The European Proceedings of
Social & Behavioural Sciences
EpSBS

Future Academy ISSN: 2357-1330

https://dx.doi.org/10.15405/epsbs.2019.03.112

GCPMED 2018
International Scientific Conference "Global Challenges and Prospects of the Modern Economic Development"

INFLUENCE OF CORPORATE GOVERNANCE ON FINANCIAL PERFORMANCE OF RUSSIAN STATE-OWNED COMPANIES

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Abstract

The relevance of the study is due to the great scientific and practical interest in the relationship of the quality of corporate governance and the financial result of the company. In this regard, this article is aimed at identifying or disclosing the relationship of the corporate governance system and the efficiency of the company. The leading approach to the study of this problem is to put forward hypotheses confirming the relationship between the quality of corporate governance and the financial results of the company. The article materials are of practical value for Russian companies with state participation. The number of researches on the topic of corporate governance has been increasing recently. Hence, the impact of the corporate governance on the company's performance show that interest in issues of management and assessment of sustainable development in Russian companies has been growing at a constant pace lately. The relevance of the study emphasized by the fact that, in the conditions of the economic space globalization, establishing the relationship between the quality of corporate governance and financial results of a state –owned companies. The topic is relevant for businesses seeking new approaches to ensuring their competitiveness. And corporate governance is a way to achieve this goal and to protect the interests of various stakeholder groups.

Keywords: Corporate governance, state-owned companies, corporate finance, board of directors, transparency.

https://dx.doi.org/10.15405/epsbs.2019.03.112
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Selection and peer-review under responsibility of the Organizing Committee of the conference
eISSN: 2357-1330

1. Introduction

The number of researches on the topic of corporate governance has been increasing recently. Hence, the impact of the corporate governance on the company's performance show that interest in issues of management and assessment of sustainable development in Russian companies has been growing at a constant pace lately. The growing importance of corporate governance in Russian state-owned companies testifies to the importance of this issue. The main idea consists of the need to improve the corporate governance system in state-owned companies which in turn affects its financial performances. The relevance of the study emphasized by the fact that, in the conditions of the economic space globalization, establishing the relationship between the quality of corporate governance and financial results of a state – owned companies.

2. Problem Statement

The topic is relevant for businesses seeking new approaches to ensuring their competitiveness. Corporate governance is a way to achieve this goal and to protect the interests of various stakeholder groups. Corporate governance serves as a shield for firms against future financial problems. It was argued repeatedly that corporate governance structure of any company influences its ability to react to changes in business environment and it may affect its financial performance.

3. Research Questions

Article outlines theoretical principles and approaches to establish the relationship between the quality of corporate governance and financial results of a state –owned companies. These findings also consider a practical use rather than purely theoretical, thus, could be applied to construct modern business processes. As the research outcome we have developed proposals, based on which it would be possible to create a comprehensive methodology for assessing and managing the value of a company, based on the principles of corporate governance in forecasting and implementing its activities.

4. Purpose of the Study

The goal is to establish the theoretical foundation for the development of a universal methodology for the construction of a balanced and harmonized company, in terms of, economic indicators and common values.

5. Research Methods

Corporate governance as a term is frequently used in order to describe how a firm is managed, monitored, and held accountable. The fundamental principles of a corporate world are to promote transparency and accountability and fulfil fair expectations of all stakeholders. Some authors argue that good corporate governance practices generate confidence in the company. On the other hand, companies with low level of corporate governance are not as profitable. It is pointed out that corporate governance also helps companies get access to financial recourses, decreases their cost of capital, improves their financial performance and generates goodwill from all stakeholders (Belyaeva, Kharchilava, & Kozlova, 2018)

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Russia is an emerging market with a lot of potential. And despite the current unstable situation in the country, it is possible that in the nearest future there will be more opportunities for investors, In this context corporate governance might become very important. At the same time, despite rapid development of corporate governance, it is true that companies in Russia are currently paying less attention to corporate governance than in more developed countries like Europe or USA. And while for some other countries the link between corporate governance and financial performance has already been established, for Russia it is not so straightforward. Government is a major shareholder in many Russian companies. Therefore, a certain problem might occur: SOEs (state-owned enterprises) in Russia could have less motivation to have high corporate governance standards (Belyaeva & Kharchilava, 2018)

For the purpose of this study it is important to define an SOE (or GLC – government linked company). According to OECD Guidelines on corporate Governance of State-Owned Enterprises, any "corporate entity in which the state exercises ownership, should be considered as an SOE" (including joint stock companies, limited liability companies and partnerships limited by shares). SOEs can be fully or partially owned by the government. High level of corporate governance of SOEs is crucial not only at the country but also at the international level. In many countries SOEs are among the main providers of vital public services, for instance public utilities. Russia is no exception. This emphasizes the fact that these companies influence peoples' everyday life and without any doubt the competitiveness of the country's economy (Belyaeva & Kharchilava, 2016). Moreover, SOEs are becoming increasingly eminent actors in the global arena. Here we have a problem. On the one hand there have been numerous studies showing that corporate governance is positively linked to financial performance. On the other hand, Russian Government as a major shareholder in Russian SOEs could pursue its interests at the cost of minority shareholders (Belyaeva, 2016). In other words, it might be that Russian SOEs do not need corporate governance. So, the research question of this paper is the following: Is there a relationship between corporate governance and financial performance for Russian state-owned companies? The novelty of this paper is in the focus on Russian state-owned companies, evaluation of their corporate governance practices, and use of 2014 and 2015 financial results. It will be especially interesting to see the results considering the state of the Russian economy with low oil prices, devaluated national currency and sanctions from the Western countries. Goal: analyse relationship between corporate governance and financial performance for Russian state-owned companies. In order to reach this goal several tasks will be performed (Kuznetsov, Fedorov, & Mikheev, 2015). During the research, the following methods were used: theoretical (analysis, synthesis, concretization, generalization, method of analogies, modelling); empirical (studying the experience of foreign stock exchanges, rating agencies, companies with state participation); methods of the theory and practice of corporate governance, methods for calculating the index of corporate governance (Barton & Wiseman, 2015).

- Review and analyse empirical and theoretical publications on:
- Corporate Governance in emerging countries and in Russia in particular Corporate governance in state owned companies.
- Relationship between corporate governance & financial performance.

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- Based on literature review and analysis state hypotheses that will be further tested Identify proxies for financial performance and corporate governance. Evaluate selected companies using the proxies.
- Subject: relationship between corporate governance and financial performance for Russian state-owned companies.

The rationale for state ownership of a company is different for every country and industry, it is usually driven by a set of factors: mostly economic, social and strategic interests of the country (e.g. the supply of public goods, regional development, industrial policy, "natural" monopolies). Despite the trend toward privatization over the past two decades, SOEs still play significant role in the economy. On the global scale they account for about 20% of investment, 5% of work force, and up to 40% of GDP in some countries. SOEs today are under strong pressure to improve their performance. SOEs are often dominant in sectors like infrastructure and utilities (e.g. energy, transportation, telecommunications, sometimes also hydrocarbons and finance) even in countries where they play only a small role in the economy (Aggarwal, 2013).

Over the last few decades SOE participation in international investment and trade has increased exponentially. While in the past SOEs were mostly just providing basic infrastructure or other public services within their home markets, now they are progressively becoming crucial players outside their home countries.

As a result, according to Guidelines high level of governance in SOEs is very important to guarantee their positive contribution to the economy and overall competitiveness.

6. Findings

Many SOEs now rank among the world's largest companies, investors, and capital market players. In many countries, SOEs in strategic industries are increasingly viewed as tools for accelerated development and global expansion. The performance of SOEs has improved in many cases due to greater competition, exposure to capital market discipline, and better governance practices. Yet many SOEs continue to underperform, with high economic, financial, and opportunity costs for the wider economy. According to World Bank a long history of efforts at reform shows that poor SOE performance is caused more often by fundamental problems in their governance than exogenous or sector-specific factors. One of the possible causes of corporate governance challenges can be the discrepancy of political interests of ownership (country government on behalf of the citizens) and control (directors and executives that manage the organization). These challenges can involve complex and sometimes contradictory rules, the absence of clearly identified owners, boards and management impacted by politics, lack of autonomy in day-to-day decision making, feeble financial reporting, transparency, performance monitoring and accountability systems. Where these problems are more prevalent, SOEs can also be a source of corruption (Kabir, 2017). While many problems related to corporate governance are common for all companies, some challenges are common for SOEs specifically. Table below summarizes some of the major issues. International and Russian Guidelines on corporate Governance OECD Guidelines on corporate Governance of State-Owned Enterprises (O'Kelley, Goodman, Martin, & Reynolds, 2017).

The Guidelines include:

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eISSN: 2357-1330

- State ownership rationale. The main goal of state ownership should be to maximize value for general society, through an efficient distribution of resources. Government should closely evaluate and disclose the goals that support the rationales for state ownership, as well as subject these to recurrent review.
- Role of the government as an owner. The country government as an owner should act in informed and active manner, ensuring that the corporate governance of SOEs is conducted in a transparent and accountable way, with a high degree of professionalism and effectiveness. The government should also give SOEs full operational autonomy in order to reach their defined objectives.
- State-owned enterprises in the marketplace. The legal and regulatory framework for SOEs should ensure a fair competition in the marketplace. A clear distinction between the government's ownership function and other functions are necessary, particularly regarding market regulation. High standards of transparency and disclosure concerning their cost and revenue structures should be sustained.
- Equitable treatment of shareholders and other investors. The state and SOEs should ensure that all shareholders are treated equally and fairly and have equal access to corporate information. In addition, it is highly recommended to follow National corporate governance codes.
- Stakeholder Relations and Responsible Business. SOEs should respect and maintain high standards of responsible business conduct. Company should report on stakeholder relations (regarding labour, creditors and affected communities). In addition, SOEs should not be used as a tool for financing political activities and should not make contributions to any political campaigns.
- Disclosure and transparency. SOE should maintain high standards of transparency and disclosure, as well as be subject to high quality accounting, compliance and auditing standards as listed companies (e.g. annual reports and financial statements should be subject to an independent external audit, reporting financial and non-financial information in line with internationally recognized standards of corporate disclosure).
- The responsibilities of the boards of SOEs. The boards of SOEs should have the necessary authority, expertise and objectivity to perform their duties of strategic guidance and monitoring of management. The boards should be assigned clear responsibilities for the company's performance and defined role. They should act with integrity and be held accountable for their actions.

The general finding of the authors based on 2327 firms was firms with better corporate governance are relatively more profitable, more valuable, and pay out more dividends to their shareholders. Except for sales growth, all of the identified financial performance measures have demonstrated a positive and significant relation with GovScore, which suggests that firms with relatively bad governance are relatively less profitable and less valuable, as well as pay-out less dividends to their shareholders. Firm performance measures were correlated with governance categories (6 financial performance measures with the 51 corporate governance factors). It was discovered that the executive and director

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compensation, is most highly associated with good performance while charter / bylaws, is least highly associated with good financial performance. As a result of correlation analysis, it was identified that there are 13 factors that are associated most often with good financial performance and 7 with bad (Kozhevina & Bataeva, 2017).

Authors perform a 2-step analysis: 1) Establishing the determinants of corporate governance 2) Analysing the link between level of corporate governance and financial performance of a firm. Authors acknowledge that corporate governance is likely to be endogenously determined. They highlight several groups of factors that have major impact on corporate governance both, on country level in general and on company level. Differences in law, as authors highlight, previous research focused on relationship between law and finance in context of corporate governance has established that the laws protecting investors differ significantly across countries, some of the reasons being the differences in legal origins (Belyaeva & Kharchilava, 2017). Differences in laws and their enforcement have an impact on ownership structure, dividend pay-out, access to and cost of external financing, as well as and market valuations of a company. How binding or flexible are the provisions (and companies' decision to accept or decline them) It is important to note that in the context of investor protection law in a country many provisions might not be binding. Therefore, companies have the flexibility to decline certain provisions or to accept additional ones, not listed in their legal code. For example, in order to improve investor protection a company could increase transparency and disclosure, select highly qualified and independent board of directors, impose disciplinary mechanisms to prevent management from expropriation of minority shareholders, etc. (Kharchilava, 2018).

Consequently, it is possible that firms in the same country have different levels of investor protection. Further authors investigate the relationship between corporate governance and financial performance of the firm. Methodology & data Country analysis scope: 374 firms from 14 emerging markets, including Turkey, Brazil, Indonesia, Chile, India, Pakistan, South Africa, Hong Kong, Singapore, Taiwan, Thailand, Malaysia, Philippines, South Korea (Kuznetsov, Tregubenko, & Soloviev, 2015). In order to establishing the determinants of corporate governance, authors used corporate governance ranking from Credit Lyonnais Securities Asia (CLSA) report, including ranking of 495 companies in 25 emerging markets and 18 industries. This ranking is a composite of 57 binary (yes/no) questions, covering 7 broad categories: management discipline, independence, responsibility, fairness, social awareness, transparency, accountability. The main governance index, used by the authors, is the sum of 6 categories (all except for social awareness). To analyse the connection between level of corporate governance and financial performance of a firm authors use ROA (as a measure of operating performance) and Tobin's Q (as a market valuation of the firm) together with the governance index established before (Tonysheva & Chumlyakova, 2014). Key findings Authors found out that higher level of corporate governance is associated with better operating performance and market valuation, i.e. better corporate governance is associated with better financial results of a company. It was also established that in countries with weak legal environments corporate governance provisions at firm-level matter more. These results suggest that firms can partially compensate for ineffective (Kuznetsov, Chubrik, & Tregubenko, 2016).

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The overall approach is the following: conduct a regression analysis to see if there is a relationship between corporate governance scores and financial performance variables. In order to do that several steps must be made:

- Gather data from secondary sources (annual reports, corporate websites, Moscow Exchange website, etc.)
- Analyse the state of corporate governance in the companies in the sample as of 2017
- Rate the corporate governance practices of the companies in the sample on 5 major categories of factors
- Calculate market cap of the companies in the sample as of 31/12/2015, 31/12/2016, and 31/12/2017
- Calculate market cap growth rates for the companies
- Calculate sales growth rates for the companies
- Calculate ROA for the companies
- Run regressions in order to test the hypotheses
- Interpret the results.

One way to use corporate governance scores would be to use the ones provided by a research agency, for example Russian Institute of Directors (rid.ru). They analyse corporate governance practices and rate Russian companies according to their methodology. But the problem with this approach is that Russian Institute of Directors and other agencies do not have the scores for all companies in our sample hence the decision was to not use corporate governance scores from 3rd parties (Mnatsakanyan & Kharin, 2016).

Another problem is that getting scores from those agencies would lead to a self-selection bias: the rated companies decide to get a corporate governance score from a research agency if they think their practice is good enough. In that case only companies with higher corporate governance practices would be analysed in this research which would lead to distorted results (Salewski & Zülch, 2014).

We expect to find a positive relationship between corporate governance and financial performance, i.e. better governed companies are more likely to get better financial results and market valuation. All hypotheses follow from the literature review. All data were obtained through secondary sources of information. The sample for the research consists of the companies included in the Moscow Exchange State Owned Companies Index (MOEX SCI). There are 16 companies from 6 sectors of activities in total in the sample: Transportation (4 companies), Oil & Gas (4 companies), Utilities (4 companies), Banking (2 companies), Metals & Mining (1 company), Telecom (1 company).

Aeroflot is the largest Russian airline. In 2015 26,1 million passengers have used this carrier. It is one of the oldest air companies in the world and was founded in 1923. In 2010 the Russian government made a decision to integrate Aeroflot with most of other state-owned air companies in the country. Aeroflot covers 51 countries all over the world and currently employs more than 30 thousand people. Since April 2006 the company has been a member of international alliance SkyTeam [www.aeroflot.ru].

Alrosa is a Russian group specialized in diamond mining. Company was founded in 1992. Alrosa is responsible for 95% of all diamonds mined in Russia and almost 25% worldwide. Estimated reserves of

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diamonds in company's possession is about 1/3 of the global ones. Currently Alrosa has 27 mining fields on territory of Russia and Central Africa and employs 40 thousand people [www.alrosa.ru].

Bashneft is a Russian vertically integrated oil company founded in 1946. Company is currently operation over 160 oil and gas fields allover Russia, 3 oil refineries and over 100 petrol stations. Company employs more than 25 thousand people. In addition to core oil and gas activities Bashneft is investing in technology development and research and is supporting a scientific center "BashNIPInef".

FGS UES (Federal Grid Company of Unified Energy System) is a Russian energy company, specialized in electricity transmission. Company is natural monopoly and is present in all regions in Russia, transmitting almost half of the entire energy consumed in the country. Company was founded in 2002 and currently employs 23,5 thousand people.

Gazprom is the largest Russian natural gas company. Company was founded in 1989 and currently employs 459,6 thousand people. It has an export monopoly and other companies are obliged to use its facilities for transportation. Gazprom has the largest reserves of natural gas – about 17% globally and 72% in Russia and exports gas to 30 countries [www.gazprom.com].

Inter RAO, one of the largest Russian energy companies, was founded in 1997 and currently employs almost 60 thousand people. Core business includes generation of power, electricity and heat as well as international energy trading. Company has a monopolistic right in Russia to export and import electricity and operates in 14 countries.

NCSP (Novorossiysk Commercial Sea Port) is the largest Russian sea port and 3rd largest commercial port in Europe. Company provides stevedoring services (loading/unloading of ships). Company was founded in 1957 and currently employs about 4 thousand people. The port is responsible for over 20% of cargo turnover in Russian sea ports and total annual turnover exceeds 130 million tons. Rosneft is one of the largest global oil and gas company. Company was founded in 1993 and currently employs 248,9 thousand people. Rosneft is also leading in oil refining in Russia and has 11 refining sites. Company is also very actively developing its retail network to increase sales to the end consumers.

Rosseti is the leading Russian power and distribution grid company. It was was founded in 2007 and currently employs about 220 thousand people. Rosseti is maintaining over 2,3 million km of power transmission lines [www.rosneft.ru].

Rostelecom is the largest network provider in Russia with more than 500 thousand km of network. Company was founded in 1993 and currently employs over 150 thousand people. Rostelecom is providing various services including TV, internet connection, and telephony in all regions of Russia.

RusHydro was founded in 2004 as a 100%-owned subsidiary of RAO UES of Russia. It operates branches, hydropower plants and subsidiaries. In twelve years of operation the Company has become one of the world's largest hydropower holdings and the Russian leader in renewable energy production [http://www.rushydro.ru/].

Sberbank's core business is banking operations: operations with corporate and retail customers, as well as operations on financial markets. Company is operating in 22 countries. Sberbank today accounts for one third of Russian banking system: it is the key lender to the Russian economy and the biggest receiver of deposits in Russia accounting for almost 45% of all retail deposits, 38% of retail loans and

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33% of corporate loans. Company has more than 130 million retail clients and over 1 million corporate clients. [sberbank.com/].

Tatneft is a vertically integrated and one of the biggest oil and gas companies in Russia. Company was founded in 1950 and currently employs more than 26 thousand people. Tatneft operates on 77 oil fields and has oil reserves exceeding 800 million tons of oil. In addition to oil and gas production, Company develops petroleum refining, the tire manufacturing, petrochemicals production and other activities [tatneft.ru].

Transneft is a Russian monopoly operating in the oil and gas transportation industry. Company was founded in 1993 and currently employs over 90 thousand people. Transneft operates more than 70 thousand kilometers of pipelines and more than 500 pump stations. Transneft is present in both domestic and foreign markets, including China, Hungary, Latvia, Poland, Uzbekistan, etc. [http://www.en.transneft.ru/].

United Aircraft Corporation was founded in 2006 and currently employs over 100 thousand people. Initial goal of founding this Company was to maintain and achieve further development of Russian aviation industry. Today UAC integrates about 30 companies from Russian aviation industry and has joint ventures with foreign partners based in Italy and India.

VTB Group is one of the leading Russian financial group. Company was founded in 1990 and currently employs over 96 thousand people. Company operates a wide retail network in Russia with more than 1,800 offices and is present in the world’s key financial markets. Currently VTB Group banks operate in 23 countries globally [http://www.vtb.com/].

7. Conclusion

The data for the study was obtained from secondary sources. Corporate governance and financial performance variables were constructed using the data from the companies’ annual and financial reports, their corporate websites, Moscow Exchange website and others.

Proxies for corporate governance. 5 aggregated categories of factors were selected as proxies for accessing corporate governance. Choice of these categories was based on both international and Russian Corporate Governance Code and empirical studies analysed in previous section.

7.1. Following guidelines & best practices (progressive practices)

Here we evaluated if a company is following internationally and locally accepted guidelines on corporate governance and if they are implementing any Progressive practices regarding corporate governance.

Rights of shareholders. This category includes evaluation of the rights of stakeholders and their protection. Includes rights to receive dividends and protection of this right, right for voting, etc.

7.2. Efficient Board of directors

We pay attention to independent directors as a proportion of the board of directors, board and their performance, as well as presence of committees and directors and officers liability insurance.

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7.3. Transparency

This category evaluates the level of information disclosure (e.g. annual financial statements, reporting financial and non-financial information etc.), transparent communication on executive compensation etc.

7.4. Efficient risk management and controlling system

In evaluation of this category were included factors like: auditing (quality of external auditor, internal audit system), risk management system etc. The scores were assigned based on how well the companies follow Russian Corporate Governance Code and OECD Guidelines. Each category had an equal weight in the overall assessment of corporate governance in a given company. A resulting total "score" for level of corporative governance is on a scale of 1 to 10, with 10 being the highest possible.

The highest score is 7,5 (Tatneft and Rosneft) while the lowest is 4. Transneft follows the absolute minimum that is required by law and exchange rules. The average score for the sample is 6 which indicates that corporate governance standards in Russian state-owned companies is slightly above average. The score can be explained by the Russian law and Exchange rules that are becoming stricter. In most cases scores are not the result of conscious effort to increase the standards of corporate governance by the state-owned companies, they merely follow the rules (Liuhto, 2015).

All companies are under Russian Federation control with Federal Agency for State Property Management (Rosimushchestvo) representing the Russian Government. In all companies, as Russian law orders, the Chairman of the Board of Directors is a representative of Russian government. All that increases the risk of Russian Government pressuring the companies in order to pursue its interests at the expense of minority shareholders.

The majority of the companies in the sample are characterized by lack of independent directors on the Boards of Directors, lack of evaluation of directors by a 3rd party, underdeveloped risk management system.

In this paper we tried to find if there is a relationship between corporate governance and financial performance in Russian state-owned companies. The results suggest that there is no relationship between corporate governance scores for 2014 and financial performance of 20142015 in our sample. One of the main reasons is the period used. Years 2014 and 2015 in Russia are associated with low oil prices, devaluated national currency, sanctions from the Western countries, high inflation. Overall, Russian economy is in a crisis. It could be possible that external events affected the companies in the sample so that we can't see the relationship between corporate governance and financial performance. There is, however, a positive relationship between corporate governance and companies' valuation: the higher the governance standards, the higher their Tobin's Q is, which supports other studies (Hugh & Mac, 2018).

The results might have been different for a bigger sample. Hence the future research could be conducted for a bigger sample with companies from different markets and the data for 5-10 years.

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