development factors (KDF) include:

[4] Martin Lipton. Some thoughts for board of directors in 2013. http://blogs.law.harvard.edu/corpgov/2012/12/31/some-thoughts-for-boards-of-directors-in-2013/

[5] We assume that all companies unconditionally comply with all corporate governance requirements that are described in applicable laws and regulations.

- The stage/phase of the company's development (life cycle) – **Ph** (phase);
- Forms of financing the company's development – **I –** (investments);
- The required level of control by its major owners and the company's role in their investment interests, as well as their management/leadership style – **C** (control);
- Development strategy – **S** (strategy).

With a certain degree of conventionality this functional dependence can be described by the following equation (we assume that this equation describes qualitative dependence):

$$_{\mathbf{cg}} = f(\mathbf{Ph}, \mathbf{I}, \mathbf{C}, \mathbf{S})$$

Let us now take a quick look on how these factors affect governance practices in a company.

Stage/phase in a company's development ***(Ph).*** A generally accepted theory states that owners are at the same time top managers of a company just at earlier stages of its development. However, even in the developed economies there are many decades-old companies where the controlling shareholder is the top executive. This model is typical for most companies in the emerging markets – not only for private businesses but also for companies where some shares have domestic and global listings. This is particularly common for Russia. Every leading non-state Russian company (including those with domestic or global listings) de facto has the controlling shareholder or a small group of closely-related shareholders that effectively control the company. There is not a single Russian company where ownership is dispersed to such an extent that the controlling shareholder has disappeared, i.e. was "diluted." In November 2011, 57 % of 150 leading Russian companies had the controlling shareholder who is also the CEO, and in 43 % of companies he was chairman of the board with a high level of involvement in management.

A key recommendation of OECD is for the board (with a majority of seats held by independent directors) to exercise actual full-fledged oversight over the company's operations, particularly in such aspects as approval of strategy and evaluation of its outcomes. The board should also have a decisive impact on how internal control framework is built and operates. But in this environment these recommendations are scarcely feasible, to put it mildly. The controlling shareholders are heavily involved in management, and this encourages most of them to treat their boards as advisory, expertise-offering or negotiating bodies but not as overseeing bodies. No less important is the fact that nomination and election of most candidates to the board depend on the controlling shareholders in companies with high ownership concentration. The controlling shareholder can certainly nominate people who are not employed in the company or have business interests with it. But even in this case such board members clearly understand that their membership and reelection fully depend on the majority shareholder's position and his evaluation of their behavior in the boardroom. And, as facts show, in many or even most cases this becomes the decisive factor for the board members' behavior and their position toward problems in corporate development. Interestingly enough, there is high concentration of equity among minority shareholders, too. This is why their votes most often do not elect the "classical" independent directors who are equally distanced from all shareholders. They elect employees of an investment company who are tacitly required to represent interests of the company and those minority shareholders that had backed them with their votes. The work of these board members differs from "classical canons" and is very often controversial. On the one hand, in many cases they raised the timely alert when managers tried to strip assets and made deals that were obviously related-party transactions but were not officially recognized as such and exposed companies to possible damages. On the other hand, they are often interested in substantial improvement of the company's short-term performance that directly affects the value of their shares, so that holders of large minority stakes could sell them at a high profit. Meanwhile, pushing up for such short-term gains might be at variance with the company's long-term interests and strategy. The position of these directors poses an objective risk that they will use insider information in the interests of investment companies that they represent in the first place.

Recommendations to elect external board members who might prospectively have a strong influence on the process of taking strategic decisions and control will be objectively feasible only if and when major owners gradually disinvolve themselves from management. In this situation majority owners have an *objective* economic need to use some CGBP components while maintaining control over the company and its key managers as they themselves change the form of participation in the management process. A change of stage in the company's life cycle (its "prime" as Adizes put it) leads to a more complicated management framework including a corporate governance system. This is an objective basis for delegation of authority within the management hierarchy, building of the board as a body of real strategic governance and control, and for bringing in members who are expected to provide highly independent judgments/assessments and ready to defend them. Evolution toward more mature stages ("stability," "aristocracy" and "bureaucracy") would objectively require a more accomplished and complex system of corporate governance (including the necessary process and procedures of corporate governance as well as additional governance bodies, such as board committees, internal audit and risk management). Mismatch between the level of development and complexity of the corporate governance framework and the level of corporate maturity is in itself a major governance risk, says Adizes.[6]

Forms of financing the development of a company (investments) **(I)** make probably the strongest impact on its governance practices.

These forms might be arranged in the following order in terms of their impact:

- Self-financing by internally generated revenues;
- Project investment financing by banks;
- Private placements among private equity funds and other financial institutions;
- Financing via public debt (bonds);
- Financing via public equity (IPOs and subsequent share placements).

[6] Ichak K. Adizes. Corporate Life Cycles. Prentice Hall Press. 1990.

We would like to note that even when IPO is used as a form of financing (in this case a company must comply with the strongest requirements to governance practices) there are marked differences among listing rules that apply to governance practices, e.g., at LSE and NYSE, and among listing levels at one exchange (the main and alternative markets at LSE; "old" and "new" markets at São Paulo Stock Exchange; A1, A2, and B at MICEX). These differences might obviously be the basis for a company to develop its governance practices in a stage-by-stage way and match each stage with the requirements to these practices in the listing rules of a given exchange. While doing so, the company should measure costs and gains of entering the equity markets through a particular exchange and one or other of its listings.

Another factor that objectively makes a substantial impact on a company's needs in terms of its governance framework is the *required level of control over companies by their major owners (controlling shareholders), role of companies in their investment interests, and their management/leadership style* **(C).** This factor plays a particularly important role in companies with highly concentrated ownership; most Russian companies fall in this group, as do most companies on the emerging markets. Clearly, different plans of majority owners with respect to the level of control over a company, and differences in their leadership styles make a substantial impact on how governance frameworks are built in companies.

We can see at least two types of models that major shareholders use to control a company, a "hard" model and a "soft" one. The "hard" model means that a company is controlled by one owner or a small group of very closely related owners; the company is the major business, a "darling child" for all of them, and they believe it necessary to be actively involved in taking all important decisions. In terms of managerial/leadership style, this model is used by the controlling owners of charismatic (R. House) or entrepreneurial and production (I. Adizes) nature. The "soft" model means that a company is controlled by a group of owners that have a more or less equal standing and equal rights. The company is not the main business for all (or most) of them. It is administered by hired managers on the basis of a compromise between its main owners and through "involvement" of hired managers in corporate governance and award to them of a minority stake in the existing or planned business. In terms of the managerial/leadership style, this model is used by the controlling owners of transforming (J. Burns) or integrator (I. Adizes) nature.[7] Obviously, differences in these approaches to the model which is used for managing the company as a whole and in the views on the company's role in the business strategy of its owners are an objective basis for differences in how they build a corporate governance framework, stages of its development, and in how quickly the company will move from one stage to the next.

[7] see, Adizes I. Leading the leaders. Adizes 2004a; Adizes I. Management/mismanagement styles. Adizes 2004b; Burns J. Leadership. 1975.

Development strategy (S) is extremely important for understanding a company's basic needs in terms of its governance practices. Companies can always implement one of several strategic scenarios. Accordingly, there is a set of governance practices for each scenario – they give the best effect for development and differ from practices that correspond to other strategic scenarios. For example, the choice between selling a company and its further development as an autonomous entity (at least in the medium term) will be decisive for medium-sized companies in terms of their strategies. Clearly, the content and scope of work related to implementation of corporate governance practices in any given company will vary greatly, depending on which of these two strategic choices will be made by its major owners.

Sale of the company implies that it will be fairly quickly "equipped" in conformity with corporate governance standards that are tailored to a particular buyer in line with his preferences. Buyers (new owners) might vary greatly even due to their nature, i.e. whether the buyer is a strategic investor in the form of a public or private company, private equity fund, individual financial investor, etc.

Retention of control over the company by its existing owners will be the basis for a rather long and stage-by-stage evolution of corporate governance that would be owner-tailored.

A company's governance practices are influenced by such a strategic aspect as acquisition of businesses in the form of public companies in countries with different (usually better) practices of corporate governance. In our view, one reason why some Russian companies made unsuccessful attempts to buy such businesses in Europe was underestimation of the need to improve their own governance. One can expect that an analysis of these lessons will urge the controlling owners of large Russian companies that cherish the plans to expand into Europe or North America to raise governance standards in their own companies. There is a risk, however, that they will put in place some formal attributes. Key in this case is what strategy will be the basis for new acquisitions abroad: whether the Russian buyer will turn into a true public company with no controlling stake; be a "quasi-public company" (with a controlling shareholder and some free float); or choose the strategy of a private company.

In terms of governance practices in a company with a sole shareholder who is largely disinvolved in management, there is an objective need to put in place more elements of the governance framework that are recommended by CGBP. But the toolkit of these components will be limited, and they will be "non-classical" in terms of consistency with the CGBP requirements. In particular, the focus of such owner on the medium-term development of the company as an autonomous business requires looking for sound business ideas, competitive advantages and more sound managerial decisions. The owner might benefit from inviting a few external members to the board (but they may take a half the board seats, and certainly not all). Thanks to their competencies, experiences, expertise and clout these external members should be able to make a real tangible contribution to the development of the company in such aspects that are key for it (finance, marketing, strategic development, motivation, etc.). Furthermore, they should be motivated to defend their position (if their incentives are linked to the corporate performance). The more complicated and competitive a company's business is, the larger will be the objective gains from inviting such board members. We mean external board members, i.e. people who are not employed by the company, but not "independent members" that meet certain formal criteria of independence. In this situation the consistency with the independence criteria that are set in the global best practices does not make any sense. It is the ability to contribute to the development of the company that makes such members valuable for the company owner. The fact that they are dependent on the owner who can replace them at any time is of minor importance. The key factor in this case is their understanding of their value for the owner as a source of additional experience, view on the situation, and possibilities for corporate development. We believe it would be reasonable to invite professionals advising the company on its development strategy to sit on the board, so that they would implement this strategy "from inside" for a sufficiently long time.

Organization of the boardroom work which is based on the abovementioned changes in the key factors requires a more detailed and technical description of the board's authority. In particular, there is a need to outline issues that are the sole authority of the board. In the new conditions internal audit should report to the board instead of to CEO, and this is an objective need. At the same time the absence of board committees in such companies does not necessarily mean that governance practices are obviously weak. A small size of the board and a limited size of the company's business, as well as its relative simplicity, might make board committees unnecessary. CGBP recommendations about corporate information policy, information transparency and dividend policy look unreasonable for such companies. A high level of external information transparency does not give any advantages to mid-sized Russian businesses that focus on autonomous development in the medium term. Moreover, it is fraught with high risks. These risks are related to very poor legal protection of business in Russia and widespread raider takeovers. But there is also a risk of objective weakening of competitiveness if information is disclosed about intended new products, sources of inputs, parts and their prices, new orders, new customers, sales channels, unit costs, etc., which is typical for any markets. These risks should also be taken into account in evaluation of governance practices in such companies. What is important for the sole owner is not the formal independence of external auditor from the company but the auditor's qualification and understanding that his main customer is the owner who will decide how long the company will retain this auditor.

As the company moves to the sale stage, it should take certain relevant steps, e.g. make detailed financial and economic reports (not necessarily under IFRS in the Russian environment: good management reporting is far more important. Regular historical audits by an independent auditor are not particularly important either); conduct preliminary legal due diligence of the key managerial decisions that had been taken earlier (such as establishment of the company, issue of shares, changes among shareholders and executives); check whether the company legally owns its core assets, patents, trademarks, etc. The way of selling the business and the type of its buyer (strategic owner, private equity fund, or IPO) will certainly be

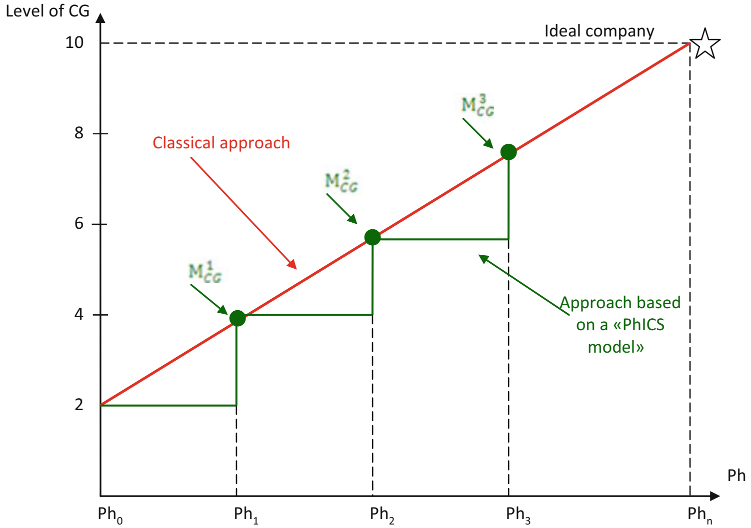


Fig. 1 The path of corporate governance development in companies

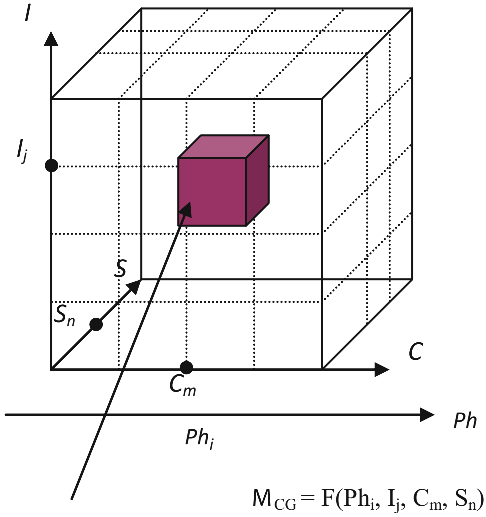
an important aspect of the further development of corporate governance in the company.

Thus, the path of an evolutionary progress of a company's governance practices in the process of shaping and furtherance of its PhICS model is not, in our view, a linear process where increasingly more features of an "ideal governance model" are put in place. It is a complicated path of moving within coordinates that are set by the factors described above. The focus of this movement is on the general effectiveness of a company's performance which is driven by the need to improve continuously. This process might be shown as follows in Fig. 1 (with a degree of conditionality).

In the above figure we showed the path of our proposed approach in the form of a step curve with inflection points (i.e. such points where the corporate governance model of a company changes fundamentally). M_{CG} are local PhICS models of a company's corporate governance that correspond to a certain set of the abovementioned variables of the key development factors.

We believe that a specific local PhICS model corresponds to each particular set of factors, and major changes in the set of CGBP recommendations are inappropriate from the economic standpoint within this model. Only a major change in one of the development factors can be an objective basis for substantial alterations in a company's governance practices, i.e. when a company effectively moves to a new local PhICS model. Therefore, we think it would not be constructive to criticize any given company for an "insufficiently high" current level of its corporate governance (for example, Level 4 corresponds to model M^1_{CG} on the rating scale) as compared to the highest possible level in the "ideal model" or to the governance level in another company (for example, a company with model M^3_{CG} that corresponds to Level 6). This would be the same as to criticize a Grade 3 pupil for not knowing

Fig. 2 PhICS model of corporate governance in a company



trigonometry (which he/she will study in Grade 9). Furthermore, we believe that a desire to achieve the absolute level of development for a company's corporate governance (grade "10" on the rating scale) would be contrary to the logic of development of companies that already have very definite sets of key development factors. This ambition will mean, at best, window-dressing for such companies. But this is exactly what often happens in companies globally, as was best demonstrated during the crisis of 2008.

In Fig. 2 we showed the full set of variants that are theoretically possible for local PhICS models of a company's corporate governance throughout its life cycle. We also showed the place of a particular local PhICS model with established variable values of its key development factors ($\mathbf{Ph_i, I_j, C_m, S_n}$).

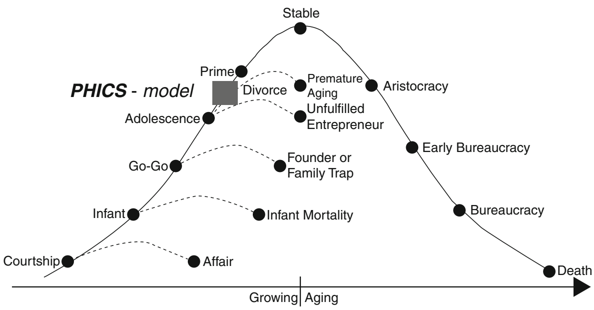
In theory, there are a certain number of possible local PhICS models of a company's corporate governance. This number is a product of the number of stages in a lifecycle of a company (i), number of forms of financing its development (j), number of levels of control/leadership styles (m) and the number of its possible development strategies (n). The actual PhICS model would be derived when we set the values of each variable factor of development (it is shown as a black cube in Fig. 2).

If the time axis of life-cycle stages is shown as a well-known Adizes curve, we will have a very nice and more illustrative picture, in our view (Fig. 3)

As a company moves along the curve, the cube sides will change along with changes in measurements of other development factors.

By way of summing up, we believe that the most adequate approach to the development of corporate government practices would be their evolution within a PhICS model of corporate governance. This model is based on a combination of components of corporate governance best practices (CGBP) that are consistent with objective needs of a company's successful progress. These objective needs, in turn,

Fig. 3 PhICS model of corporate governance on the Adizes Curve



are determined by the key development factors for medium term (3–5 years) or for a longer term (from 5 to 12–15 years). Sustainable and successful development of every company requires its specifically tailored PhICS model of corporate governance. On the other hand, models of companies where development is based on similar key factors might be very much alike.

The design and evolution of a PhICS model requires a systemic and comprehensive approach from its key participants – owners and managers. Besides, they should regularly evaluate the efficiency of the selected combination of governance components in the company in terms of successful development of its current and future business (which is not a simple synonym of growth and/or higher market capitalization), and make necessary adjustments.

A PhICS model has an economic meaning: a pre-selected set of components of international CGBP should be used to implement shareholder rights and interests. Its other objectives are to help achieve the targets of better sustainability and successful development of the company (not only in terms of a successful IPO); match costs with the development goals; and avoid excessive costs and risks. The following comparison will be appropriate in this case. It is important for all companies to make good management reporting, improve quality and timely delivery of information which executives receive about its performance, analyze this information regularly and use it in decision-making. But not all companies, regardless of their size and specifics of operations, need to buy and implement the most complicated, expensive and newest models of ERP systems, Business Intelligence and other management technologies for meeting this target. Such management products might be an unaffordable financial burden for many midsized companies operating in narrow niches, and complicate their management process instead of simplifying it. A more effective practice for them would be to collect and process management information in simpler forms. The use of more sophisticated management technologies would be more appropriate for them as their business expands in scope and complexity. An approach to the development of a company's governance practices on the basis of building and advancing its PhICS model reflects a principle which has been repeatedly confirmed by the general management practice: a simpler system with higher efficiency of each component would work better than a more complicated system with lower efficiency of every link.

In our view, the use of a PhICS model toolkit reflects such needs and trends as comprehensiveness in taking key management decisions; focus on internal resources and sources of efficiency; and individualization of development strategies that ensure success and sustainability. The tighter the company's competitive environment, the more obvious is the need for this approach.

4 Conclusion

Implementation of the best corporate governance in the Russian environment is a part of implementation of modern management methods in general. We will give just one example to make our point. Studies show that if the quality of management improves by one score (on a five-score scale) this will drive labor productivity up by 65 % and is equivalent to an increase of capital by 65 %.[8] Labor productivity in Russia is 4–6 times below the level of developed economies and slightly less so as compared to the leading emerging markets.[9] This is why implementation of efficient management technologies becomes the key point for the Russian economy in general and for every company. Accordingly, the improvement of corporate governance should be focused not just on better protection of minority shareholders but on achievement of higher corporate performance. "Higher investment attractiveness" and "protection of investor rights" will lack their fundamental basis if corporate governance and strategic management at large do not improve significantly. They will become extremely narrow concepts and turn into a promise of formal legal and additional procedural protection just from embezzlement with respect to a company's assets.

We believe that the use of "PhICS model of corporate governance" offers some advantages as compared to the traditional approach which is based on an "ideal model" of corporate governance. Firstly, it will make the company's governance development efforts a more focused and effective work. Secondly, it will make evaluations of governance practices by experts more meaningful and link them better with the companies' objective development challenges. The analytical and instrumental value of comparing the companies in terms of their respective governance practices and comparing them with a universal ideal model does increasingly resemble efforts to compare technical characteristics of a horse and a tank. Thirdly, the use of this concept will give better benchmarks to regulators in terms of what sets of requirements should be offered to different companies as far as their levels of corporate governance.

[8] Vedomosti. 16.02.2010.

[9] McKinsey. Effective Russia. April 2009.

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