

**Corporate Governance of State-Owned Enterprises in
Uzbekistan**

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CONTENTS

| | |
|---|-----------|
| Acknowledgments | I |
| Abstract | V |
| 1. Introductory section | 2 |
| 1.1 Problem analysis | 5 |
| 1.1.1 Relevance of the research | 6 |
| 1.1.2 Rigors of the research | 7 |
| 1.1.3 Innovation of the research | 8 |
| 1.2 Research objectives and questions | 9 |
| 1.2.1 Dissertation objectives..... | 9 |
| 1.2.2 Research questions | 9 |
| 1.2.3 Research limits | 10 |
| 1.3 Definitions | 12 |
| 1.4 Overview of basic concepts and review of bibliography..... | 14 |
| 1.4.1 Theoretical framework of Corporate Governance and State ownership..... | 14 |
| 1.4.2 Previous contributions to the field and knowledge gap..... | 24 |
| 1.4.3 Research construct..... | 30 |
| 1.5 Research project design | 32 |
| 1.5.1 Procedures | 32 |
| 1.5.2 Methodology..... | 34 |
| 1.5.3 Survey design | 36 |
| 1.6 Dissertation structure | 38 |
| 1.7 Conclusion of introductory section | 39 |
| 2. General theoretical section | 41 |
| 2.1 Situational dimension: the overview of CG of SOEs in Uzbekistan | 41 |
| 2.1.1 External business context | 43 |
| 2.1.2 Internal business context..... | 52 |
| 2.1.3 Conclusion on Situational dimension | 72 |
| 2.2 Strategic dimension..... | 75 |
| 2.2.1 Targeted and diverse board team composition | 76 |

| | |
|--|------------|
| 2.2.2 Critical but constructive culture of trust | 80 |
| 2.2.3 Networked board structure | 81 |
| 2.2.4 Stakeholder – oriented Board success measures | 83 |
| 2.3 Integrated board management dimension | 90 |
| 2.3.1 Targeted selection of board members | 90 |
| 2.3.2 Targeted feedback for board members | 93 |
| 2.3.3 Targeted remuneration of board members | 95 |
| 2.3.4 Development of board members | 97 |
| 2.3.5 Integrated board – management committees | 100 |
| 2.4 Controlling dimension | 103 |
| 2.4.1 Auditing function of the board | 105 |
| 2.4.2 Risk Management function of the board | 107 |
| 2.4.3 Communication function of the board | 110 |
| 2.4.4 Board success | 113 |
| 2.5 Concluding Observations and Implications for Empirical Study | 116 |
| 3. General empirical section | 120 |
| 3.1 Empirical objectives | 120 |
| 3.2 Empirical sample of participants | 121 |
| 3.3 Research methodology | 122 |
| 3.3.1 Procedures | 122 |
| 3.3.2 Interviews | 122 |
| 3.4 Limits of empirical results | 123 |
| 3.5 Empirical results | 124 |
| 3.6 Conclusion on specific empirical section | 136 |
| 4. Concluding section | 140 |
| 4.1 Recommendations for further research and academic discussions | 141 |
| 4.2 Recommendations for business practice | 144 |
| 4.3 Recommendations for implementation of the efficient Public Governance | 147 |
| List of abbreviations | 150 |
| List of references | 151 |

| | |
|---|------------|
| List of figures and tables | 160 |
| Attachments | 162 |
| Attachment 1: Underlying CG legislation in Uzbekistan (selected main acts)..... | 162 |
| Attachment 2: Comparison of main theories in corporate governance..... | 168 |
| Attachment 3: Curriculum of experts | 171 |
| Attachment 4: Questionnaire for survey | 173 |
| Attachment 5: List of institutions dealing with matters related to SOE corporate governance in Uzbekistan..... | 175 |
| Attachment 6: A sample structure of Owner-Strategy | 183 |
| Attachment 7: A sample of requirements profile to strategic leadership level..... | 186 |
| Attachment 8: A sample compensation regulation of BoD members | 196 |

Abstract

This dissertation endeavours to explain the state of corporate governance of State-Owned Enterprises (SOEs) in Uzbekistan from the viewpoint of enhancing their administration structure.

Agency Theory is utilized to analyse corporate governance issues in the case of SOEs in Uzbekistan, consider the difficulties of identifying the ultimate principal at SOEs, and develop a view on relevant mechanisms for aligning the agent's interest with that of the principal. Additionally, other corporate governance theories are exploited to outline the shortcomings of agency theory, which are mainly attributed to its focus on shareholders and senior-level executives.

The author attempts to convince the reader of the topicality and importance of the problem (Why study?), then describes the main subject (What to study?), and finalizes the paper with the research strategy and methodology (How to study?).

This research reviews the practical and theoretical aspects of ownership research, presents empirical results on corporate governance practices of SOEs in Uzbekistan, and focuses on the determinants of their "good corporate governance".

The main conclusion is that the issue of corporate governance of SOEs has acquired an increased importance and attracts attention from both academic scholars and practitioners in Uzbekistan. Therefore, new insights and evidence in the governance of public enterprises and the role of the state are required, especially in the case of ongoing systemic transformations and reforms in Uzbekistan. New tools and techniques are presented as well, which contribute to the development of good governance practices. Accordingly, the "KISS-framework", provided by

Professor Martin Hilb, has been widely employed and the results have been tested and proven by experts in practice.

The final product of this dissertation is the proposition of the concept of corporate governance of SOEs in Uzbekistan and the analysis of barriers and obstacles for the implementation of this concept in practice. In particular, the New Corporate Governance approach (Hilb, 2008) is taken as a model to determine how well selected SOEs in Uzbekistan fit the corporate governance framework, which considers both shareholder- and stakeholder-value orientations. Explored in this research are the cases of corporate governance at Uzbekistan's largest state-owned companies in such industries as power supply, petrochemical, automotive, and others. They serve as typical examples of existing local practices in corporate governance.

This dissertation employs a qualitative approach, conducting a case study on corporate governance at selected SOEs to identify existing obstacles and flaws, identify areas that need improvement, and derive relevant practical proposals as they pertain to the existing legal framework.

This dissertation also discusses the contextual differences between foreign best practices with regards to the state's involvement in managing enterprises.

Key words: state-owned enterprises, corporate governance, Uzbekistan.

Zusammenfassung

Diese Dissertation ist bestrebt, den Zustand des Corporate Governance von staatlichen Unternehmen (SOEs) in Usbekistan unter dem Gesichtspunkt der Verbesserung ihrer Verwaltungsstruktur zu erklären.

Die Agency-Theorie wird verwendet, um die Fragen der Corporate Governance im Fall von Staatsunternehmen in Usbekistan zu erörtern, unter Berücksichtigung, dass es schwierig scheint den ultimativen Prinzipal der Staatsunternehmen zu bestimmen, sowie die weiteren Ideen vorzustellen, wie man die Interesse des Agenten mit der des Prinzipals auszurichten ist.

Der Autor versucht, den Leser von der Aktualität und Bedeutung des Problems (Warum zu studieren?) zu überzeugen, beschreibt dann das Hauptgegenstand der Arbeit (Was zu studieren?), und finalisiert der Arbeit mit der Vorstellung der Forschungsstrategie und Methodik (Wie zu studieren?).

Diese Studie untersucht die praktischen und theoretischen Aspekte der Eigentumsforschung, präsentiert die empirischen Ergebnisse zur Corporate Governance – Praxis der Staatsunternehmen in Usbekistan, sowie konzentriert sich auf die Determinanten ihrer „Good Corporate Governance“.

Die wichtigste Schlussfolgerung ist, dass die Frage der Corporate Governance von Staatsunternehmen eine erhöhte Bedeutung erlangt hat und somit zieht die Aufmerksamkeit von akademischen Wissenschaftlern und Praktikern in Usbekistan. Daher werden neue Erkenntnisse und Beweise in der Governance der öffentlichen Unternehmen und der Rolle des Staates verlangt, insbesondere im Fall der laufenden Staatssystemveränderungen und Reformen in Usbekistan.

In der Arbeit sind neue Methoden und Techniken gut präsentiert, die zur Weiterentwicklung von Good Governance beizutragen haben. Dementsprechend wurde der "KISS-Ansatz", vorgestellt von Professor Martin Hilb, der umfassend verwendet und die daraus resultierenden Ergebnisse getestet und von Experten in der Praxis bewährt wurden.

Das Endprodukt dieser Dissertation ist das vorgeschlagene Konzept zur Unternehmensführung der Staatsunternehmen in Usbekistan und eine detaillierte Analyse von Barrieren und Hindernisse für die Umsetzung dieses Konzeptes in der Praxis. Insbesondere wird der neue Corporate Governance-Ansatz (Hilb, 2008) als Modell verwendet, um festzustellen, inwieweit die ausgewählten Staatsunternehmen in Usbekistan den Corporate Governance Ansatz einpassen, der beide Stake, - und Shareholder Wertorientierung berücksichtigt. Es wurden hier die größten usbekischen Staatsunternehmen aus Energie, Petrochemie, Automotive und anderen Bereichen in Bezug auf deren Corporate Governance untersucht. Sie bringen die typischen Beispiele aus bestehender lokaler Praxis von Corporate Governance.

Diese Dissertation unternimmt eine qualitative Forschung, untersucht die konkrete Fälle bei ausgewählten Staatsunternehmen und identifiziert die bestehende Hindernisse und Versagen, sowie sind die Bereiche angeführt, wo weitgehende Verbesserungen erforderlich sind. Im letzten Abschnitt der Arbeit werden die konkrete Empfehlungen und Vorschläge aufgelistet.

Schlüsselwörter: state-owned enterprises, corporate governance, Uzbekistan.

Introductory section

1. Introductory section

The work performed in this dissertation was completed at a time when the economic world was still looking good; there were no signs of the upcoming tremendous changes that would occur after the subprime mortgage crisis in the USA, which in turn transformed into a worldwide financial and economic crisis and, according to some bleak scenarios, could turn into a socio-political crisis. Currently, we have witnessed concerted governmental efforts to prevent the continuation of the crisis: adoption of rescue plans, nationalization of big business players, and re-thinking the role of a state in the economy. The active role of the state presumes the importance and topicality of corporate governance (CG) in state-owned and state-controlled enterprises.

As noted by Schleifer (1998:134) and Shirley and Walsh (2001:3), while the subject of CG has rather recently drawn great attention from both the academic and business worlds, the topic of state versus private ownership is an enduring debate since the origination of economics as a science. In this regard, as shown in the drawing below, Professor M. Hilb (2008) has proposed an alternative approach called, “Non for profit organizations”, which means the organization is state-owned, but behaves as if privately owned:

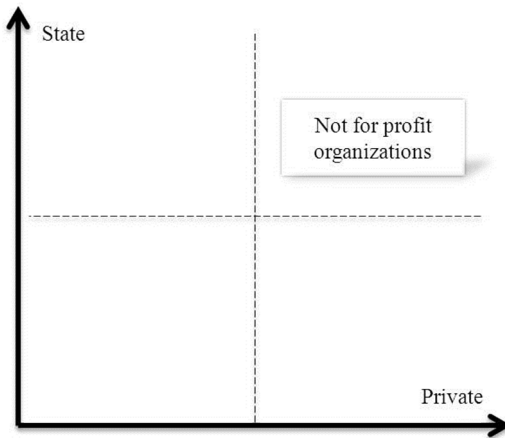


Figure 1: Alternative model for State companies

After the collapse of the Soviet centrally planned economic system, which was predominantly a state-owned national economy, a number of empirical studies were conducted to analyse the question, “*How does one build a market economy?*”¹ In the context of economic transition and reform endeavours, the CG of any type of enterprise develops into an important discussion.

State ownership still prevails in the Uzbek national economy, and considering that private ownership and market-oriented management practices were absent for a long period, there is an immense demand for knowledge and expertise when building efficient governance and management systems and practices. In particular, the relationship between politicians and professional managers of state-owned enterprises (SOEs) in Uzbekistan needs to be analysed more precisely, because the balance between the political influence and market-oriented management capability of SOEs has been disturbed since the initiation

¹ See for example J. Kornai (1990).

of reforms and as a consequence of dismantling the old “Soviet” type of governance and lack of practices.

The case of Uzbek SOEs has been chosen not only because of its unique historical, geographical, cultural, and socio-economic viewpoints; Uzbekistan is a crossroad between the Orient and Occident, located in the area called the “Heartland” surrounded by Russia, China, India, and Iran, existing between the Islamic, Christian, and Buddhist worlds. For 20 years it has faced the challenges of transforming its own state system from a strong, centralized, planned socialistic nation to a free market-oriented democratic nation. Although Uzbekistan is considered a very well-endowed country and possesses leading positions in exports of energy goods and commodities, the living standards of the population are relatively low. It was a challenge for many experts for a long time to find out why people in such a rich country cannot gain appropriate prosperity.

In this research, based on the KISS-model, presented by Hilb (2008:7), the following objectives are set:

- (1) to provide a comprehensive overview of the current status of the CG of SOEs in Uzbekistan;
- (2) to evaluate and formulate the concept for further development of CG of SOEs;
- (3) to test the concept of the THE KISS-model in Uzbekistan in practice and;
- (4) to present conclusions and recommendations for good governance of SOEs.

1.1 Problem analysis

As mentioned above, since 1991, Uzbekistan has faced challenges in rebuilding its economic system from a centrally-planned economy to a market economy. In this regard, Ruziev et al. (2007:8-10) considered the case of Uzbekistan as special, in terms of its unique historical features and currently existing conditions:

- Uzbekistan, as the political entity in its current geographical boundaries, was established in the 1920s;
- The entire state system evolved during the Soviet period, i.e. the national economic system was based on central planning and administrative command principles when communist ideology was widespread. All societal memory of private property and old feudal relationships of the colonial time of Russian tsars was brutally eliminated by the Communist regime;
- Industrialization and establishment of present-day corporations first occurred during the Soviet period. This process was guided by the exploitation policy and industrial needs of metropolises regarding commodities such as oil, natural gas, gold, and agricultural goods like cotton. Therefore, for over 70 years, the Uzbekistan national economy had experienced a one-sided development path;
- A centrally-planned system, coupled with communist ideology, resulted in state governance of industrial enterprises, i.e. management was integrated into the political system and, as part of a state machine, pursued planned economic goals;
- High dependence on resources from other republics and relatively fewer industrial interconnections were the starting point of economic reforms in Uzbekistan in the early 1990s.

Under such circumstances and conditions, an alternative governance system had to be adapted for both private and state-owned organizations in Uzbekistan. The problem was worsened by the fact that the main industrial giants in the commodity, energy, and construction sectors, along with big service providers in the telecommunication, postal, and transportation sectors, still remained in state hands and needed reformation without privatization, as was declared in the State Privatization Program for 2007-2010².

In line with the privatization process, the Uzbek government adopted a few legislative acts which generally regulate the corporate governance framework, as shown in Attachment 1.

According to the report of the Centre of Economic Research (CER, 2006), the main barrier for the future development of CG in Uzbekistan is the absence of “soft” legislation that should include practices and concrete recommendations.

1.1.1 Relevance of the research

From a *theoretical* standpoint, the research should contribute to:

- a) A better understanding of the reasons and motives for the existing CG framework of SOEs in the context of enduring socio-economic changes and system transition; in other words, it should resolve how the transition and these changes have led to contemporary governance practices in Uzbekistan.
- b) The theoretical explanation of the current challenges and barriers by introducing a “new” concept of CG of SOEs based on the KISS-Model.

² Resolution of the President of the Republic of Uzbekistan «On measures to further deepen the processes of privatization and active attraction of foreign investments in the years 2007-2010», adopted 20 July, 2007, #PP-672.

- c) The disclosure of the state ownership-specific features of CG, which should be considered in creation of the governance framework.

The research should be considered relevant for *practice* because:

- a) This is an insightful overview of the current state of CG, particularly with focus on the governance practices of SOEs in Uzbekistan.
- b) The research is oriented toward multiple stakeholders: politicians, government officials, executives, society, scholars, experts, and others.
- c) The proposed concept will include detailed governance practices and concrete recommendations. It needs to be first discussed and tested among experts in practice and then presented as a separate implication.
- d) The concept of CG of SOEs possesses a high degree of applicability in practice, and therefore can be revised due to changing circumstances and environment.

1.1.2 Rigors of the research

The research on CG requires quantitative facts and figures and qualitative information. The data are collected from statistical information, legal departments, and qualitative interviews with Uzbek state authorities, SOE representatives, and other experts. To add to the rigor of the research, both types of information were combined and integrated into one concept.

The concept of the “KISS-framework”, presented by Hilb (2008), was extensively used to identify and estimate the actual status (“Situational dimension”) and then develop the target status of CG of SOEs in Uzbekistan (“Strategic, Integrated and Keep it controlled dimensions”).

The involvement of interested parties and leading experts in the discussion and analysis of the proposed concept of CG of SOEs will help to identify weak points and enhance its practicality.

1.1.3 Innovation of the research

One of the major motives for performing this research was the provision of new insights of the governance practices in Uzbekistan and the presentation of empirically-tested evidence from the governance of state companies in transition economies. As mentioned above, the Uzbek government faces challenges in corporatization without privatization of big state companies. Under these circumstances, the outcome of the current research will help to enhance the governance thinking approach and consider, in theory, the findings of CG and best business experiences of other nations.

1.2 Research objectives and questions

In this section, the summary of the scope and objectives of the research project are presented:

- What are the objectives of the research?
- What questions should be answered?
- What are the boundaries of the intended study?

1.2.1 Dissertation objectives

The objective of the research is to observe the CG level of SOEs in Uzbekistan and to propose an approach for continuous review, assessment, identification of barriers and problems, and creation of action plans to overcome those obstacles. In the long term, this study should contribute to a better understanding of the essential importance of CG and, therefore, overall improvement of the CG and management practices in SOEs. In the medium and short term, the research aims to enable all types of interested parties to recognize and to develop their own governance framework. The users would start by assessing the situational context, in which their enterprises act toward more deep-rooted entrepreneurial dimensions.

Summing up, the research objective can be formulated as follows:

This thesis aims to study the development level of Corporate Governance of SOEs in Uzbekistan and to propose an approach for continuous review, evaluation, and identification of problem areas and formulation of the preventive actions to boost governance practices of SOEs in Uzbekistan.

1.2.2 Research questions

In order to achieve the research objective, the following combination of research questions needs to be answered:

RQ1: What are the situational dimensions of CG of SOEs in Uzbekistan?

- What type of model of CG has been adopted in Uzbekistan?
- What is the external business context: institutional, normative, economic, and socio-cultural environments?
- What is the internal business context: ownership, board configuration, organizational complexity, board key players, and board functions?

RQ2: How have CG practices evolved?

- Strategic dimension: board staff, structure, culture, and measures of success;
- Integrated management dimension: board member selection processes, board management review and feedback practices, remuneration, and board development processes;
- Controlling dimension: audit and risk management committee, auditing, risk management, communication and evaluation functions of the board.

RQ3: What is the targeted status of CG of SOEs and what obstacles should be overcome to accomplish the desired conditions of CG of SOEs in Uzbekistan?

RQ4: What measures should be undertaken and recommended for the future development of CG practices of SOEs in Uzbekistan?

- Definition and addressing the recommendations;
- Purposeful initiation of the governance reform program to implement the actions and follow up on the results for further transformation of CG of SOEs in Uzbekistan.

1.2.3 Research limits

The current research has its own limits as well:

- Research concentrates primarily on Uzbekistan, but the validity of the findings could be extended to countries with a similar situational context;
- This is a research on CG of state companies, hence, the proposed concept could be applied with various adjustments to other types of enterprises, such as family business, non-profit organizations, private companies, etc.;
- Success and effects of the proposed concept depend on whether it will be enforced on a continuous basis, otherwise it will be only a static snapshot of CG;
- Since the current research is explorative, it can be considered an invitation for future studies that focus on specific elements of governance in state companies.

1.3 Definitions

Before going deep into the details of the research, it is essential to acquire a common understanding of the expressions and abbreviations used. The purpose of giving definitions is to avoid confusion and misinterpretation, and enhance comprehension of the research logic.

| | |
|--------------------------------|---|
| Corporate Governance (CG) | <ul style="list-style-type: none">• “...is the system by which companies are directed and controlled.” (Cadbury, 2002).• “is a system by which companies are strategically directed, integratively managed and holistically controlled in an entrepreneurial and ethical way and in a manner appropriate to each particular context”(Hilb, 2008:9-10). |
| State-Owned Enterprises (SOEs) | Legal entities founded by a government to undertake commercial or business activities on behalf of a government owner. |
| Board of Directors (BoD) | “ is a group of individuals chosen by the stock holders of a company to promote their interests, or in the case of a not-for-profit corporation by its members, by the previous Board or through some other mechanism in its by-laws or by statute in the case of a public corporation.” (Webster’s Business dictionary). |
| Management | “... (from Old French <i>ménagement</i> “the art of conducting, directing”, from Latin <i>manu agere</i> “to lead by the hand”) characterizes the process of leading and directing all or part of an organization, often a business, through the |

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|------------------|--------|---|
| | | deployment and manipulation of resources (human, financial, material, intellectual or intangible). ...” |
| “Hard” law | | The body of binding and enforcing legal acts. |
| “Soft” law | | Quasi-legal instruments which do not have any legally binding force, or whose binding force is somewhat "weaker" than the binding force of traditional laws, often contrasted with soft law by "hard law". |
| Special act | | An act considered or performed upon by a legislature that helps a single individual, group of individuals, or corporate entity, by affording relief from another law, granting a unique benefit, or relieving the individual from legal responsibility for some allegedly wrongful act. |
| the framework | “KISS” | This definition was first introduced by Professor Martin Hilb in his seminal book “New Corporate Governance”. It is the new approach of CG based on the reversed principle of “Situational, Strategic, Integrated and Keep it controlled”. |

1.4 Overview of basic concepts and review of bibliography

In this section, the theoretical foundations of CG and state ownership are summarized and presented. The research works of scholars in the field of CG of SOEs and their empirical evidence will be shown and highlighted in relation to the current study. Within the analysis of previous contributions to the field, the knowledge gap and needs for the research will be defined and will be covered along with the current study of CG of SOEs in Uzbekistan. Based on existing theories and epistemological findings, the theoretical construct for the research on CG of SOEs in Uzbekistan is formulated in the last chapter.

1.4.1 Theoretical framework of Corporate Governance and State ownership

The pioneering work of Berle and Means (1932) and the essay of Coase “The Nature of the Firm”(1937) referred to a modern corporation and questioned the first classical assumption of a firm and attempted to address the reasons that business firms exist, their boundaries, and their internal organization. These works have contributed to a more rigorous understanding of the sources and nature of transaction costs and of the incentive properties of alternative types of economic organization. Following these works, extended contributions have been made in property rights theory (Alchian and Demsetz, 1972; and Grossman and Hart, 1986), the theory of incomplete contracts (O. Williamson (1975), agency theory (Jensen and Meckling, 1976), and transaction cost theory (O. Williamson (1985:16ff).

All these theories contributed to further development and broadening of the theory of the firm and helped establish distinct perspectives within modern economics of organization. The theory of the firm is the

departure point to explore the CG and ownership aspects of modern corporations.

General theories of corporate governance

The vast majority of theoretical and empirical work refers to the corporate governance systems of the United States or Japan, analysed from a U.S. perspective. Studies of corporate governance of Uzbekistan, especially analysed from a domestic perspective, are virtually non-existent.

Derived from review of prevalent studies, Wahl (2008 and 2009) highlighted the following key areas of CG issues:

- ownership research;
- ownership classification system;
- structure research;
- board of directors;
- shareholder activism;
- disclosure audit and internal controls;
- executive pay and the market for corporate control; and
- stakeholder involvement.

Most of the corporate issues are concerned with multilevel phenomena, yet most of the corresponding studies imply a single level of analysis. A micro- or macro-level approach alone generates partial perception at either level. Conversely, applying a multilevel method allows one to embrace the dimensions required to fully examine research questions.

To enrich the impact of management research, Hitt et al. (2007) outlined the following considerations: (1) apply multilevel designs to existing models; (2) consider bottom-up effects; (3) collaborate across

disciplines on multidisciplinary topics; and (4) address major real-world problems via multilevel approaches.

The Author's effort to analyse existing theories allowed him to come up with the comparative table (see Attachment 2).

Micro theories of corporate governance

The following theories contributed to the broad understanding of the fundamental aspects of governance and provided the logical framework for comprehending CG phenomena: agency theory, stewardship theory, and stakeholder theory.

Jensen and Meckling (1976) presented the model that integrates the theories of agency, property, and finance. They characterized the idea of agency costs, demonstrated its links to the "separation and control" issue, examined the essence of agency costs generated by the presence of debt and external equity, and showed who bears these costs and why.

Eisenhardt (1989:57-64) provided an exceptional review of agency theory, clearly demonstrated its contribution to organization theory, and developed testable propositions. In her paper, the author states that agency theory (a) deals well with outcome uncertainties and, explains backgrounds of incentives and risks in a corporation, and (b) offers an empirically rational perspective, especially if accompanied with complementary theories.

Fama and Jensen (1983) analysed the separation of "ownership" and "control" in corporations, where decision agents do not bear the wealth effects of their decisions. The authors discuss that separation of decision and risk-bearing functions survives in organizations partly because of the benefits of management specialization and risk bearing and also because of the effective common approach to control the implied agency problems. In particular, the contract structures of all these organizations

separate approval and monitoring from the initiation and implementation of the decisions.

Davis, Schoorman, and Donaldson (1997:20ff) postulated an alternative model of “homo economicus”. Based on sociological and psychological approaches of governance, they tested hypotheses of agency theory, such as those that portray a man as “individualistic, opportunistic, and self-serving”, and presented the stewardship theory that depicts the man as “collectivist, pro-organizational, and trustworthy”. In their research, these authors attempt to reconcile the differences between these assumptions, proposing a model based upon subordinate psychological attributes and the organization’s situational characteristics.

Blair’s (1995) book, “Ownership and Control: Rethinking Corporate Governance for the Twenty first Century”. serves as an effective guide for CG debates. The author has clearly outlined three broad views of ongoing CG-related debates: (1) how governance arrangements affect the performance of corporations; (2) the ability of governance arrangements to generate wealth; and (3) how CG rules should be reformed. Besides the in-depth analysis of the “finance model” and “market myopia”, a third view is developed – the “social wealth maximizing model”. Based on this new model, the author proposed a number of recommendations that would make CG institutions and practices more open for changes.

Clarke (1998:187) examined stakeholder theory and its potential for solving the issue of how to satisfy the competing claims of shareholders and other stakeholders. The author has presented the development path of stakeholder theory and the viewpoints of other scholars, and appealed for further investigation and research on the stakeholder concept.

National governance systems (NGS)

The main challenge in the corresponding research is to identify factors that affect and explicate the development of NGS. In this regard, the following theories have explanatory power: (1) law and finance theory, (2) political theory, (3) endowment theory, and (4) socio-cultural theory.

Notable contribution to *Law and Finance theory* was made by works of La Porta., Lopez-de-Silanes, Shleifer and Vishny (1998). These authors argue that law shall effectively protect investors from the expropriation attempts of managers and/or large shareholders. Legal frameworks of a number of NGS are analysed, primarily through the prisms of Anglo-Saxon Common law and Civil law traditions.

The political theory of NGS, as related by works of Roe (1990; 1996), states that politics dominate the decision-making process when forming the legal framework and financial system of the country, which comes in response to the interests of various political groups. Hence, in the past, political constraints influenced the development of corporate governance through establishing powerful financial institutions that have crucial effects on the discipline exercised by investors over management.

The endowment theory, described by Beck, Demirgüç-Kunt and Levine (2003), contends that countries that are not well-endowed should have difficulties in creating efficient institutions, particularly financial institutions. In a historical context, the creation of institutions was dependent on colonial policies: (1) implantation and (2) resource extraction strategies. The authors' findings indicate that *social and cultural variables*, such as religious practices, languages, customs, and traditions greatly affect the development of financial and legal institutions.

La Porta et al. (1998) studied the role of trust and social capital in relation to the efficiency of the legal system and financial development.

They concluded that the characteristics of social and cultural traditions (hierarchical organization of religion: Catholic, Orthodox, and Muslim) impacted the quality of institutions and the level of their development.

Hilb (2008) presented a new, holistic approach to corporate governance called New Corporate Governance, which is based on a reversed KISS principle: keep it Situational, keep it Strategic, keep it Integrated and keep it Controlled. Additionally, his approach attributes simultaneous value to shareholders, customers, employees, and society. Markedly, this new approach integrates CG components that the academic community has historically treated in isolation of each other.

Overall, Hilb's (2008) approach meets the crucial criteria of a "sound" model: simplicity, clarity, use of logical rationale, and realism, therefore it is applicable for practical projections. Thus, the "new corporate governance" offers confidence to investors, businesses, and other practitioners and reinstates the links between a company and those who hold future financial claims against that company.

Hilb et. al (2013) presented an excellent book on Public Corporate Governance. Authors have highlighted the main subject of Direction and Supervision in the public companies from the business, legal and political standpoints. This praxis oriented work offers to participants of Corporate Governance processes a wide spectrum of tools, samples and evidences.

In contrast, Filatachev et al. (2007:1ff) argued that dealing with various issues of CG deriving from asymmetric information and incomplete contracts requires public policy responses to mitigate market failures and ensure that companies progress on route to "good" CG.

The *Situational Dimension* (keep it situational) is based on institutional theory (Aoki, 2001:3), and the contingency theory of leadership (Fiedler 1996) and differentiates between external and internal contexts.

The *Strategic Dimension* (keep it strategic) draws from stewardship theory (Davis et. al., 1997) and role theory (Neuberger, 1987) and labels four pivotal elements of success in CG. The first prerequisite for a board operating in the milieu of constructive criticism and trust is the targeted selection of a best-fit and well-diversified board team; one that consists of persons acting as exemplars for both shareholders and stakeholders. Constructive criticism and trust shall be brought about by simple networked board structures and processes. All these factors together shall lead to efficacious development, implementation, and evaluation of board success measures, adding simultaneous value to shareholders and stakeholders.

The *Integrated Board Management Dimension* (keep it integrated) issues from resource dependency theory (Hillman et. al., 2000) and integrates the targeted recruitment, evaluation, remuneration, and development of members of the board and management. It states that, for large, publicly listed companies, it is important to have a designated committee which specifically deals not just with nomination and remuneration of board/management members but also cohesively addresses their evaluation and development.

The *Controlling Dimension* (keep it controlled) stems from agency theory (Jensen and Meckling 1976) and stakeholder theory (Freeman 1984). It reviews, in detail, such functions of the board as auditing, management of risks, conducting internal and external communications, and providing feedback.

State Ownership

The seminal work by Alchian (1965), “Some economics of property rights”, contributed to the ongoing debate on public versus private ownership. The main point of the author is that the innate feature of SOEs is their inefficiency compared to private firms – such a view has inspired intense debates on the pros and cons of state ownership. Shirley and Walsh (2001:4) have provided the sufficient literature survey of the current conditions of debates related to public ownership and summarized it in three approaches that researchers deal with:

- (1) Market competition, not property rights, is the determinant of enterprise performance. Scholars who studied in this direction argue that market competition creates incentives for better resource allocation and the lack of the former will lead to inefficient allocation and bad performance, regardless of ownership. Applying this argument to SOEs, Schleifer and Vishny (1994) hold that even in a fully competitive environment, SOEs will be inefficient due to the distorting interference of politicians primarily pursuing their political goals. However, Kay and Thompson (1986) debate that a blend of competition and such viable threats as takeover or bankruptcy, will promote the productive efficiency of SOEs.
- (2) State uses SOEs for purposes other than social welfare. Another stream of research on SOEs deals with the various objectives of state and government. Typically, two qualities of government behaviour and SOEs were mentioned: social-welfare-maximizing governments and self-interested governments. The former quality assumes that public ownership is the best solution for market failures and that the social benefits can offset economic costs. Nonetheless, it is hard to judge and quantify the costs and benefits of social goals (Hart, 1997 and Shirley and Walsh,

2001:16). Hart (1997) and Schleifer and Vishny (1994) argue that decision on public services is similar to a firm's decision to produce in-house or to buy on the market – similar to notion, introduced by Coase (1937). In terms of inefficient political market, bureaucrats behave like rational actors who maximize their own screen performance and therefore SOEs will be used to produce political benefits at the cost of SOEs operations. Schleifer and Vishny (1994) have itemized SOE inefficiencies, listing them as emerging from “politicization” of SOEs and the self-interested behaviour of politicians.

(3) Regardless of government goals, private firms will be more successful than SOEs in addressing CG issues. In this area of research, scholars have focused on efficiency problems based on studies of separation and control³. The differences in CG of private and public enterprises could be examined in the context of:

- monitoring by owners (Alchian, 1965);
- legal constraints (Schleifer and Vishny, 1997:739ff);
- takeovers (Coffee, 1986); and
- bankruptcy (Schleifer and Vishny, 1997:752-754 and Kornai, 1980).

From the viewpoint of agency theory, the essential contrast in CG of SOEs derives from its characteristic of having the state as the owner. Therefore, poor performance of many SOEs can be ascribed to the specific challenges they face in governance, as opposed to private firms⁴.

³ See for example Fama and Jensen (1983:8ff).

⁴ See for example Wong (2004:5ff).

This distinctive feature infers challenges that impede SOE governance reform; however, such reform is necessary to improve their poor performance in comparison to private firms in the same industry. It is worth noting that no government yet has been able to fully tackle the problems. That said, privatization is often seen as a solution; however, it rarely yields expected results, markedly when there is political resistance or SOE candidates for privatization are not attractive for investments due to a legacy of mismanagement. Thus, CG reform, in practice, remains a rational choice which helps make SOEs as profitable and efficient as their private counterparts in the same industry.

All companies, including the ones where the state holds shares, have an extensive network of corporate relations. Participants of corporate relations include entities associated with the company's business and have a direct impact on its activities and, to a certain extent, depend on them. It is primarily management of the company, shareholders, staff, suppliers, and consumers.

Every participant of corporate relations is the carrier of a certain interest. The content of these interests is determined by the place of the participant in the system of relations. The following aspects usually hold a central place in the corporate relations of a typical company:

- setting company objectives;
- accessing company information;
- distributing financial assets of a company; and
- acquiring decision-making rights.

In practice, the positions of the subjects of corporate relations on these issues are not always the same, which can lead to corporate conflicts, particularly between the interests of shareholders, management, and majority and minority shareholders. These conflicts hamper the

development of companies, distract resources and contribute to significant increases in costs.

The position of the state in the system of corporate relations is ambivalent. On the one hand, in relation to the company, the shares of which are owned by the state, it acts as a participant of external relations, as a regulator of national economy, and on the other hand as one of the owners of the capital and acts as a subject of corporate relations.

The experience of some developed countries (Sweden, Australia, New Zealand, Denmark and others) shows that the state has managed to become an effective owner, which provides a high level of CG. In this regard, some economists believe that productivity and the efficiency of large enterprises depend not so much on a form of property, but the form, level, and nature of management; management depends not on who is the owner of the enterprise, but rather on control rules, rational decisions, and ways and means of evaluating the effectiveness of the management system and its leaders. Establishing the responsibilities of owners and managers is equally important to the promotion of initiative.

1.4.2 Previous contributions to the field and knowledge gap

As noted by Schleifer and Vishny (1997:738ff), the literature on practices in international CG, in general, varies broadly from the analysis of the Anglo-Saxon and Continental models of CG in advanced economies to the research on CG developments in developing and transitional countries.

The privatization, corporatization, and reforms of public enterprises have encouraged several empirical studies and roundtable discussions on CG of SOEs among government officials and interested institutions. The first efforts to create a benchmarking tool and country assessment in CG

of SOEs were undertaken in 2002 by the Organization for Economic Co-operation and Development (OECD) Steering Group on Corporate Governance. As a result of close cooperation and consultancy between representatives from OECD member countries, the World Bank and the IMF, and various interested institutions, the first draft of a non-binding set of recommendations for CG of SOEs were presented to the public. After a number of useful and constructive comments and recommendations, the “OECD Guidelines on Corporate Governance of State-Owned Enterprises” were finally established in 2005.

As pointed out by Chang (2003), the issue of CG of government enterprises became increasingly relevant due to efforts to reform SOEs and privatize and liberalize economic systems.

Bozec et al. (2004:79ff) provided a comprehensive study of the effect of the reform of *Canadian* SOEs on the characteristics of boards and board committees. Results confirmed adjustments in board characteristics following two major events: commercialization and privatization. This study shed fresh light on the processes and practices of adjusting CG mechanisms of SOEs to new strategies and environments.

Detter (2006:7-8) presented a case study on CG of *Swedish* SOEs after the reforms of public companies. The author reviewed the experience and practices of the enterprise reform in Sweden and analysed the impact of this reform on the value of SOE portfolios in the local stock market between 1999 and 2001.

Whincop’s (2005) book, “Corporate Governance in Government Corporations”, made a significant contribution to the study of CG of SOEs. The author reviewed and synthesized the theoretical literature on corporate and public governance and, through the example of *Australia* and *New Zealand*, provided empirical evidence from government arrangements in governance of SOEs.

Schedler et al. (2007) presented the study on CG in *Switzerland*. The authors dealt with the question of management in state-participated enterprises; they analysed the two challenging aspects – the state as an ultimate assurer and the state as an owner.

Schedler et al. (2013) presented a book on Public Corporate Governance for practical applications. Authors have extensively covered a number of topics in the area of Public Governance (legal framework of Public Governance, outsource and transfer of specific functions of State, direction and supervision of public companies, the role of owner in the governance process, owner objectives and owner strategy, service level agreement/financing, function and objectives of strategic leadership level, etc.) verifying with in-depth theoretical explanation and offering real life practices, tools, samples and business-cases.

Mueller (2007) provided a report on CG of organizations and enterprises in the public sector of the *Principality of Liechtenstein*. The author analysed the status of organizations and enterprises acting in the public sector; examined the possibilities of the adaptation of international practices in CG of SOEs; and provided recommendations for further formation of a balanced relation between state responsibility as an owner and the necessity of abstention from political influence.

Mueller et al. (2014) presented and published the 4th edition of an extensive handbook on subject of “the Board of Directors”. This handbook is very helpful for the academics as well as the practitioners with topics of competencies, rights and legal responsibilities of Board of Directors presented in details. Along with in-depth analysis and explanations authors offer a number of samples, check-lists and practices which could be applied in a real business life.

An excess of research has been conducted in the last three decades in the area of corporatization, privatization, and reform of SOEs in

transitioning and developing countries. In the early 1990s, the issue of SOE became the central discussion point among academics and practitioners in countries that faced the challenge of transforming their economic systems, or, as pointed out by Kornai (1990), were seeking the recipes for transition from a centrally-planned socialist economy to a market economy. In his further works, Kornai (2000) noted that several reform strategies relating to ownership were proposed, from emphasizing the urgency of rapid “mass privatization” and the dramatic reduction of state ownership to a sophisticated, gradual reform path advancing the organic growth of economy.

McGee and Preobragenskaya (2004:6ff) addressed the question of how transition economies deal with CG issues and extra obstacles they have to overcome due to a lack of established financial institution infrastructure, examining case studies in CG from *Croatia, Hungary, and Russia*.

Radygin (2000:10ff) presented the results of research on CG of state-owned companies in *China*. This study offered a well-grounded analysis of the legal environment, types and specific features of state holdings, and existing instruments of state management and their effectiveness.

Black et al. (2000:5ff) presented the results of their study on privatization and CG in *Russia* and tried to explain why the rapid mass privatization of SOEs in Russia did not have the expected results and spectacularly failed. Their analytical explanation is connected to the development of CG in *Russia*.

The increasing role of *China* in the world economy and the success of China’s economic reforms attracted attention of many scholars. A number of research projects were undertaken in the area of state enterprises reform, corporatization and governance system of SOEs. Tenev et al. (2002:12-17) delivered a very comprehensive report on CG

and enterprise reform in *China*. They explored the evolution of governance mechanisms in China's state sector, development of CG in transformed small- and medium-sized enterprises, ownership and control, the role of stock markets and information disclosure, and building a modern governance system.

Aivazian et al. (2005:5ff) examined the reform program in *China* concerning SOEs – “corporatization without privatization”. They find that corporatization, which can be traced to reform of the internal governance structure, is an effective way of improving the performance of SOEs without massive privatization.

Berkman et al. (2007:32ff) addressed the question of how CG can be improved where the state is controlling block holders, and present the empirical results of their study from *China*. They examined changes in market values and accounting returns on a sample of publicly-traded Chinese firms around announcements of block-share transfers among government agencies, market-oriented SOEs, and private investors. The authors found that changes in market value and accounting returns are directly linked with functions of the incentives and managerial expertise of a new block holder, and therefore they concluded that CG can be improved in state-controlled companies by improving the incentives and managerial expertise of controlling block holders.

Tomasic et al. (2006:123ff) discussed some of the key corporate governance tensions that emerged from the corporatization of state-owned assets. They examined the attempt to apply private sector ideas to the corporatization of SOEs in *China* and *Australia*. The authors' testing changes brought about the adoption and introduction of guidelines and standards, such as the OECD Guidelines on the CG of SOEs.

Rabelo and Coutinho (2001) presented a report on CG in *Brazil*. They observed the development path of CG in Brazil, explored the problems

of long-term finance linked with CG, examined the impact of adequate CG on the efficiency of resource allocation in the economy, and analysed the privatization process and its predicted impact on further development of CG in Brazil.

Amann and Ferraz (2004:2ff) examined the impact of privatization on the ownership structure and the role of the state in the Brazilian steel industry. Their empirical findings suggest that the results of privatization are considerably more complex than expected and the state continues to play an active role, both as a lender and as an important indirect investor.

Based on the review of all of the above presented works on CG of SOEs, it can be concluded that the following gaps exist:

- (1) The research subject, “Corporate Governance of State Owned Enterprises”, has not been extensively explored among scholars and academics, compared to other types of ownership. In practice, the problems and questions regarding governance structure and system, balance of power in principal vs. agent/steward relationship, and board management remain open and need to be intensely analysed.
- (2) Except for the efforts of international organizations, there are no other insightful, complete research studies on CG of SOEs and the above-mentioned difficulties have not been theoretically explained in a structured and systemized manner;
- (3) The call for “corporatization” and “organic growth” without “privatization” of state enterprises in the context of enduring economic reforms requires suitable tools, techniques, and models for professional set-up of governance mechanisms and practices in Uzbekistan;

- (4) The message for state companies “to remain state owned, but behave as if private” is not empirically proven and needs to be reviewed among practitioners in the business world.

1.4.3 Research construct

In the following chapter, the theoretical approach of the intended research is presented and summarized.

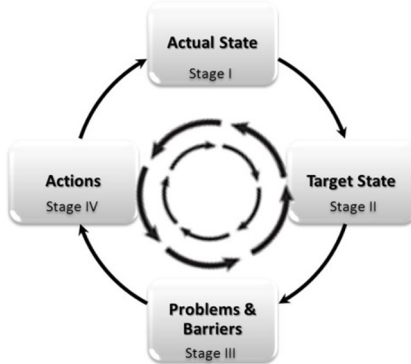


Figure 2: Research approach

This approach includes 4 stages and allows me to:

- Stage1 → Evaluate the current situation of CG development of SOEs in Uzbekistan;
- Stage2 → Define the target state and design the concept of CG of SOEs;
- Stage3 → Identify barriers and problems for achieving the concept in practice;
- Stage4 → Formulate measures to move towards the desired state of CG.

It should be mentioned here that the above-presented approach presumes the focus is on a circulated spiral movement, which will allow review and enhancement of CG on a permanent basis. The KISS-model will be

utilized to study the development level and define the target state of CG of SOEs in Uzbekistan.

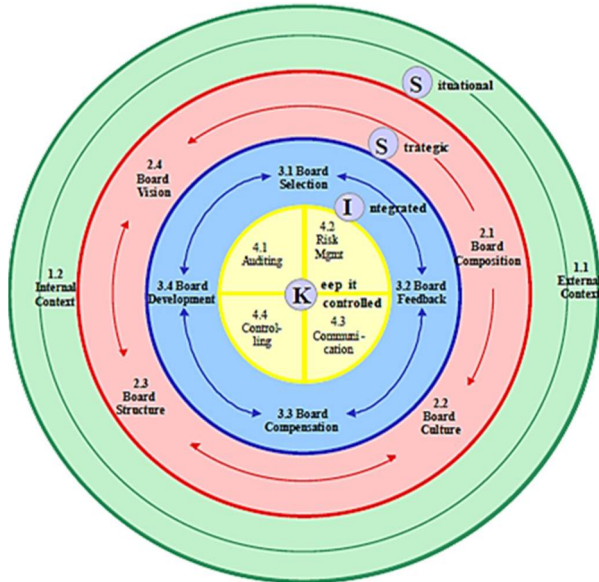


Figure 3: The KISS-Model

The study on situational dimension (external and internal business contexts) permits us to pre-define the strategic, integrated, and controlled dimensions of CG, leading to the specific concept of CG of SOEs in Uzbekistan. In the general empirical part of the dissertation, the developed “new” concept of CG of SOEs is addressed towards experts, practitioners, and all other interested parties. A number of qualitative interviews and discussions with experts help to enhance and discover the weak and strong sides of the concept. The second goal of the empirical work is to identify and qualify the existing problems and barriers to implementation of that concept in reality.

In the final general chapter of the dissertation, the actions and further steps for the development and renewal of CG of SOEs in Uzbekistan are formulated and recommendations are provided.

1.5 Research project design

The research procedures and methodology are described in this chapter. Procedures are divided into steps, which are built on the logical chain of actions and opportunity to cover the whole research scope.

1.5.1 Procedures

Procedures consist of the following steps:

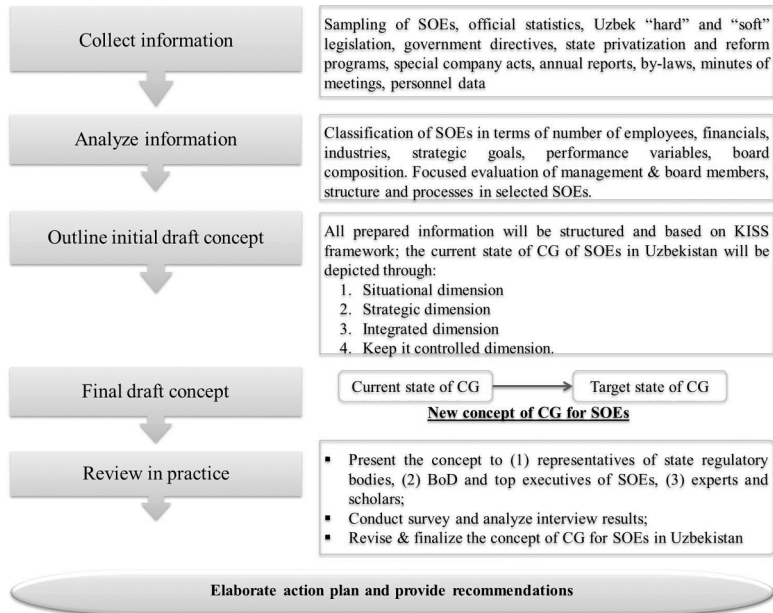


Figure 4: Research procedures

The criteria to choose respondents for qualitative interviews and experts' discussion are shown on the chart below.

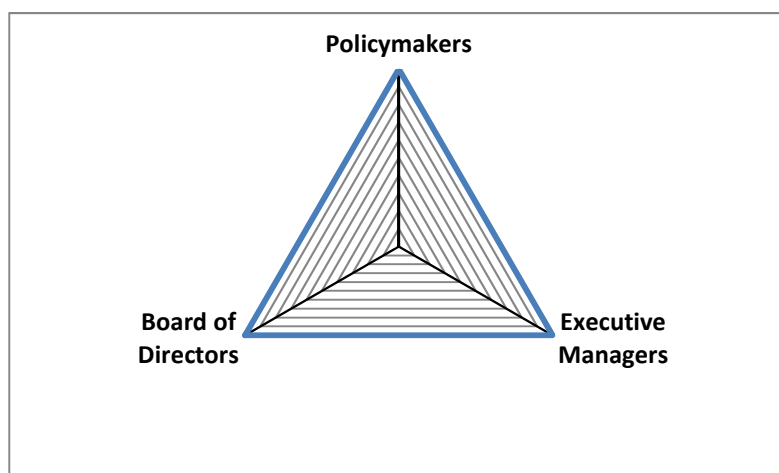


Figure 5: Criteria for choosing respondents

- **Policymakers:** Representatives of central and local government, parliament, research and education centers, professional associations, non-government regulatory institutions.
- **Board of Directors:** Representatives of state companies serving as members of the board, who are responsible for strategic direction and control.
- **Executive Managers:** Representatives of state companies responsible for the professional management of the company.

Such differentiation enhances the diversity of viewpoints and contributes to the precision of the research. The list of respondents (curriculum of experts) is shown in Attachment 3.

1.5.2 Methodology

The fieldwork is methodologically conducted in two steps: (1) preliminary short questionnaires and (2) qualitative interviews.

The purpose of the preliminary questionnaire is to initiate links with respondents, to introduce and awaken their interest in the research, and to screen their views regarding the central points of the concept. The questionnaire covers the points of board staff, management, and performance evaluation processes and practices in SOEs. Qualitative research is an iterative process in which data collection, data recording, intermediary data analysis, reflections, and generation of new questions are part of continuous efforts.

When the concept of CG for SOEs in Uzbekistan is completed and the first results of the brief survey collected, the next step, qualitative interviews with each expert, will be conducted.

Thus, adapting the Mayring (2001) approach, the interview cycle should encompass the following

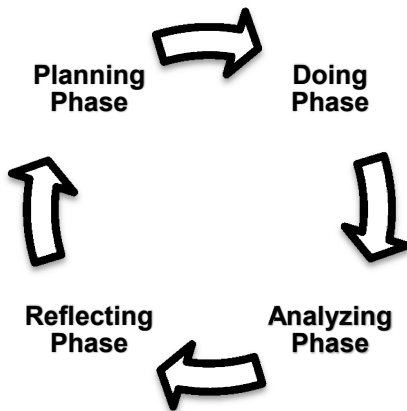


Figure 6: Qualitative research process

The following topics were discussed and reviewed during the interviews:

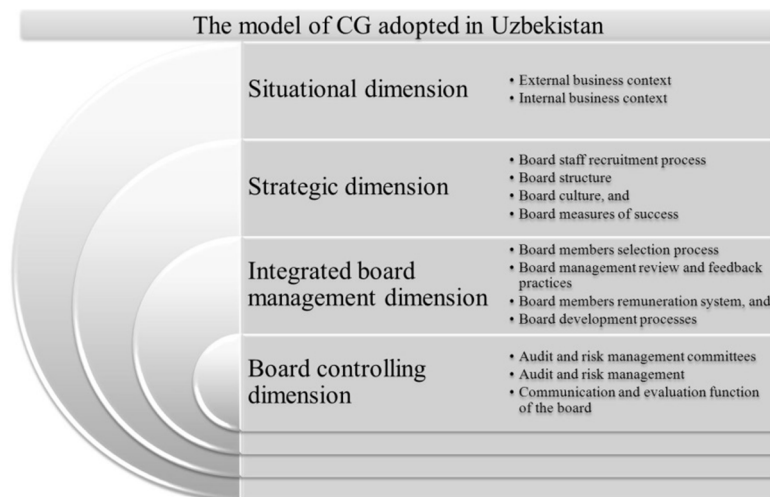


Figure 7: List of discussed topics

All interviews were standardized and contained open-ended questions, so that results of interviews can be structured and analyzed on a comparable basis. The details of questions reviewed during the interviews will be highlighted in the general theoretical section of the dissertation.

When all interviews are completed and recorded on tape, the transcription process has to be accomplished in order to bring more transparency to the interview results and identify the main message of respondents. The process of analysing the experts' opinions and comparing them with the concept of CG of SOEs will fulfil the main objective of the research.

1.5.3 Survey design

The author has used the survey to help address research questions related to CG of SOEs in Uzbekistan through the collection of corresponding qualitative data and the assessment of expert opinions.

Survey questions

For the purposes of the survey, open-ended questions (verbatim) were used. Because the main challenge is to develop reliable and valid measures and to sample representative data, the research questions for the dissertation were formulated employing key elements of the KISS framework presented by Hilb (2008). The questions listed in Attachment 4 were directed to experts.

The questionnaire was designed to gain insight into the expert's thoughts and ideas about CG of SOEs in Uzbekistan and are useful for capturing new ideas & information on the survey subject.

Sampling

For the purposes of this survey, clustering sampling was used to address experts with relevant academic and practical backgrounds with regard to the above questions. Thus, experts who deal with the subject matter of CG, such as scholars, members of a board of directors (BoD), and employees of regulating authorities were chosen for the survey, based on a review of the list of institutions which deal with matter related to SOE corporate governance in Uzbekistan (see Attachment 5).

Order of survey

- (1) The goals of the survey were established – to collect and assess qualitative data on the desired state of affairs in the field of CG by the opinion of experts.
- (2) The sample was determined to address the relevant audience who have corresponding backgrounds and are familiar with the CG of SOEs in Uzbekistan. A sample of at least 15 experts were selected in order to have a representative sample.
- (3) Interviewing methodology was decided – in this regard, email interviews were perceived as the most convenient and time-efficient option, both for the author and the sampled experts.
- (4) The questionnaire was created based on the fundamentals of the KISS framework, so that relevant questions were addressed during the survey to help identify areas of interest as a part of the dissertation project.
- (5) The survey interviews were conducted and expert opinions were collected using email communication.
- (6) The collected data was then analysed to produce a summary of findings and elaborate recommendations for further academic research and business practices.

1.6 Dissertation structure

The dissertation consists of the following 4 sections in brief:

1. Introductory section.

The statement and analysis of the problem (Why?), research objectives, questions, and basic concept (What?), project design (How?), and structure of the work (With what?) are presented here.

2. General theoretical section.

The main study on the current and target state of CG of SOEs in Uzbekistan was presented and discussed in this section using the KISS-framework. In the conclusion of this chapter, the author delivers a comprehensive report and a “new” concept for CG of SOEs in Uzbekistan, so that an empirical fieldwork and round of qualitative interviews can be performed.

3. General empirical section.

The concept of CG of SOEs has to be reviewed and discussed with experts through a number of qualitative interviews. The results of these interviews were structured and analysed in order to present empirical evidence and new findings. The conclusion of this chapter was reflected in the “new” revised concept of CG of SOEs with the list of existing barriers and problems hindering its successful adoption in the real world.

4. Conclusions and recommendations.

The main results and conclusions of the research project are highlighted in this section. Based on the outcome from the theoretical and empirical work, the draft action plan and further recommendation to practitioners and scholars are proposed. The practice-oriented concept for CG of SOEs in Uzbekistan and further recommendations for its successful implementation and use in practice is the final product of the dissertation.

1.7 Conclusion of introductory section

From the preliminary literature search in the area of CG of SOEs in Uzbekistan, and subsequent to formulating a research agenda, the following conclusions have been made:

- In theory, it is important to know how to shape the governance mechanisms in public companies in the context of enduring systemic transformation and continuous change; what types of challenges and barriers have taken center stage and what are the possible solutions? The reality requires not only observation of the current state and determination of the target state of CG of SOEs in Uzbekistan, but also tools and techniques to gain desired CG conditions.
- The study concentrates on CG of SOEs in Uzbekistan. The main objective of the dissertation is to present an overview of CG of SOEs, identify barriers and problems, and provide recommendations and solutions to overcome existing obstacles.
- To meet the objectives of the research, the KISS framework of Professor M. Hilb is employed. This tool helps to cover all relevant topics and create the concept of CG of SOEs in Uzbekistan. With a number of qualitative interviews among experts, the elaborated concept should then be proven for practice.
- The tested and revised “new” concept of CG of SOEs in Uzbekistan, coupled with the action plan and recommendations for its successful implementation in practice, is the final product of these research efforts.

General Theoretical section

2. General theoretical section

In this section of the dissertation, there are two main objectives:

1. Provide a comprehensive overview on the development of CG of SOEs in Uzbekistan;
2. Elaborate and present a concept of CG of SOEs in Uzbekistan.

In order to achieve ambitious goals, the “KISS-Framework” of Professor M. Hilb will be extensively used:

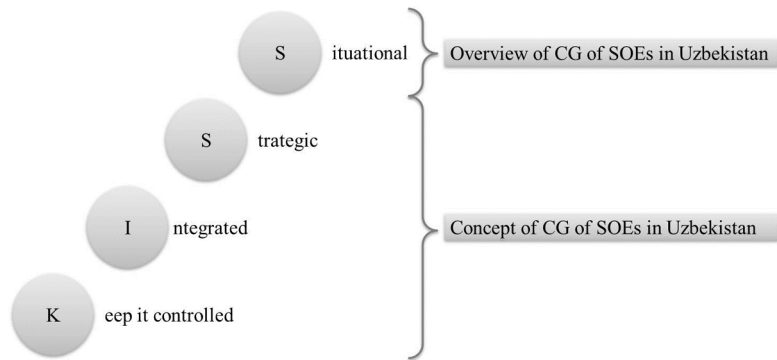


Figure 8: Illustration of the “KISS-Framework”

2.1 Situational dimension: the overview of CG of SOEs in Uzbekistan

The study on CG of SOEs in Uzbekistan is built on an integrated chain, which starts with the search and review of situational dimensions focused on the actual state of CG and identification of the major problems and determinants of a firm’s success.

According to Hilb (2008:18, based on McGrath, 1976), the main determinants of success related to CG are as follows:

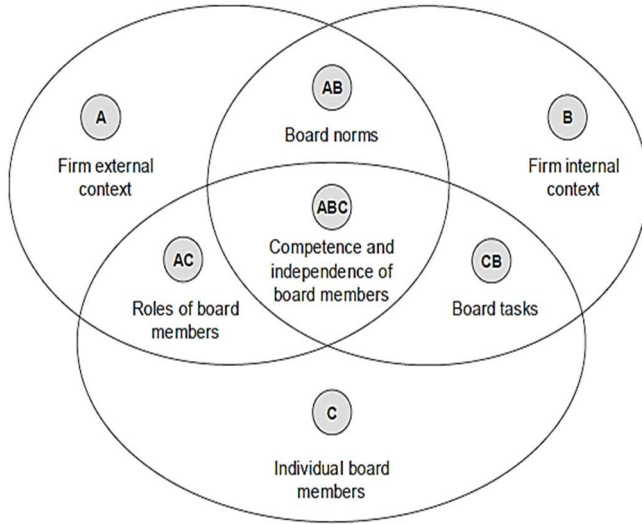


Figure 9: Determination of firm's success

Nexuses in the chart result in the following impacts:

- Firm internal and external business contexts → Board norms and standards (AB);
- Firm's external business context and individual Board members → Roles of board members (AC);
- Firm's internal business context and individual Board members → Board tasks (BC);
- Firm internal, external business contexts and individual Board members → Competence and independence of board members (ABC).

The firm's external and internal business contexts are analysed in detail in the chapters below.

2.1.1 External business context

In analysing and explaining the impact of external business context, Professor M. Hilb (2008:20ff) differentiated between the institutional culture, national culture, and normative context.

2.1.1.1 Institutional context

“Actor-centered institutionalism”, first introduced by Scharpf (1997), makes it possible to explain the differences in CG rules, systems, and practices in different regions on the basis of diverse, institutional mechanisms.

The institutional mechanisms determine the influence and roles of multiple stakeholder groups. Therefore, in the comparison of different CG systems, Aguilera and Jackson (2003:448ff) suggest taking three stakeholder groups into account:

1. Providers of capital;
2. Employees; and
3. Management

Having analysed the annual reports and financial figures of SOEs in Uzbekistan for the last 3 years, it can be concluded that the investments in Uzbek state companies have been made primarily by the Uzbek government (State) and are strategically motivated. This conclusion has been proven by the empirical study of the development of the capital market in Uzbekistan (CER, 2007:15). The research on Uzbekistan’s structural reform challenges (Broadman, 2000:22) has stated that, although many Uzbek SOEs have been recently transformed into shareholding companies, the business decisions on investment are still often politically-triggered and not market-based.

According to company laws, the role of employees in the design and execution of the companies’ governance is neglected and is not legally regulated. Hence, trade unions in Uzbekistan are prevailing

organizations representing the interests of employees in negotiations with management regarding working conditions, security, and non-financial incentives. Additionally, the Labor Code dictates that the main task of a trade union is to represent employees' interests to management, and the former also takes responsibility to solve conflicts among workers and promote the corporate discipline and culture within the organization.

Broadman (2000), as well as the study on the development of CG in Uzbekistan (CER, 2006:6ff), testify that the top management class in Uzbekistan is not developed yet and professional associations of managers are not established as independent institutions.

Troschke and Zeitler (2006:24-28) noted that, in Uzbekistan, state associations continue to interfere in the SOE decision-making process and largely affect SOE activities; they also noted that Uzbek CEOs pursue the top-down approach and careers are primarily promoted within a single organization.

The combination of institutional domains, in the opinion of Aguilera and Jackson (2003:460-461), impacts the shape of CG at the firm's level, where the following conflicts have been foreseen:

- “Class conflict” will arise when the interests of the owner and top management diverge from the interests of employees. In the case of Uzbekistan, this conflict could become acute because the owner (State) and top management of SOEs represent the state's interests in a very broad manner, and the position of employees is considerably weak.
- “Conflict between insiders and outsiders” will arise when the interests of employees and top executives, as insiders, oppose the interests of the owner as an outsider. In this respect, this type of conflict would be less relevant because the management of Uzbek SOEs is strongly hierarchically-politicized and the weight

of employees in company governance is minimized (Troschke and Zeitler, 2006:12ff). However, similar to the old Soviet system, the top executives of SOEs in post-socialist economies tend to increase the social, economic, and political significance of their organizations through non-market-based increases in organizational size (number of corporate branches and subsidiaries, number of employees, etc.), lobbying and intensive networking with high government bodies to protect and strengthen their monopoly position, and to gain more state investments (subsidies) and non-competitive privileges (taxes).

- “Alignment conflicts” could arise when the interests of the shareholder and top management are too divergent. On the one hand, the top executives in Uzbek SOEs are politicians pursuing political interests of the state, but on the other hand, CEOs are individuals with opportunistic behaviour and self-interest that may cause corruption and abuse of power.

2.1.1.2 National context

For the review of the national context, Hilb (2008) proposes to analyse and consider two major factors that impact the shape of governance framework:

- Value orientation of the board
- National culture

Value orientation of the board consists of three types of firms:

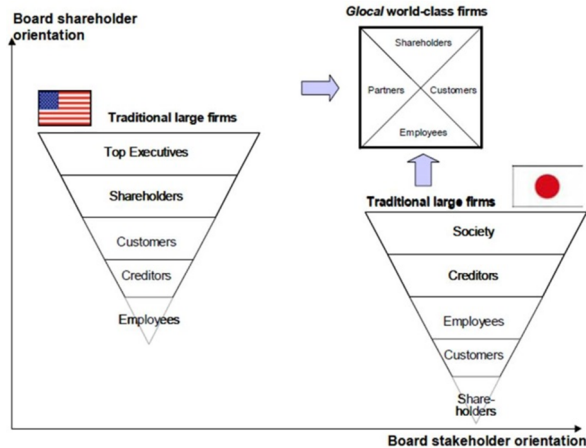


Figure 10: Value orientation of boards by M. Hilb (2008)

From the review of corporate charters, by-laws, and special government acts, it can be concluded that the main purpose of boards of Uzbek SOEs is to protect and represent the interests of the state that is the shareholder⁵.

None of the state companies in Uzbekistan have developed their own corporate policy towards stakeholders, and this is underlined in the recent studies as a lack of governance practices⁶.

Categorizing the value orientation of boards of Uzbek SOEs, according to M. Hilb, seems to have some similarity with the shareholder vs. owner value orientation. However, in the transitional change of environment where the state is dominant and the management of SOEs is enormously politicized, such as in Uzbekistan, the interests of other

⁵ Full texts of legislation are freely available at the National legislation database of Uzbekistan (www.lex.uz).

⁶ See for example CER (2006:33ff).

stakeholders, such as employees, clients, and creditors, will automatically become subordinate.

The national culture of Uzbekistan has emerged, geographically and historically, under the influence of different factors. Geographically, Uzbekistan is located in the heart of Central Asia; it is one of only two countries in the world (the other is Liechtenstein) that is doubly landlocked, as it is surrounded by Russia, China, India, and Iran. Historically, this area has been conquered and hugely influenced by:

| Events | Impact |
|-------------------------------|---|
| Alexander the Great | Ancient Greek culture |
| Parthian Empire | Persian traditions and dominance of Persian language |
| Arabs | Adoption of Muslim religion and Arab language |
| Mongolian Chingiz Khan | Nomadic culture, consolidation of nation, and formation of single territorial entity |
| Tamerlane | Establishing the great Turk empire of Tamerlane “Turon” |
| Russian Empire | Colonization and the “Great Game” with British empire for supremacy in Central Asia |
| Soviets | Introduction of communist ideology, industrialization, and centrally planned agricultural economy (Ruziev et al., 2007:8) |

Table 1: Representation of historical influence

All these events have left their tremendous mark and contributed towards the emergence of Uzbek national culture, mentality, traditions, language, customs, and values which are present today. Therefore, the cultural profile of Uzbeks simultaneously has the elements of both a “hard” and “soft” culture:

| | Dimension | Type of Culture | |
|----|-----------------------------|---------------------------|------|
| | | Hard | Soft |
| 1 | Time horizon | Short term | |
| 2 | Emphasis | Relationship orientation | |
| 3 | Driving force | Goals | |
| 4 | Reinforced qualities | Commitment and loyalty | |
| 5 | Motto | “Nobody is indispensable” | |
| 6 | Decision making | Top-down | |
| 7 | Goal | Innovation | |
| 8 | Strategy | Flexibility | |
| 9 | Distinctive feature | Adaptability | |
| 10 | Feedback | Controllability | |

Table 2: Elements of culture

To a certain extent, the above depicted attributes of Uzbek national culture may also have negative impacts when they are overemphasized. In this regard, in the case of Uzbekistan, overemphasizing could lead to over-structuring, demotivation of individuals, obsession with the group, lack of social grace, obsession with planning, ambiguity, exaggerated power games, chaos, and overemphasizing of hierarchy (Hilb, 2008:26).

The features of national cultures determine the normative regulation of CG in Uzbekistan, which will be presented in the next section.

2.1.1.3 Normative context

Below is the normative context of the CG domain due to the “KISS”-Framework, which is analysed in two dimensions:

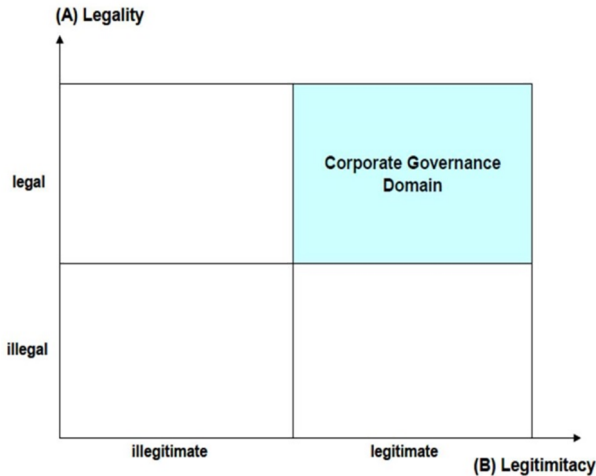


Figure 11: Dimensions of normative context by M. Hilb (2008:27)

Legality of Board management in Uzbekistan

The legal framework of CG of SOEs in Uzbekistan consists of *hard* and *soft* norms and *special enterprise acts*. The basic law which regulates and constitutes the governance system is the Law on Joint Stock Companies and Protection of the Rights of Shareholders (Company Law), entered into force on April 26, 1996, which has been amended several times. Although EBRD assessment of the commercial laws of Uzbekistan indicates “medium” compliance with OECD Principles of Corporate Governance (EBRD, 2005:9), much space for improvement still remains, as shown on the chart below.

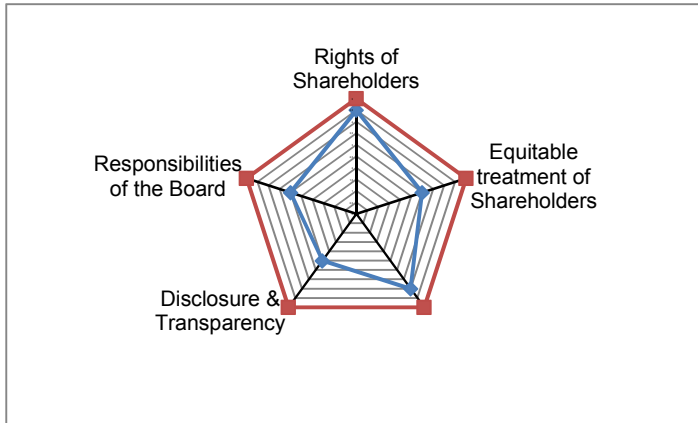


Figure 12: Quality of Corporate Governance Legislation: Uzbekistan (EBRD, 2005)

The following requirements to the improvement of CG in Uzbekistan have been provided by EBRD:

- Preparation of quarterly reports and group accounts on a consolidated basis, in line with international accounting standards;
- Guarantee on auditor's independence;
- Specification of board management practices (Tasks, Responsibility, Roles, Structure and System of Board Management);
- Information on compensation of board members and key executives;
- Disclosure and transparency;
- Legislation on insider trading.

The report on the development of CG in Uzbekistan, provided by the Centre of Economic Research in Uzbekistan (CER, 2006:9ff), has identified that the main obstacle and problem for further enhancing the governance practices is a lack of soft norms, such as guidelines, codes,

recommended governance policies concerning structure and remuneration of Board members, audit and risk-management systems, recommendations for effective board management, etc. Indeed, the State Committee for Privatization, Demonopolisation and Development of Competition of the Republic of Uzbekistan⁷, Centre for Management of State Assets and the Centre for Coordination and Development of Securities Market have issued some exemplary templates of corporate by-laws for BoDs, Annual Shareholders' Meetings, and internal audit⁸, but these documents embody general recommendations without any detailed prescriptions for CG processes and practices.

State-owned enterprises, in particular state natural monopolies, are not registered under the Company Law and their governance is regulated through special enterprise acts and individual decrees of the Uzbek government, listed in Attachment 1.

The establishment of Uzbek legislation provided a promising foundation for the development of sound CG but it cannot guarantee its successful implementation, due to the great difficulties in law-enforcement and legitimacy of board management in an economic transition context. This will be presented in the next chapter.

Legitimacy of Board management in Uzbekistan

The prominent academics who are focusing on development policy and transition economics have reviewed the results of reforms in transition economies and all have made reference to the biggest failure in these countries – unqualified disregard of the institutional, national, and normative environment of a single country and blind implementation of the “standard” reform package known as the “Washington consensus”⁹.

⁷ Hereinafter – State Competition Committee.

⁸ Further information available at www.gki.uz.

⁹ See for example Stiglitz (1999:10ff).

The fast-changing surface and rules of governance of SOEs in Uzbekistan has not altered the substantial basis and values that consequently lead to the conversion of the main idea of CG into reality. This lack of integrity between rules and values, as pointed out by Hilb (2008:33), hinders the basic task of boards to ensure the continued existence of a firm in the interest of all relevant stakeholders.

Former ministries of different economic sectors in Uzbekistan were transformed into state-owned enterprises labeled as state holding companies, state shareholding companies, state associations, state unitary companies, national companies, among others.

However, the governance of these SOEs has been formally modified, whereby the state has introduced a BoD and some elements of CG, but it is still far from the sufficient compliance with OECD principles of CG of SOEs. For example, CEOs of SOEs are appointed by government decrees and are automatically government members, while BoDs are comprised only of representatives of different government institutions pursuing primarily the interests of their political authority and not that of SOEs; transparency and disclosure of corporate information is not regulated, and there are no communication policies or standards. All of this can be recognized as insufficiency in the legitimacy of Board management.

2.1.2 Internal business context

Along with the relevance of analysing the external business context, the internal business context plays an important role in the formulation of the CG domain. In this regard, Hilb (2008:36) suggests drawing attention to the following dimensions:

- Ownership;
- Board configuration;
- Organizational complexity;

- Board key players;
- Degree of internationalization;
- Mix of board functions.

2.1.2.1 Ownership

Hilb (2008:36) points out that different types of ownership provisions in companies determine the governance system: family-based governance, cooperative governance, non-profit governance, public governance (SOEs), and CG.

The state versus private ownership disputes have haunted the academic world since the origination of economic science and such enduring debates on the role of the state in the free-market economy has led to the establishment of different schools of economic thought¹⁰. According to Ha-Joon Chang from the UN DESA¹¹, “... despite popular perception, encouraged by the business media and contemporary conventional wisdom and rhetoric, SOEs can be efficient and well-run...” (Chang, 2007:8). Such a statement can be supported by several success stories, listed below:

- *Singapore Airlines* – often voted as the best Airline in the World, owned by government (Temasek Holding);
- *Bombay Transport Authority of India* – also a world-class SOE example;
- *EMBRAER* – Brazilian jet manufacturer;
- *Renault* – French carmaker, initially succeeded as an SOE;
- *POSCO* – Korean steel-maker SOE.

¹⁰ See for example A.Schleifer (1998); M. Shirley and P. Walsh (2001).

¹¹ Further information available at <http://www.un.org/esa/desa/>.

Besides the above-mentioned real-life examples and success stories, some theoretical justifications for the existence of SOEs are presented as follows:

Justification for SOEs¹²

Natural Monopoly: In industries where technological conditions dictate that there can only be one supplier, the monopoly supplier may produce at less than the socially optimal level or charge more than the appropriate rate.

Example: railways, water, electricity.

Capital Market Failure: Private sector investors may refuse to invest in industries that have high risk and/or long gestation periods.

Examples: capital-intensive, high-technology industries, such as aircraft (in Brazil) or steel industries (Republic of Korea).

Externalities: Private sector investors do not have the incentive to invest in industries which benefit other industries without being paid for the services.

Examples: basic input industries such as steel and chemicals.

Equity: Profit-seeking firms in industries that provide basic goods and services may refuse to serve less profitable customers, such as poor people or people living in remote areas.

Examples: water, postal services, public transport, basic education.

As noted by Schedler et al. (2007), one of the main challenges in the governance of SOEs is maintaining the delicate balance between political influence and management efficacy. The main message of task-

¹² Chang (2007:12).

dependence theory of public governance is that the design of governance of SOEs strongly depends on the goals that have been forced on SOEs from the state as owner.

In Uzbekistan, SOEs are governed by several institutions. The State Competition Committee and the Centre for Management of State Assets are tasked with providing and implementing sufficient governance systems in Uzbek SOEs. The strategic state companies of commodity, transportation, banking, electricity, postal, and telecommunication sectors are directly subordinated to the government and managed by different departments of the Cabinet of Ministers. The state regional and municipal governments exercise their ownership functions in the SOEs which have local relevance. By presidential decree Nr. 3202 in 2003, and other normative acts which derived from this decree, the Uzbek government attempted to reform the governance of state shareholding. It made the mechanisms of governance of state ownership more transparent and, for the first time, introduced the tender-based procedures to hand over the rights of the management of state shares to professional management (trust) companies.

In Uzbekistan, joint-stock companies operate through general meetings of shareholders, the BoD, and the Management Board. Limited liability companies operate through the Management Board and may opt to establish a BoD. In the case of SOEs, regardless of legal form, establishment of a BoD or its analogue is mandatory in practice, although no such legal norms foresee such obligation for state unitary enterprises or limited liability companies.

The general meeting of shareholders (participants) has the highest authority in the company and is to be convened at least once a year. It approves the annual report, distributes profits, elects the Supervisory

Board¹³ and auditors, amends the charter, increases or decreases share capital, and decides on voluntary dissolution of the company, according to law. Resolutions are usually passed by a simple majority vote. However, for certain important matters, such as making an amendment to the Charter or termination of its operation, and for resolution to decrease or increase the share capital, a majority vote of 2/3 is required. The Management Board is an executive body which represents and manages the company. The Management Board must report activities and performance to the Supervisory Board at least once every quarter. The Supervisory Board plans the strategic activities of the company, arranges its management, and controls the Management Board. An employee of the company cannot be a member of the Supervisory Board.

Comparison of the main SOE forms in Uzbekistan is presented in a table below.

| Form | Ownership | Features |
|------------------|---|--|
| State enterprise | In accordance with Civil Code and Special Statute ¹⁴ , adopted by the Cabinet of Ministers, it is a unitary enterprise fully owned by the state. Specific owners (founders) of SE can only be official bodies (ministries, State Competition | Commercial Entity aiming to gain profit from its activities. Administered by the Founder (Sole owner) and the Management, appointed as its executive body. State holds full liability on |

¹³ The terms “Supervisory board” and “BoD” are used as synonyms, if not implied otherwise by the context.

¹⁴ Resolution of the Cabinet of Ministers of the Republic of Uzbekistan «On measures for ensuring effective governance of enterprises with state share in charter capital and proper account of state property», adopted on 16 October 2006, #215.

| | | |
|---------------------------|---|---|
| | Committee, the Cabinet). | obligations of the State Enterprise. |
| Limited liability company | In accordance with Civil Code and Special Law ¹⁵ , state could participate as a member of the limited liability company. Number of owners cannot exceed 50 entities. | Corporate structure, managed by Meeting of participants, Supervisory board (optional), and Executive body (director). |
| Joint stock company | In accordance with Civil Code and Special Law ¹⁶ state can act as a shareholder of a joint stock company. | Corporate structure, managed by Meeting of participants, Supervisory board, and Executive body (director). |

Table 3: Comparison of main SOE forms in Uzbekistan

From a historical perspective, the prevailing form of SOEs in Uzbekistan is the state enterprise.

Over the years of independence, more than 31000 state entities and objects were privatized in Uzbekistan, of which 21.5% (6600) were reorganized into joint stock companies (Statistical Digest, 2013:52).

¹⁵ Law of the Republic of Uzbekistan «On companies with limited and additional liability», adopted on 6 December, 2001, #310-II.

¹⁶ Law of the Republic of Uzbekistan «On joint-stock companies and protection of shareholders' rights», new edition adopted on 06 May, 2014, #370. Such a provision was also foreseen by a previous edition of this law, adopted on 26 April, 1996, #223-I.

Later, in 2003, the special Decree was adopted by the President, which raised minimum charter fund requirements for joint stock companies. As the minimum charter fund requirement was set at an equivalent of 50,000 US dollars, and later to 400,000 US dollars, many companies opted to change their form to a limited liability company, and only some 1,100 currently hold joint stock company status in Uzbekistan, of which less than 400 have state participation¹⁷. Thus, the prevailing form of SOE was a limited liability company. The number of SOE's, by form of organization, is currently as follows:

| Joint stock company | Limited liability company | State enterprise |
|---------------------|---------------------------|------------------|
| 344 | 644 | 1380 |

Table 4: Number of SOEs in Uzbekistan¹⁸

A specific feature related to management of SOE's in Uzbekistan is reflected in their Board structure, as members of the Board in SOEs can be divided into state trustees (nominated by the Cabinet of Ministers decision and not subject to election by shareholders), state representatives (elected by shareholders), and representatives of the authorized agency for state assets management (State Competition Committee and the Centre for Management of State Assets).

Another specific feature of SOE management in Uzbekistan relates to the decision-making procedures, by which such important matters as distributing profits are subject to prior agreement with the Ministry of Finance, and matters related to changing charter capital and appointing executive directors are subject to prior agreement with the Centre for Management of State Assets. Furthermore, in SOEs that are large

¹⁷ Data obtained from Central Securities Depository www.deponet.uz.

¹⁸ Data obtained from the Center for state assets management.

strategic industry holdings, the head of the executive body and members of the supervisory board are appointed by government resolution.

The vertical hierarchy within industries is clearly reflected in SOE capital structure. In such a manner, Uzbekneftgas holding company (JSC), owned by the State, holds a major stake in all lower oil & gas SOEs in Uzbekistan. This is typical across all major industries where the state considers majority stake holdings as strategic (chemical, railroad, flour & milling, cotton processing, etc.).

Summing up, the representation of state ownership throughout the different institutions and its governance looks as follows:

| | | Central government | | | | Regional government | Professional trust companies |
|--------|-----------------------|--------------------|-------|-------|-------|---------------------|------------------------------|
| | | Dep.1 | Dep.2 | Dep.3 | Dep.N | | |
| SOE1 | State holdings | X | | | | | |
| SOE2 | | | | | | | |
| ... | | | | X | | | |
| SOE8 | State associations | | X | | | | |
| SOE9 | | | | | X | | |
| ... | | | | | | | |
| SOE20 | National corporations | X | | | | | |
| SOE 21 | | | | | | X | |
| ... | | | | | | | |
| SOEn | | | X | | | | X |

Figure 13: Representation of state ownership throughout different institutions

The State Commission for Monitoring the Effective Use of State Ownership monitors the governance of state companies and consists of high-level Government representatives, members of parliament, academics, and prominent politicians.

2.1.2.2 Board configuration

The analysis of the board configuration dimension is important in terms of detecting the distribution of power within the BoD and their degree of involvement, governance, and management style. The illustration, adapted from Hilb (20:44), of the different orientation of the BoD shows four development levels:

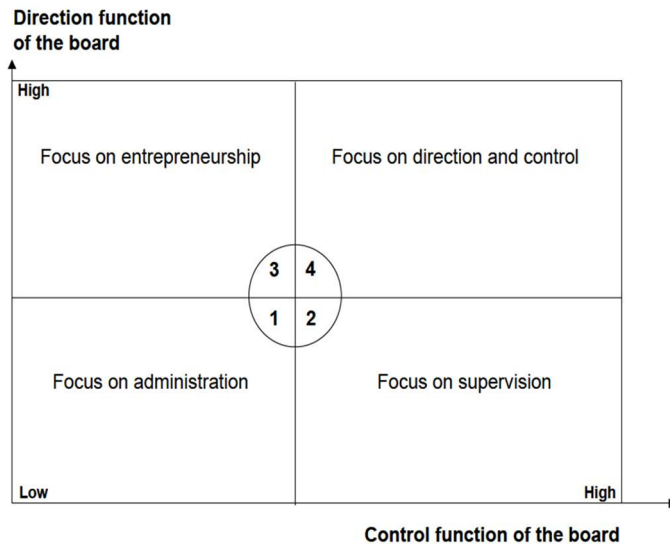


Figure 14: Different developments in boards by Hilb (2008)

Hilb (2008) emphasizes that overall development in CG should go towards BoDs focusing on direction and control.

The main objective in the board configuration is to find a balance between Supervisory and Management boards. In international practice, different countries have established their own national board systems and models, which have pros and cons:

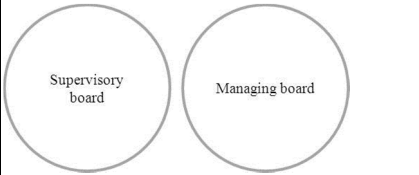

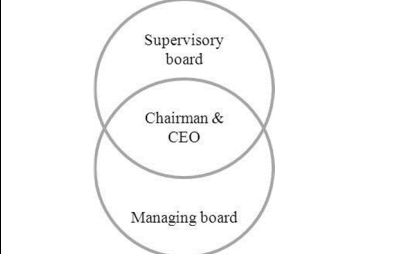
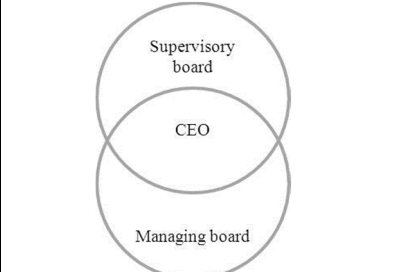
| | |
|--|--|
|  | <p>The “dual” board system. The supervisory board model</p> |
|  | <p>The “monistic” board systems:</p> <ol style="list-style-type: none"> 1. The executive board model |
|  | <ol style="list-style-type: none"> 2. The non-executive board model |
|  | <ol style="list-style-type: none"> 3. The “third way” model: board as a mechanism for direction and control |

Figure 15: Board systems by M. Hilb (2008)

According to joint-stock company law, the “dual” board system has been adapted in Uzbekistan. However, special acts and government decrees were prescribed to system-relevant state companies, which, in most cases, are natural monopolies, to adjust to a kind of “monistic” board system similar to the executive board model. For instance, CEOs and their deputies of the “Uzbekneftegaz” national oil company,

“Uzbekenergo” State Joint Stock Company, “Uzbektelecom” State Company, “O’zbekiston temir yo’llari” Uzbek railway company, and a number of other Uzbek state corporations have supervisory board mandates by law.

2.1.2.3 Organizational complexity

The organizational complexity of a company influences the design of CG framework, where two dimensions can be distinguished (Hilb, 2008:50):

- organization size;
- stage of company development

A number of empirical studies have investigated the relationship between company size and CG features. The size of the organization can be classified as small, medium, or large in terms of financial indicators (turnover, equity, market value, etc.), non-financial indicators (number of employees, number of corporate branches, geographic location, etc.), and hybrid indicators (for example, value added per employee). The CG features are sampled based on board characteristics, such as number of board members, number of board committees, etc.. Professor M. Hilb recommends the following board staff:

| | Organization size | | |
|-------------------------|-------------------|-----------|-----------|
| | Small | Medium | Large |
| Number of Board members | 3 Members | 5 Members | 7 Members |

Table 5: Number of board members in different organizations by M. Hilb (2008)

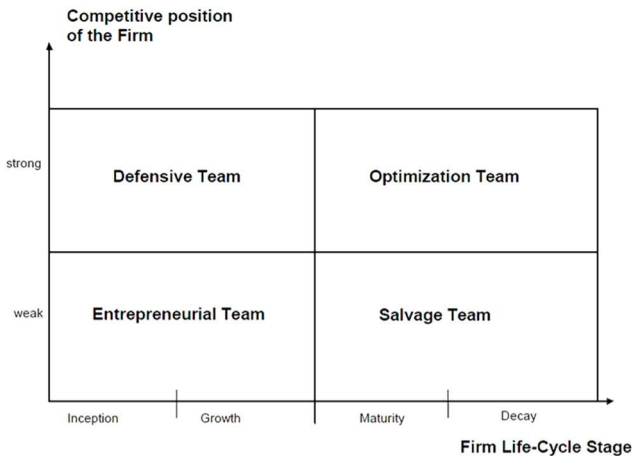
The absolute number of board members is up to the complexity of know-how, roles, and social characteristics of the board (Hilb, 2008:51).

In Uzbekistan, the majority of SOEs are considered large corporations because¹⁹:

- these are mainly former economic sector-specific ministries transformed into state corporations and, due to the lack of sufficient competitiveness, they possess the dominant position in their sectors to date;
- these are usually “natural” monopolies;
- Uzbek SOEs have the relevance of the entire national economy and are main players in industrial and structural policy of the government;
- Uzbek SOEs are the largest employers.

The number of board members of Uzbek SOEs varies from 7 to 14 members. There is no standard requirement and/or specific disposition concerning BoD staff.

The governance of a company has to be comprised and structured depending on the stage of development of a firm:



¹⁹ See for example H. Broadman (2000:12).

Figure 16: Competitive positions of a firm across life cycle

The firm life-cycle approach is also valid for state companies, in terms of the commercial life cycle. Therefore, the aim of the governance system of SOEs is to effectively maintain the growth and maturity phases (product and market) and continuously assess the competitive position of a company.

According to Uzbek legislation, SOEs in Uzbekistan may not go into bankruptcy, because the state, as the owner, is liable for its own enterprise²⁰.

2.1.2.4 Board key players

The analysis of the board's key players contributes to the better understanding of the internal business context and its impact on the governance framework of a company. Usually, the following roles on the board can be distinguished:

- (1) Chairperson of the board;
- (2) External/independent board members;
- (3) Board secretary.

Role of the chairperson of the board

The position of the chairperson in the board shall be analysed in terms of his/her functions, tasks and goals, managing of board meetings (agenda, time, place, discussion topics, decisions and conclusions, communication), his/her relationship with top managers of the company, and leadership tools and instruments.

The main function of the chairperson is to guarantee that the board is provided with leadership and provide control over the processes.

²⁰ For more information please visit www.gki.uz.

The professional management of board meetings is one of the most important tasks of the chairperson. For example, Cadbury (2002) recommends arranging the agenda in three subject areas: (1) information of company progress, (2) matters requiring board decisions, and (3) matters which need resolution or on which the executives are seeking board guidance.

The important issue is the personal and professional relationship between the chairperson and CEO (and other top executives). The best practices worldwide recommend that the chairperson and CEO should see their jobs as complementary to each other; they have to establish trust in each other on the individual level, and the competencies and responsibilities of the chairperson should be described and agreed upon.

The chairpersons of Uzbek SOEs, in all cases, are high government authorities such as the prime-minister, vice prime-ministers who coordinate and supervise respective economic sectors where SOEs are operating, and ministers. It is questionable whether an optimal and efficient relation between a chairperson and CEOs of Uzbek SOEs could be established, considering that CEOs are (1) members of the government and (2) appointed by and report directly to the government (not to the Board of directors).

Role of the independent/external board members

All international best practices recommend having a large number of independent external directors on boards. The role and the impact of independent external board members on a company's performance has been analysed and assessed in a number of research studies.

What qualities distinguish the independent board member? In this regard, Hilb (2008:54-55), based on Clarke (1998:122), summarizes that such a board member shall:

- not be a former executive;
- not be a professional advisor;
- not be a significant customer or supplier;
- not be appointed as the result of a personal relationship;
- be selected by a formal process;
- not stay on the board too long;
- not be a close relative to an executive/director;
- not be an employee;
- not participate in share options schemes;
- not be considered to have pensionable services;
- not represent a major shareholder;
- not have directorships in common with other directors;
- not hold a position with a body that received donations.

Apart from requirements regarding the professional profile of independent external directors and questions about their remuneration and incentive mechanisms, a director's development and maintenance of their "independency" arise. Some authors recommend having a budgeted allowance for advice services and development of independent directors.

In regard to SOEs, OECD (2005:49) recommends having independent and external members of the board. Several empirical studies have found a positive correlation between the portion of independent directors on the board and (1) SOE performance, (2) instigation and implementation of strategic initiatives, (3) effectiveness in strategic decision making, and (4) attraction of foreign investments in SOEs.

The board members of Uzbek SOEs are only high government executives and full-time top managers of other state organizations. There are no exemplary cases with independent and/or external board members or with foreigners as members of the BoD.

Role of the board secretary

The role and importance of the board secretary has been underestimated. The board secretary, also referred to as the compliance officer and company secretary, is not a board member but a key partner in board management processes. In explaining the role of board secretary, we need to answer: (1) Which companies need a compliance officer and why? (2) What are his/her main tasks and functions? and (3) Who has to appoint the compliance officer and to whom does he/she have to report?

In large public companies with an active and involved BoD, the position of company secretary is essential in terms of successful execution of all administrative and other board management practices. The good practice guidelines of CG recommend authorizing such an administrative unit as board secretary with the following functions:

- facilitating the induction of newly appointed members;
- facilitating professional development programs for the board;
- ensuring effective information flows
 - within the board;
 - from the board to its committees and from the committees to the board;
 - between the members and the public entity's management;
- advising members on the legal obligations of members and of the public entity;
- advising the board and individual members on corporate governance principles and plans;
- advising the board on implementation of CG programs, such as risk management and performance assessment;
- performing instructions of the board, assisting in implementation of corporate strategies and providing practical effects to the board's decisions.

The board secretary should be elected and appointed by the board and his/her position should be described and regulated by corporate by-laws. Usually, the board secretary has to report to the BoD.

Uzbek SOEs have company secretaries as well; however, they are appointed by the management of organizations and perform formal administrative duties only. As a consequence, their contribution is diminishing due to the improvement of effectiveness of governance and board management practices.

2.1.2.5 Degree of internationalization

One of the important aspects in analysing the situational dimension of CG in the internal business context is the degree of internationalization of a company. Hilb (2008:57) has grouped the development stages of the board and management into four categories:

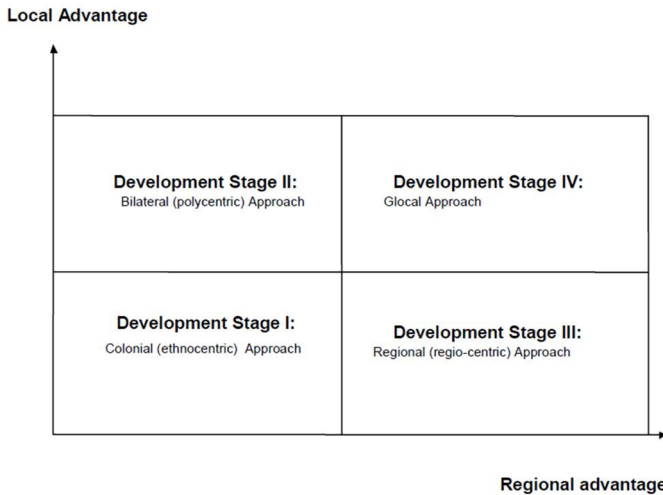
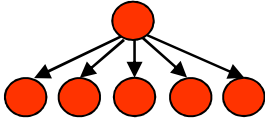
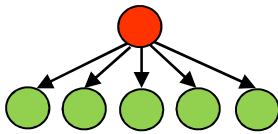


Figure 17: Stages in multicultural board and management development by Hilb (2008)

Development stage I: Colonial (ethnocentric) approach**Figure 18: Colonial approach**

The main idea in this approach is that the governance policy of the head office is dominantly applied to all local and foreign subsidiaries. This approach is often used at the beginning of internationalization and during the crisis period. The boards of the local and foreign entities are comprised of the well-experienced members of the head office. The circles are BoDs of the head office and subsidiaries, coloured in “red” because of the unitary policy provided from top-down.

Development stage II: Bilateral (polycentric) approach**Figure 19: Bilateral approach**

The bilateral approach (polycentric) is the next step in internationalization, where supervisory and managing boards of subsidiaries (“fresh green” circles) will be recruited locally. Indeed, the national needs of the local market environment will be better taken into account; foreign entities tend to secede from the global strategy of the head office.

To avoid such problems, companies deploy the next approach in their internationalization strategy.

Development stage III: Regional (region – centric) approach

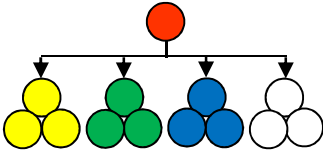


Figure 20: Regional approach

In this stage of internationalization, companies set up their regional head offices in the markets of large trading areas (such as Asia – “yellow”, North America – “green”, Africa – “blue” and Europe – “white”). The supervisory and managing boards of the regional branches will be comprised of the representatives of given regional areas.

The global board and human resource potential cannot be optimally developed because of the false assumption about “unified” national cultures (such as “Asian” or “European” cultures).

Development stage IV: Glocal approach

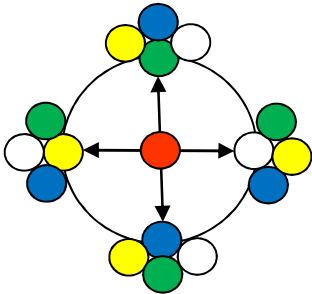


Figure 21: Glocal approach

This approach, proposed by professor M. Hilb, considers the “both-and” advantages of true multicultural boards and personnel development. The main advantages of the *glocal* approach (Hilb, 2008:60) are:

- better alignment of board and management teams of all subsidiaries with the global vision of home office;
- promotion of the cosmopolitan learning-oriented corporate culture, taking the comparative advantage from the strength of different national cultures.

Upon the review of degree of internationalization in Uzbekistan, Uzbek SOEs stand at the beginning of this process. Following the approaches above:

- Governance policy of the head office is dominantly applied to all subsidiaries of Uzbek SOEs;
- Supervisory and managing boards of SOEs are comprised of members of the head office;
- In electing and/or appointing the top managers of their local branches, Uzbek SOEs have to consider the opinion of local governments and reach agreement on such nominations;
- The extent of internationalization of SOEs is outstretched to the foundation of joint-ventures and cooperative alliances with foreign companies.

2.1.2.6 Mix of board functions

The analysis of the functions of the BoD is an important component in a CG study. Hilb (2008:70) summarized the main functions of the boards as follows:

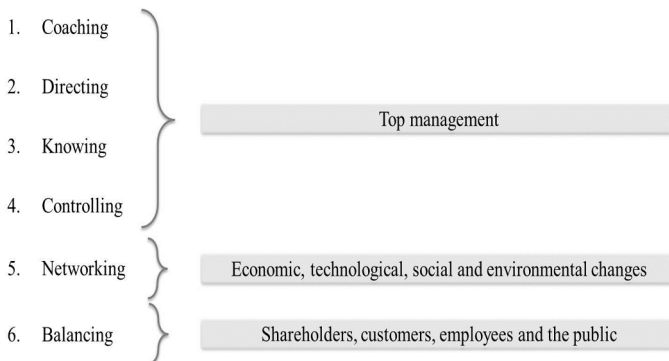


Figure 22: main functions of the board

As mentioned above, the State Competition Committee has developed the exemplary template policy regarding the BoD²¹. The functions of the BoD are described in very common sentences without any structuring or distinguishing between types and purposes of functions. For instance, the authors of this template have mixed, in one cluster, board-operation related functions with true board functions, such as strategic direction and control. There is no regard to how a BoD should behave and determine its strategy towards a specific target group.

The BoDs of Uzbek SOEs must follow the government's industrial policy and supervise its proper implementation at the company level. From discussions with some top executives of Uzbek SOEs, it was stated that the biggest problem is the absence of clear delineation and understanding of functions between supervisory and managing boards.

2.1.3 Conclusion on Situational dimension

In this section, the actual state of development of the CG of Uzbek SOEs has been analysed using the Situational dimension.

| Situational dimension | Current state |
|------------------------------|---|
| External business context | |
| Institutional context | |
| Providers of capital | State generally executes strategically-motivated, long-term investments. |
| Employees | No representation on the Board. Employees do not take part in governance processes. |
| Management | Management class is at the beginning of its representation. Top executive's |

²¹ For more information please visit http://www.gki.uz/index.php?option=com_content&task=view&id=1777&Itemid=68.

| | |
|-----------------------------------|--|
| | ideology of career path is a top-down approach within one organization. |
| National context | |
| Value orientation of the board | Strongly shareholder vs. owner value orientation. |
| National culture | Includes elements of both “hard” and “soft” cultures. |
| Normative context | |
| Legality | Evaluated as “Medium” in compliance with OECD Principles of CG. |
| Legitimacy | Lack of integrity and insufficiency in the legitimacy of board management |
| Internal business context | |
| Ownership | Different institutions are representatives of the state as owner (central and local governments, other government organizations, and private professional management companies). |
| Board configuration | <ul style="list-style-type: none"> - Focus on administration; - Dual-board system has been adapted; however, Uzbek SOEs apply a one-tier board system with elements of an executive board model by law (Special acts). |
| Organization complexity | |
| Organization size and size of BoD | 7 – 14 members. |
| Stage of company development | Depends on SOE. Uzbek SOEs may not go into bankruptcy by law. |
| Board key players | |
| Chairperson | High government representatives |

| | |
|---|--|
| | (Prime-Minister, Vice Prime-Ministers, Ministers). |
| Independent/External members | No representation. |
| Board secretary | Formal duties without any impact on the board management. Usually subordinated to the management of SOE. |
| Degree of internationalization and BoD approach | At the early stage of internationalization, colonial ethnocentric approach. |
| Board functions | <ul style="list-style-type: none"> - Determined in very common sentences; - Main target of BoD is to follow and supervise the instructions of Uzbek government; - No clear separation between functions of supervisory and managing boards. |

Table 6: Situational dimension: summary of findings for SOEs in Uzbekistan

2.2 Strategic dimension

The relationship between the company's strategy, its success, and the BoD is clearly seen in a number of studies. In particular, Hilb (2008:70), in his book, mentions the study conducted at the University of Basel in Switzerland, which confirms that a higher share price and lower cost of capital are directly linked to good CG.

Just having a strategy (even a well-elaborated one which clearly address the interests of the company and all its stakeholders), doesn't guarantee, by itself, the success of a company. A BoD's inability to perceive the strategy and share it entirely, as well as its failure to articulate strategy to stakeholders, may lead to situations where a carefully designed strategy remains unrealized.

Thus, the pressing question, "What can I do to get my board to employ a more strategic outlook and focus?" will remain a growing challenge for companies, including SOEs. Developing a more strategically-focused board involves examining the BoD structure, processes, functions, and even behaviour.

Henceforth, it requires a number of actions and steps to shift the BoD to a more strategic focus, and the present dissertation attempts to address this matter based on the KISS framework approach, outlined by Hilb (2008).

In particular, Hilb (2008:13) identifies "...four central success factors in corporate governance."

The first prerequisite for a board culture characterized by constructive criticism and trust is the targeted selection of an exemplary board team, one comprised of people who act as role models for both share- and stakeholders.

The culture of constructive criticism and trust is implemented through simple networked board structures and processes. These three success factors are prerequisites for the development, implementation, and evaluation of stakeholder-oriented board success measures”.

2.2.1 Targeted and diverse board team composition

Hilb (2008) has noticed that, until the recent financial crisis, many large corporations had a large number of board members and shared some common features, including male dominance and a senior age composition of members, most of whom serve(d) as current or former chairperson CEOs of other large firms.

Consequently, Hilb holds that ideal board compositions do not exist and a carefully selected diverse board of 5-7 members should be established in line with criteria relevant to the company’s strategy.

From this perspective, the board composition of SOEs in Uzbekistan reflects that a typical board is comprised of 7 to 9 members. A special Statute on Supervisory Boards, adopted by the Cabinet²², dictates that if the number of shareholders exceeds 500, then the company has to have at least 7 members on the board, while companies with more than 1000 shareholders shall have at least 9 board members.

Depending on the nature of the company and its context, BoDs of SOEs in Uzbekistan typically include representatives of the industry in which the company operates, officers of state bodies, and representatives of other non-state shareholders, due to a cumulative voting procedure, which was introduced by law to take minority shareholders’ rights into account.

²² Resolution of the Cabinet of Ministers of the Republic of Uzbekistan «On measures for improvement of corporate governance of privatized enterprises», adopted on 19 April, 2003, #189.

Demographic data on the board composition of SOEs in Uzbekistan reveals that most members are males between 25-45 years, while chairman positions are rarely held by persons over 60 years of age, and women hold board positions in 11% of cases²³.

Analysis of SOE boards in Uzbekistan, in a manner set forth by Hilb (2008), resulted in the following findings:

- know-how – industry representatives on the board have practical experience and knowledge in subject-specific areas of competence. However, given the importance of the various areas of competence and the levels of satisfaction with the existing board, according to the board members, the top management team, and major shareholders, areas of competence missing in the actual board need to be identified for each board.
- team roles – clear division of business area-related matters to be advised by industry representatives, hiring and remuneration matters up to officers delegated to the board from relevant state bodies, while other matters are decided together.
- demographic data – board composition reflects overall distribution of portfolio positions in state bodies. Given the current demographic situation in Uzbekistan, the average population age is 27.5 years (Statistical Digest, 2013:84), with most administrative positions in state bodies held by persons between 25-50 years of age.

Based on provisions of the relevant legislation, there are some specific features attributable to the board composition of companies (including SOEs) in Uzbekistan:

- no employee may become a member of the board;

²³“Gender at a glance. Uzbekistan” report by the World bank (available at <http://www.datatopics.worldbank.org/gender>) indicates that 11% of firms have female top managers and the share of women among ministers comprises 11%.

- state trustees are included in the board membership automatically without being elected by voting;
- the quantity of board members depends on the number of shareholders; there cannot be less than 7 if there are more than 500 shareholders, and cannot be less than 9 if there are more than 1000 shareholders. If there are less than 30 shareholders, then board functions may be performed by a meeting of the shareholders;
- duration of membership on the board is 1 year, after which each member is subject to re-election, and the state trustee is subject to reappointment;
- the board may define the size of management remuneration, if such a function is delegated to the board by the shareholders;
- the board approves all company rules and regulations pertaining to the company bodies' order of functioning;
- the board exclusively decides on matters such as the company's purchase of other corporations' shares and establishing the company's subsidiaries and/or branches and representation offices;
- the board must require a quarterly performance evaluation report from the management and make decisions, based on its efficiency;
- when the board convenes, the quorum requirement is 75%, if not set higher by the company's charter;
- board members are to be held liable on a solidarity-basis for their decisions which contradict the company's interests and cause losses, and any shareholder owning at least 1% of the company's shares may sue any board member for reimbursement of losses caused to the company;
- election of board members is conducted only by cumulative voting;

- all the board members attending the meeting must sign the corresponding protocol (minutes of the meeting).

The chairman plays a central role on the board, which is stipulated by its functions reflected in the relevant Law and Special Statute; however, in Uzbek SOEs, there are no such legal provisions that enable the chairperson to maintain the central responsibility for targeted board selection – it is a function of a special authority, the Centre for management of state assets. Nonetheless, the chairperson is in charge of arranging constructive work both within the board as well as in interaction with the CEO, while carrying out associated duties.

Another important aspect of board performance is meetings – the role attributed to the chairman who is responsible for effective handling of related tasks. The effectiveness of a board can be strongly influenced by the design of its meeting agenda. In this regard, SOEs in Uzbekistan have to comply with relevant legal provisions which set clear requirements for holding board meetings and design the minutes of held meetings. Furthermore, if the agenda includes certain items of importance, such as raising charter capital, hiring / dismissing the CEO or board members, recommending dividends or income distribution, such matters are subject to prior concord with the relevant state body.

Thus, the typical chairperson in Uzbekistan's SOEs would have to prepare for a board meeting by holding preliminary discussions with the relevant ministries and board members to be able to effectively proceed to decision-making when the board actually convenes.

2.2.2 Critical but constructive culture of trust

As Lareker and Tayan (2013:1) elaborate, fundamentally, “trust” is having certainty about how another person will act²⁴.

In a corporate setting based on trust, employees, managers, and board members adhere to a working manner which implies diligent work in line with commitments.

Some studies assume that relationships based on trust are more productive than relationships based on contracts. Kramer and Cook (2004) outline the main reasons why this is so:

- First, it is impossible to write a contract that specifies all behaviours. A contract to prevent self-interested behaviour will be incomplete because it is impossible to predict and anticipate all expressions of such behaviour. On the contrary, mutually trusting parties understand the limits of acceptable behaviour even when they are not explicitly stipulated in a contract.
- Secondly, an accenting contract instigates employees to “work to rule”. Sticking to the formal terms of a contract leads to emphasizing the minimum amount of work required for an employee to satisfy his or her obligations and avoid punishment. A contract can therefore degrade, rather than enhance, productive effort.
- Thirdly, trust creates more certain environments and such environments are less costly, while uncertainty implies a “risk premium”. Supervisors must allocate extra resources to monitor employees and employees must exert extra effort to express conformity with the company’s standards. In a milieu of trust, the

²⁴ For reviews of the research literature, please see: R. Kramer (1999); and D. Rousseau et al. (1998).

motivations of each party are certain, their behaviours are predictable, and the “risk premium” is removed.

Thus, a governance system based on trust might reduce costs, controls, and procedures, and the responsibilities of the board could be significantly narrowed.

Finkelstein and Mooney (2003:101) developed the following guidelines, based on an empirical study:

- Goal 1: engage in constructive conflict
- Goal 2: avoid destructive conflict
- Goal 3: work together as a team
- Goal 4: know the appropriate level of strategic involvement
- Goal 5: address decisions comprehensively.

The context of SOEs in Uzbekistan suggests that many board members in Uzbekistan share a similar background of working in an official state agency. In that manner, the behaviour and approach of each board member is rather expectable and thus lays groundwork for a certain degree of trust when addressing matters within the board.

Similarly, one member (e.g. representing financial agency) would trust the opinion of an industry representative on issues related to production, while the same will apply to the latter if the matter concerns the financials of the company.

2.2.3 Networked board structure

As recommended by Hilb, depending on the size of company, a fit board would have deliberately selected a strategic, diverse, accountably directing, and controlling board of three, five, or seven members.

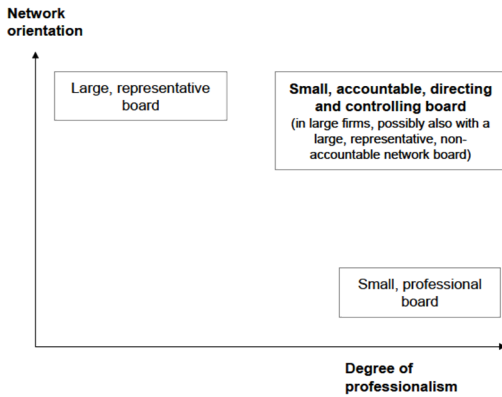


Figure 23: The directing and controlling board (Hilb, 2008:88).

Putting this recommendation in the context of SOEs in Uzbekistan, the following propositions can be derived:

- A typical board of SOE in Uzbekistan would be comprised of 7 or 9 members²⁵;
- Representatives having expertise in relevant fields will be nominated as board members, after a deliberate selection process²⁶ which also ensures diverse composition;
- Controlling functions of board members will be stipulated both by their legal authority as board members²⁷ and subject-specific powers which each member has as a state agency official;

²⁵ Resolution of the Cabinet of Ministers of the Republic of Uzbekistan «On measures for improvement of corporate governance of privatized enterprises», adopted on 19 April, 2003, #189.

²⁶ See for example Resolution of the President of the Republic of Uzbekistan «On approving board composition of selected large shareholder companies with state assets», adopted on 24 June, 2006, #PP-424.

²⁷ Article 75 of the Law of the Republic of Uzbekistan «On joint-stock companies and protection of shareholders' rights», new edition adopted on 06 May, 2014, #370. Such a provision was also foreseen by a previous edition of this law, adopted on 26 April, 1996, #223-I.

- Accountability of the board is ensured by prior concord procedures²⁸ when deciding on selected items of importance and their quarterly evaluated reports²⁹, which must be submitted to the supervising state agency, as well as remuneration of board members³⁰, which directly depends on the company's performance (business plan parameters, financial ratios, adherence to timely disclosure, etc.).

2.2.4 Stakeholder – oriented Board success measures

While some boards function better than others, there are essential elements that ensure the board's success, the most important of which is to align board and management activities with the interests of stakeholders. The more board members stay conscious of this fact, the better they perform. To put this into a practical prospect, direct contact of board members with shareholders and stakeholders plays a vital role. As mentioned in "2012 Board Practices Report", published by the Society of Corporate Secretaries and Governance Professionals and Deloitte Development LLC, 42% of directors covered by the conducted survey report having direct contact with shareholders or shareholder groups³¹.

²⁸ Statute on the order of state assets management in corporate structures (27.04.2005, Ministry of Justice Reg. #1473).

²⁹ Statute on the order of monitoring the efficiency of state trustees on managing state shares (30.07.2004, Ministry of justice Reg. #1394).

³⁰ Statute on remuneration for services of state asset management and state trustees on special participation right in governance of joint-stock companies ("golden share") (09.09.2011, Ministry of justice Reg. #2263).

³¹ "2012 Board Practices Report Providing insight into the shape of things to come", p.6

<http://www.corpgov.deloitte.com/binary/com.epicentric.contentmanagement.servlet.ContentDeliveryServlet/USEng/Documents/Board%20Governance/Deloitte%20Board%20Practices%20Report%202012.pdf>.

To move toward success, the definition of success shall be clearly established from shareholder, stakeholder, board, and CEO perspectives, which will also help to ensure relevant success-oriented measures to produce results that are expected and continued improvements.

Nevertheless, successful performance is hindered if board members overly stress efforts to differentiate the company from competitors, failing to comprehend how board members get along when interacting in a board.

Deriving from major areas of competence, board members face certain levels of both competition and cooperation, but attaining the optimal balance between these two, to a great extent, defines overall board success in ensuring stakeholders' best interests.

As put by Hilb (2008) using a specially-derived combination term, "coopetition" is the successful balance of cooperation and competition in the board.

The traditional view of roles suggests that initiation and implementation of success measures are within management's competence, whereas ratification and monitoring are undertaken by the board. In contrast, Hilb (2008) upholds that strategy initiation (or the development of success measures) requires the involvement of both the board and top management.

In Uzbekistan, one of the most important functions of the BoD is determining and monitoring strategy³². However, the law does not specify that the board is required to develop strategy all by itself, and in

³² Article 75 of the Law of the Republic of Uzbekistan «On joint-stock companies and protection of shareholders' rights», new edition adopted on 06 May, 2014, #370. Such a provision was also foreseen by a previous edition of this law, adopted on 26 April, 1996, #223-I.

practice, management, board members, and relevant state agencies work together and play a key role in initiating strategic measures.

Hence, the representation of role distribution with regard to strategy-related matters can be reflected in the table below.

| Phases / Participants | Owner's Strategy | Framework objectives of SOEs | Strategy development | Strategy ratification/ approval | Strategy implementation | Control over the implementation | Monitoring over the strategy |
|-----------------------|------------------|------------------------------|----------------------|---------------------------------|-------------------------|---------------------------------|------------------------------|
| Government | V | | | | | | V |
| BoD | | V | | V | | V | |
| Management | | | V | | V | | |

Table 7: Decisions on strategic matters: W-shape roles in strategizing process³³ (SOEs in Uzbekistan)

By adapting Hilb’s et al. (2013) breakdown of roles to the case of SOEs in Uzbekistan, the following patterns can be derived:

Phase 0 and 1: Owner’s strategy and framework owner’s strategic objectives

- (1) These phases in Uzbekistan are not regulated at all. There is a room for explanation of meaning and advantage of Owner’s strategy in the strategizing process of SOEs.
- (2) As per Schedler et al. (2013:127ff.) it is one of the fundamental duties of State as owner (executives and legislatives) in the Public Corporate Governance to regulate its strategy with regard to SOE. As displayed on the chart 24, the Owner’s Strategy and Objectives have to be developed on the political level in close and intensive cooperation with strategic leadership (BoD) of SOEs.

³³ Derived by author, based on M. Hilb et al. (2013:20).

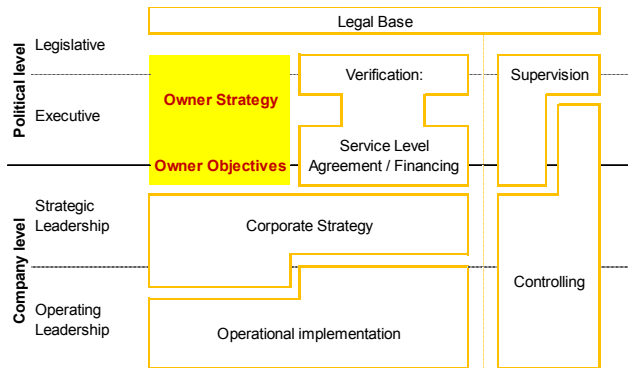


Figure 24: Classification of “Owner’s strategy” in Public Corporate Governance overview (adopted from Schedler et al., 2013:127)

It is recommended by academics (Mueller in Hilb et al.: 2013: 69) to develop for each SOEs individually a comprehensive policy on Owner’s strategy, have it reviewed each four years, and adjust it, as required. This document should clearly indicate strategy parameters towards the following topics:

- Objectives of owner (entrepreneurial, economic, political, social)
- Requirements to leadership (BoD and Management of SOEs)
- Requirements to supervision and control system (reporting, controlling, company business reports)
- Requirements to efficiency (organizational aspects, managing of meetings, public communications)
- Requirements to transparency (strategizing process, confidentiality)
- Other conditions (amendments, legal validity, deviations and exceptions)

A sample structure of the content of Owner’s Strategy policy in details has been demonstrated in Attachment 6 (adopted by Mueller in Hilb et al., 2013: 94-96).

- (3) As it is stated by Schedler et al. (2013:25), the advantage of regulated Owner's strategy is (1) to explain the intention of state in ownership on the company and (2) to pre-define the framework conditions to SOEs where objectives and realization of objectives have been indicated.
- (4) In order to develop the Owner's strategy, it is recommended to hold a separate workshop with representatives of executive power (politicians) and representatives of strategic leadership of SOE (BoD). Moderation of the workshop as well keeping meeting's minutes should be done by persons that have no dependency either to executives or to SOE. On that workshop both parties should sort out all open points from content of Owner strategy regulation and finalize it as one single document – Owner's strategy. (Schedler et al., 2013: 131-138).

Phase 2: Strategy development

- (1) Based on relevant empirical targets set by the board, the management prepares a cohesive report, outlining pros and cons of different alternatives of executing strategy and submits the report to the board no later than 15 November each year in a form of a business plan;
- (2) The business plan prepared by management is then sent to relevant state agencies for critical review, with management responsible for justification of the selected alternative in close cooperation with that state agency and the board.

Phase 3: Ratification of strategy

- (3) Corresponding state agencies outline their position after reviewing the business plan and then instruct their representatives on the board, while the state trustee (who usually presides over the board) gets a clear "Vote for", "Vote against", or "Abstain

from vote” directive³⁴ from the agency for state assets management.

- (4) In case the majority of state agencies’ representatives get “No objection” instructions and the state trustee gets a “Vote for” directive, the business plan is then approbated by the board and its final version sent to the relevant state agencies. Upon approbation of the business plan, the management is in charge of its implementation, while the board shall monitor its execution at least once every calendar quarter.
- (5) Shareholders, in their annual meeting (which is held no later than 30 June each year), then approve the business plan or amend it, if such a decision is considered appropriately in-line with factual conditions to date. Alternatively, the meeting could delegate the function of the business plan’s approval to the board, if relevant provisions are allowed by the company’s charter.

Phase 4: Implementation of strategy

- (6) When the business plan is approbated by the board, the management sets an action plan for SOE structural divisions and focuses its efforts to put the strategy into action in an appropriate manner, using a functions-based approach.

Phase 5 and 6: Monitoring strategy implementation

- (7) The duties of the management to perform a business plan and provide that all approved parameters are attained in a duly manner are reflected in the hiring contract³⁵.

³⁴ Statute on the order of state assets management in corporate structures (27.04.2005, Ministry of justice Reg. #1473) .

³⁵ Article 79 of the Law of the Republic of Uzbekistan «On joint-stock companies and protection of shareholders’ rights», new edition adopted on 06

- (8) The SOE and state trustee provide quarterly reports to the agency for state asset management that include a separate chapter on business-plan execution; if there is a significant divergence, the agency prompts corresponding measures. The duties of the board set by legislation dictate that the board shall review business plan execution at least once each quarter³⁶, so that at each of its meetings the board can monitor key indicators and progress with respect to important milestones so as to introduce appropriate interventions, including termination of management's hiring contract, if it fails to perform on a business plan.

May, 2014, #370. Such a provision was also foreseen by a previous edition of this law, adopted on 26 April, 1996, #223-I.

³⁶ Resolution of the Cabinet of Ministers of the Republic of Uzbekistan «On measures for improvement of corporate governance of privatized enterprises», adopted on 19 April, 2003, #189.

2.3 Integrated board management dimension

The Integrated Board Management Dimension integrates the targeted recruitment, evaluation, remuneration, and development of members of supervisory and managing boards. For SOEs, it is important to have a special body which handles nomination, remuneration, evaluation, and development in an integrated way.

2.3.1 Targeted selection of board members

The integrated board management concept, developed by Hilb (2008), comprises three dimensions:

1. The strategic elements that are the focus of attention:
 - best possible board team;
 - constructive, open board culture;
 - effective board structure; and
 - stakeholder-oriented board success standards.
2. The main processes of the integrated cycle concept are:
 - selection and composition;
 - review and feedback;
 - remuneration; and
 - development.
3. Regular check of board work success.

As outlined by Hilb (2008), “this concept ensures that the processes of selection, performance management, reward and development of board members and top managers offer added value for all stakeholder groups”.

Selecting a BoD is an important matter in any corporation. Board members are involved in making important decisions and shall meet the requirements set by legislation, shareholders, and company documents.

Such requirements, though, may contradict each other, as illustrated by Hilb (2008:103):

| BOTH... | ...AND |
|--|--|
| Has no conflicts of interests | has broad, practical experience in different firms |
| Is an independent, outside member | has an intimate knowledge of the firm |
| Has a track record of long-standing international business success | is not CEO of another institution |
| Has time to be a committed board member | has either independent board seats |
| Is not paid too highly | commits enough time to preparation and attendance of board meetings & workshops, and to passing on implicit know-how |
| Is already was well-off as possible | is not dependent on the board position |
| Takes on personal risk as a board member | has unlimited solidarity with firm performance |

Figure 25: Contrasting requirements of board members.

This, in turn, makes it hard to find right candidates which meet all the requirements for SOE board membership.

Reflecting on Hilb's (2008) approach to targeted selection of board members with regard to existing procedures, mostly prescribed by relevant legislation in Uzbekistan, the following comparative table was derived:

| Hilb (2008) approach | Current practice of SOEs in Uzbekistan |
|--|---|
| Phase 1: Determination of the main tasks of the board of directors | Phase 1. Agency for state assets management keeps database of possible candidates and, when needed, selects nominees for SOE board membership. The database is formed based on proposals from relevant ministries and state agencies, as well as references on |

| | |
|---|---|
| | experts, who are acknowledged in the field of corporate government. |
| Phase 2: Determination of main tasks of the new chairman of the board | Phase 2. Each year (usually in January), the agency for state assets management submits proposals to the: (a) Commission for monitoring effective management of state share in corporate structures on nominees for appointment of state trustees (for SOEs where state share exceeds 25%); (b) State committee for competition on nominees for appointment as board members (for other SOEs) |
| Phase 3: Know-how and distribution of roles in the new board | Phase 3. Proposals on approved nominees are then sent to SOEs where the shareholders meeting reviews proposals and votes for nominees, except for state trustee nominees, which are awarded board membership without voting. |
| Phase 4: Determining the chairperson's job profile | Phase 4. State trustees (who usually preside over the board) sign a contract with the agency for state assets management, which outlines job profile, duties, powers, and responsibilities of the state trustee. |
| Phase 5: Development of a recruiting process | Phase 5. The shareholders meeting is held to review the proposals on nominated candidates and vote on their board membership. State trustee votes on state shares. |
| Phase 6: Systematic structuring of the selection process | Phase 6. Elected board members (together with state trustee) hold an initial meeting of the board, and select |

| | |
|---|----------------------------|
| | the chairman of the board. |
| Phase 7: Selection committee processes candidates' information | N/A |
| Phase 8: Study applicants' references | N/A |
| Phase 9: Presenting the candidate to the board and top management | N/A |
| Phase 10: Induction of the new chairman | N/A |

Table 8: Comparison of board member selection process

The selection process is conducted in such a manner that doesn't foresee interviews with nominees or a widely-announced and transparent recruitment procedure. Furthermore, the general notion behind such a selection is that the initiative for selection comes not from nominees, but from references from industry or state agencies.

2.3.2 Targeted feedback for board members

Although formal performance assessments of board members are not conducted in Uzbekistan, quarterly reports by the board to the agency for state assets management could serve as evaluation of the board.

Quarterly reports indicate board member participation in discussions (number of meetings attended, matters initiated by the member for review at the board meeting, and board decisions (agreed/disagreed/not decided)).

In particular, the report includes data covering the following parameters:

- results of financial-economic activity of the SOE (9 main indicators, including financial ratios);
- business plan execution (on each indicator);
- measures initiated by the board member, their execution / no execution (indication reasons);

- dividends incurred and paid;
- information on board and shareholder meetings (such as attendance, questions reviewed and voted on, etc.).

Also, an integral part of such a report is an analytical memo, which covers in detail every major aspect of SOE activities, reflecting the board's role in achievements or failure. Special attention in the memo is paid to: reasoning; how the board is being proactive or retroactive on issues, such as growth of non-performing receivables or accounts payables; failure to pay dividends due or salary on time; decline in net income or sales revenue; and penalties or other charges being applied to the SOE.

Apart from reports, the agency for state assets management constantly seeks to evaluate board members during seminars and informal discussions intended to address practical issues in CG.

Furthermore, board members with most extensive powers – state trustees – shall undergo attestation, regularly conducted by the special Commission for monitoring effective management of state share in corporate structures, chaired by Cabinet members. During attestation, their skills, knowledge, and performance over the period will be tested during the interview and written exam.

This Commission also requires regular in-person reports, on a Cabinet level, from state trustees of strategic SOEs (usually, several industries every quarter), which aim to evaluate the performance of the board and its members.

When evaluating a board's performance, claims and complaints from personnel and clients are also taken into consideration, as resolving existing issues within its competence is also a board responsibility.

2.3.3 Targeted remuneration of board members

Remuneration is seen as a measure to reduce agency costs and, as such, incorporates different components designed to align the interest of the board members with that of shareholders.

With this in mind, board remuneration issues are addressed in great detail, both in relevant legislation and corresponding contracts with certain board members (state trustees).

In particular, the law on joint stock companies and protection of shareholders rights establishes that board members may receive payment from the company, and the shareholders meeting sets the size of such payment; additionally, the law decrees that board members can get reimbursement for costs incurred due to participation in board activities. The Statute on Supervisory boards, adopted by Cabinet resolution, establishes that *“the amount of remuneration for each member of the Supervisory Board is determined by the General Meeting of shareholders, depending on the effectiveness of its activities”*³⁷. In this regard, industrial associations and relevant state agencies issue remuneration recommendations addressed to specific SOEs, based on their performance indicators.

Hence, board members can get two types of remuneration: (1) reward for performance and (2) compensation for travel. As to the form of remuneration, it's usually paid in cash form, as other forms, such as equity-type remunerations, are very rare.

³⁷ Article 25 of the Standard statute for supervision board of a joint stock company, Annex 1 to the Resolution of the Cabinet of Ministers of the Republic of Uzbekistan «On measures for improvement of corporate governance of privatized enterprises», adopted on 19 April, 2003, #189.

Decision on payment of remuneration is solely within the competence of shareholders meetings, and there is no requirement to establish a special committee for remuneration matters stipulated in legislation; such committees are virtually non-existent in practice. However, the agency for state assets management takes a scrupulous approach to remuneration of state trustees, thoroughly evaluating its remuneration proposals. Every quarter, such proposals on remuneration of state trustees are submitted to the ministry of finance for expertise, and, upon approval, are paid by the agency for state assets management.

As payment decisions are coordinated by state agencies and industry associations, their size and criteria are somewhat uniform, which ensures that relevant market comparisons, firm performance, competence, and conformity with requirements are taken into account. Such an approach is perceived as both externally and internally fair and derived from the personal contribution of each board member in the SOE's performance.

State trustees get additional payment from the agency for state assets management³⁸ if their performance meets established criteria. This additional remuneration is not paid if:

- The state trustee fails to submit reports in time;
- SOE arrears have risen on dividends accrued on the state share;
- The SOE has incurred losses.
 - The remuneration of the state trustee is subject to a 40% cut if any of the following occurs:
- The SOE has arrears on dividends accrued on the state share;
- The SOE fails to execute on the net income forecast provided in the business plan.

³⁸ Statute on remuneration for services of state asset management and state trustees on special participation right in governance of joint-stock companies ("golden share") (09.09.2011, Ministry of justice Reg. #2263).

Apart from quarterly remuneration, the state trustee can get annual bonus payments equal to 2% of dividends accrued and paid on state shares and the net income above the business plan forecast and the last year's volume. This bonus is also paid by the agency for state assets management.

2.3.4 Development of board members

Each nominated candidate to the board of a SOE is considered to have relevant skills and experience and a good understanding of CG. However, every board should periodically review its effectiveness with a view toward improving the quality of its governance, boardroom discussion, and decision-making.

In some cases, this review might include use of an external facilitator and a formal board or governance assessment tool, as is the case when the agency for state assets management initiates such a review upon occasion. One criterion during such reviews is to what extent the board uses the induction process, director reviews, and gap analysis to assess continuing professional development needs (relevant to the SOE) and to enhance the relevant skills and knowledge of board members. Another important question during the review is the availability of necessary financial resources to support vital skill development in that particular SOE.

In other cases, such a review may involve informal one-on-one interviews conducted by the chair, another designated board member, or an expert external consultant (because one of the issues often being assessed is the effectiveness of the chair), supplemented by discussion at a board meeting(s) (typically without management present). This approach remains very rare, in practice, in SOEs in Uzbekistan.

However, the agency for state asset management encourages board members to participate in professional development activities that enhance their effectiveness in their role in SOE governance and regularly holds orientation workshops for elected board members, aiming to assist them in understanding issues relative to the operation of the SOE.

During their term of office, board members may participate in other professional development initiatives that are consistent with governance needs, held by various state agencies, industry associations, and the school of CG³⁹.

That said, the agency for state asset management remains responsible for designing and implementing procedures and forms for keeping track of expenditures associated with the professional development of board members in SOEs, as well as resource allocation toward board member professional development.

Overall, one of the principal functions of the nominating body, the agency for state assets management, encompasses development of relevant and cohesive procedures for the induction, training, and development of board members in SOEs, which it performs by issuing corresponding guidelines and ongoing advisory activities.

The approach to development of board members, expressed by Hillb (2008), highlights three major levels of such development:

1. Individual members of the board
2. Board teams

³⁹ Established by the Resolution of the Cabinet of Ministers of the Republic of Uzbekistan «On creation of the Center for corporate governance», adopted on 4 July, 2003, №304.

3. The entire organization.

Applying this approach to the case of SOEs in Uzbekistan, the following conclusions can be derived:

At an individual member level:

- each board member can participate in workshops and seminars held on CG;
- board members have to undergo regular attestation (usually every two years) in the form of a written exam and interview, during which their knowledge and performance are evaluated by the special Commission in accordance with established procedure;
- a succession schedule is applied to state trustees, and in between appointments the nominees usually participate in relevant orientations and courses at the school of CG.
- The notion behind these measures is to ensure that each individual board member has board-relevant competence, motivation, and integrity to direct and control the company.

At the board team's level:

- as most board members share a similar background of state agency or industry association work environments, it is rather easy for them to form an efficiently operating board team;
- board members interact within social networks, which facilitates exchange of subject-specific knowledge and skills and unification of approaches to corporate issues and implementation of know-how;
- an environment of trust formed due to the predictive decision-making procedure with SOE boards helps members to evolve their naturally immanent informal roles of a “creative thinker”,

“implementer”, “controller”, “networker”, etc., within the board, which helps the board to develop into an effective team;

- regular rotations, in line with an established succession schedule, help to transfer knowledge and skills across different SOEs and improve their boards’ performance as a team.

At the level of the entire organization:

- acquaintance with the best-practice SOEs during their reports on a Cabinet level helps to form relevant approaches to the board and SOE development;
- every SOE keeps an on-going succession schedule of its board members and CEOs, coordinating its nominees with the agency for state assets management, which facilitates development-oriented performance within the organization;
- within the SOE hierarchy, a career path is usually clear for every employee and promotion is implemented step by step, which fosters organizational development in a transparent manner.

Overall, the SOE, as an organization, offers an opportunity to its board members to apply their own knowledge and skills so that new knowledge and skills are created and brought to bear on SOE decisions and actions.

2.3.5 Integrated board – management committees

As most SOEs in Uzbekistan represent entire industries (oil and gas, chemicals, power generation and supplies, railways, cotton, food products, etc.), they are large and, in their day-to-day activities, board members deal with a wide range of issues requiring subject-specific knowledge.

However, legislation prescribes that only one special collegial body, in the form of an internal audit service, can be established under the board,

while no provisions in legislation empower the board to create issue-specific bodies (nomination, remuneration committees) or form joint board-management committees.

The law on joint stock companies and the protection of shareholders' rights has a provision for creating an internal audit service under the board. In accordance with the Presidential decree dated 27 September 2006, #PP-475, an internal audit service is mandatory for companies having assets (balance sheet value) in excess of UZS 1 bln or more.

Subject to the above provisions, the majority of SOEs in Uzbekistan have to create an internal audit service consisting of at least two certified auditors, who are independent of the SOE & its affiliates.

The relevant Statute on internal audit service prescribes the review of compliance to CG principles at the company as one of the main functions of an internal audit service⁴⁰.

The legislation further specifies that no member of the executive body may join the board as a member, but rather the head of the executive body attends board meetings upon invitation and has no voting right.

In practice, though, most boardroom discussions involve the executive body and relevant personnel, who, while having no voting rights, deliver reports on subjects in review by the board and present their reasoning and opinion to its members.

⁴⁰ Article 13 of the Statute on internal audit service on enterprises, Annex 2 to the Resolution of the Cabinet of Ministers of the Republic of Uzbekistan «On measures for ensuring effective governance of enterprises with state share in charter capital and proper account of state property», adopted on 16 October, 2006, #215.

Nonetheless, such issues as selection and composition, evaluation of performance (feedback), and remuneration of board members remain, to a large extent, outside of board's review, as decisions on these issues are made by the relevant state bodies.

Within the agency for state assets management, separate divisions deal with nomination and remuneration of board members and state trustees; for ordinary members, these two functions are performed (1) as per nomination by industry associations HR and corporate governance departments, and (2) remuneration by CG and finance departments of industry associations and the particular SOE. Thus, to a certain extent, such an approach forms independent decision-making not affected by relationships and personal attitudes. Furthermore, it's a common practice to set remuneration of ordinary board members as a percentage of the state trustee's. Also, in many cases, state trustees are remunerated only from the agency for state assets management and are independent of the SOE when deciding on corporate matters.

2.4 Controlling dimension

Boards are primarily tasked with monitoring of management. In Uzbekistan, the two-tier system of CG and the tasks of running and monitoring the company are clearly attributed to the members of the management and the board, respectively, and a person cannot be a member of both simultaneously.

The main task of the board is monitoring of management. Moreover, the board is involved in decisions of fundamental importance. The chairman of the board plays an important role, as he is usually attributed a double-voting right in firms subject to parity.

According to legislation, state trustees should ensure that they have sufficient time to perform their tasks as supervisory board members by not holding more than one simultaneous state trustee seat.

Monitoring by the BoD is of key importance for the protection of shareholders' interests. This notion implies that effectiveness of monitoring should depend on both the incentives and skills of the board. However, the skills of the board may be determined by the unobservable and time-invariant characteristics of individual members (e.g. experience, expertise, reputation).

Overall, the board has a special obligation to monitor company operations and financial position, and, consequent of the hierarchical structure, to ensure that management discharges its obligations.

For SOEs in Uzbekistan, the tasks of running and monitoring the firm are clearly assigned to the members of the executive and the supervisory boards, respectively. Additionally, state agency and industry

associations are presumed to have monitoring functions over SOE performance.

The board of directors is a collegial institution. This means that a member of the board is not entitled to act on his own behalf or independently from the board. The only way for a member of the board to obtain information about particular issues concerning the company is by raising a question about it at a board meeting.

The monitoring function of the board in Uzbekistan is emphasized by the following facts:

- members of the board may not be employees of that company at the same time⁴¹.
- state trustees or state bodies cannot intervene in the day-to-day operations of the management of the company⁴²;
- the board has power to dismiss management in cases prescribed by legislation⁴³;
- no functions of the board can be delegated to management, as stipulated by law.

Regarding the scope of the supervisory duty, it can be said that a member of the board does not normally have to investigate each and

⁴¹ Article 9 of the Decree of the President of the Republic of Uzbekistan «On measures for cardinal raise of share and significance of private sector in the economy of Uzbekistan», adopted on 24 January, 2003, #UP-3202.

⁴² Article 9 of the Statute on state trustees in joint-stock-companies, Annex 2 to Resolution of the Cabinet of Ministers of the Republic of Uzbekistan «On measures for improvement of corporate governance of privatized enterprises», adopted on 19 April, 2003, #189.

⁴³ Article 75 of Law of the Republic of Uzbekistan «On joint-stock companies and protection of shareholders' rights», new edition adopted on 06 May, 2014, #370. Such a provision was also foreseen by a previous edition of this law, adopted on 26 April, 1996, #223-I.

every aspect of the management's administration. It is not the duty of a board member to go so far in his supervisory activity as to review each decision made by the management. If there are reasons to suspect mismanagement, the board should get more information with the help of, for example, the company's auditor.

Distribution of functions is otherwise such that the BoD shall devote itself to the central problems of the company's business operations, with emphasis on the company's financial position, whereas the management shall attend to the daily operations of the company. It is, therefore, not required that a member of the board shall have the knowledge of, or that he must involve himself in, each detail of the company's business.

2.4.1 Auditing function of the board

The audit function of the board closely relates to oversight of the financial reporting process, selection of an independent auditor, and acknowledgement of audit results, both internal and external. This function, if duly performed, assists the board in fulfilling its CG and oversight responsibilities in relation to an entity's financial reporting, internal control system, and risk management system, as well as internal and external audit. An audit function will typically encompass:

- overseeing the financial reporting and disclosure process.
- monitoring the choice of accounting policies and principles.
- overseeing hiring, performance, and independence of the external auditors.
- oversight of regulatory compliance, ethics, and whistle-blower hotlines.
- monitoring the internal control process.
- overseeing the performance of the internal audit function.
- discussing risk management policies and practices with management.

- role in oversight of financial reporting and accounting.

Foreign practices foresee that an audit committee will be formed to review financial statements quarterly and annually. In addition, members of the audit committee will often discuss complex accounting estimates and judgments made by management and the implementation of new accounting principles or regulations. Audit committees usually interact regularly with senior financial management, such as the CFO and controller, and can comment on the capabilities of these managers.

In Uzbekistan, legislation stipulates that a special body under the board, in the form of an internal audit service, must be established in case the balance sheet value of a company exceeds UZS 1 bln⁴⁴. Since the majority of SOEs are large industry giants and have significant assets, almost all of them have established an internal audit service that is accountable to their boards.

The main provisions of the Statute on internal audit services, adopted by the Resolution of the Cabinet of Ministers, dates 16 October 2006, #215 establish that this service is responsible for:

- conducting internal audits (quarterly and for the reporting year) through appropriate tests in the areas specified by the board;
- examining contracts of the company to ensure compliance with legislation;
- providing structural subdivisions of the company with methodological assistance in accounting and financial reporting, advising them on financial, tax, banking, and other matters;

⁴⁴ Resolution of the President of the Republic of Uzbekistan «On measures to further develop securities market», adopted on 27 September, 2006, #PP-475.

- assisting the board in the evaluation of proposals, as well as making recommendations when mandating that an external audit organization to perform the audit.
- The number of employees of the internal audit service should be sufficient to effectively achieve the goals and objectives of the internal audit set by the board and must comprise at least two certified internal auditors.
- In accordance with the above Statute, the internal audit function is carried out only by members of the internal audit service by conducting inspections and monitoring:
 - implementation of the approved business plan;
 - compliance with CG principles;
 - the state of accounting and financial reporting;
 - calculation and payment of taxes and other obligatory payments;
 - compliance in implementation of financial and economic activity;
 - condition of assets;
 - internal controls.

The board may define other areas of inspection in accordance with the law, based on the profile of the enterprise.

The board is mandated to quarterly hearings of internal audit reports, covering the results of inspections, and to take corresponding measures to eliminate shortcomings and improve the efficiency and effectiveness of the financial and economic activity of the company.

2.4.2 Risk Management function of the board

The results of the study conducted as a part of this research reveal that the prevailing notion behind the risk management function of the board is that it should not be involved in actual day-to-day risk management. Instead, through its risk oversight role, the board has to make sure that

the risk management procedures designed and implemented by management are consistent with the company's strategy, that these procedures are functioning as directed, and that necessary steps are taken to be risk-aware, with risk-adjusted decision-making applied throughout the organization.

Through its oversight role, the board shall cause management and employees to apply comprehensive risk management, while ensuring that it won't serve as an impediment to the conduct of business.

There is also a clear understanding that running a company is an exercise in managing risks in exchange for potential returns. That said, assessment of risks, accurate calculation of risk versus reward, and the prudent mitigation of risk are an integral part of all decision-making in SOEs.

However, the centerpiece of risk-management in SOEs in Uzbekistan is mainly loss minimization.

Furthermore, risk management policies and procedures and codes of conduct and ethics should be incorporated into the company's strategy and business operations, with appropriate supplementary training programs for employees and regular compliance assessments.

Survey results with regard of SOEs in Uzbekistan are fully consistent with Hilb's (2008:165) position on risk management function, stating that "they are restricted to operational risk management and are only practiced at the management level". Therefore, typical weaknesses in the risk management approaches outlined by Hilb (2008) are fully attributable to SOE practices in Uzbekistan.

Consequently, even at the management level, the prevalent practices of SOEs in Uzbekistan suggest that risk-management efforts remain fragmented and incoherent with other functions; such a feature was also highlighted as a typical weakness by Hilb (2008:165).

From a shareholder perspective, the legislation provides that the choice of securities as an investment object and, therefore, the consequences of this choice is the risk of the investor⁴⁵.

Staying conscious of these provisions in the law, for cases where the state acts as a shareholder, the potential of being liable for losses incurred by the SOE (and subsequently by the state as a shareholder) are more evident in practice. Therefore, for SOEs and their board and management, avoiding losses (including lost profits) is of utmost importance, which greatly affects their business practices and processes. One illustrative example is that, before a sale of assets (regardless of their value), SOEs are obliged⁴⁶ to hire an independent assessment company, which recommends price range, and it is common for SOEs to select the highest price of the range when putting in a related offer, as well as a strict position not to lower that price, even when demand for the asset is not present at that price. Such a focus on loss-minimization when managing risks can obstruct the search for entrepreneurial opportunities for SOEs and might serve as an indicator that many of them, using the formulation cited by M.Hilb (2008) and Ernst and Young (2002:7), “*have not achieved the balance between comprehensive checks and the necessity of sufficient entrepreneurial freedom of movement and optimized risk costs*”.

⁴⁵ Article 58 of the Law of the Republic of Uzbekistan «On securities market», adopted on 22 July, 2008, #163.

⁴⁶ Article 11 of the Law of the Republic of Uzbekistan «On assessment activity», adopted on 19 August, 1999, #811-I.

2.4.3 Communication function of the board

As all the boards are composed as collective bodies with members having diverse expertise in various fields, communication within members, between board and management, and external communication of the board with stakeholders is important for successful company function. Likewise, the absence of such communications will hamper the company's CG efforts.

Communication within the board

To make informed decisions which serve the best interests of stakeholders and their representatives elected to the board, it is important that board members effectively communicate with each other. In practice, communication in boards is held back for different reasons, mainly due to the limited time allocated for discussion, as board members are usually very busy and tight on their schedules. Consequently, much discussion happens outside boardrooms.

Another obstacle to communication comes from conformity traditions common to the vast majority of boards. Additionally, board voting requirements, set by legislation, impose a ban on voting by secret ballot; thus all members present at a meeting have to undersign the corresponding protocol (minutes). In such a setting, board members often abstain from open expression of views which might contradict the shared opinion of others in the board. Hence, the pressure for conformity greatly affects the board's decision-making routine, and urges board members to communicate with others prior to the meeting. From this perspective, conformity at the decision-making stage encourages better communication and may have a positive effect on board decisions.

State trustees, who get written instructions from state agencies before voting on certain issues, usually care the least about conforming to

others, and the other members of the board will conform to his voting. When there is no state trustee on the board, a similar role is attributed to the board chair, who is often more experienced amongst members and leads boardroom discussion.

Communication with management

When addressing an issue of board communication with company management, one must consider the importance of balance between control and collaboration in the board-management relationship.

Hence, it is hard to maintain equilibrium when performing seemingly contradictory board functions of controlling and communicating with the management, as indeed the communication between board and management requires a solid sense of balance and the ability to clearly express opinions. Fundamentals of such communication would include:

- clarity of board function, as well as management's role and responsibilities;
- clearly articulated expectations of the board and management;
- mandates for management to act within its competence without always asking for the board's permission, while keeping the board informed;
- key objectives for the organization, mutually agreed upon between the board and management;
- shared exertion for fulfilment of mutual obligations which bind management and board together in a common purpose.

One major insight emerging from the survey conducted as a part of the present research is that the majority of interviewed practitioners stress that the relationship between management and the board (whose members are aware of the company's context), and their concurrent

involvement in the process of governance is important for sustainable development of the SOE.

Once the balance between controlling and communication functions is attained, then it helps the board perform more efficiently in monitoring management, protecting stakeholder interests, and, where required, deliver prompt and relevant advice.

External communication

Undoubtedly, communication between the board, stockholders, and other interested parties is an important part of the CG process.

At an external communication level, stakeholders expect the board to be active in developing ideas, refining possible solutions, deciding the final strategy, and reviewing the process of strategy implementation.

A key role attributed to the board, in this regard, is to direct management in the long-term interest of the company and its stakeholders, so that the interests of boards and stakeholders are seen as fundamentally aligned.

Therefore, effective communication with stakeholders is essential for the board's success and determines how well it performs on the above expectations.

However, most SOE boards in Uzbekistan have no separate policy on external communication and the board's information shared with the public comes as a part of the company's overall disclosures. In this manner, board-related material facts are disclosed by company, in cases prescribed by relevant legislation⁴⁷.

⁴⁷ Article 39 of the Law of the Republic of Uzbekistan «On securities market», adopted on 22 July, 2008, #163.

There is also a link between the board and stakeholders, as representatives of stakeholders elected to the board closely interact with the latter when preparing meetings.

2.4.4 Board success

With regard to reviewing board success, there are two relevant functions:

- the controlling function of the board
- the self- and external evaluation of the board.

Applying Hilb's (2008) approach to determination of board success with regards to its controlling function, the survey, conducted as a part of the present research, revealed the following:

| Questions | Case of SOEs in Uzbekistan |
|--|---|
| 1. Does the board get regular (e.g. quarterly) information on the financial situation of the company? | Legislation prescribes that the board has to review the company's financial results as a part of management's performance report at least once each quarter. |
| 2. Does the financial reporting contain statements on all financial indicators (company value, cash flow, profitability, liquidity)? | Common practice is that financial indicators are a part of a business plan. The board must, by law, review performance of management on business plan execution at least once each quarter. Hence the board, as a rule, has access to financial reporting that contains statements on all financial indicators. |
| 3. Is the extent of the reporting fine-tuned (not too much, not too little)? | Financial reporting forms are standardized across all SOEs (balance sheet 3 pages, income statement 2 pages, cash flows statement 2 pages). Along with that, common practice is to use a 'snapshot' comparative table on business plan parameters (planned and factual). Thus, one might consider that |

| | |
|---|--|
| | the extent of the reporting is fine-tuned. |
| 4. Does the board get regular information on non-financial indicators (e.g. market shares, employee satisfaction, competitor behaviour)? | Getting regular information on non-financial indicators (e.g. market shares, employee satisfaction, competitor behaviour) is not a common practice of SOE boards, although they are mandated to request and receive such information from the company. On the other hand, considering that most SOE boards have members representing industry associations, they are well aware of market share and competitor behavior. |
| 5. Is strategic control enabled through reports on significant deviations from the strategy implementation? | Such reports are not used in practice by SOEs in Uzbekistan. |
| 6. Has the board communicated its requirements and expectations to the management concerning frequency and form of the (delivered) information? | The frequency and forms of reports are set by legislation. For the SOE-specific parts of the report, common practice is to apply industry association recommendations, and if those are not present, then the board approves such a form and sets the time periods when it shall be delivered. |
| 7. Is there a possibility that the board can check the accuracy of the information that is delivered (e.g. via the internal audit)? | Each SOE has an internal audit service under the board, which must check the accuracy of reports, oversee the process of their preparation, and report to the board within 10 days after each such examination. |

Table 9: Summary of findings with regards to controlling function of the board of SOEs in Uzbekistan.

From an external viewpoint, the success of the board can be evaluated by rating agencies, but those are not yet implemented in Uzbekistan, as no rating standards or practices are in place to serve the purpose of

board evaluation by rating agencies. Similarly, domestic research institutes haven't yet approached the matter of evaluating the success of SOE or other companies' boards.

Yet there is an external body that serves, to a certain extent, to evaluate SOE board success in Uzbekistan – the agency for state assets management, which regularly collects reports from state trustees and SOEs and takes part in board member appointment, remuneration, and dismissal.

However, the reports-based formal approach to evaluate boards might lead to the case when, as is common with many bodies who find it difficult to measure performance, the agency may be tempted to fall back on the measurable, whilst numbers can't capture the true essence of how a board functions. Indeed, it is commonly believed in practice that a SOE's success suggests the success of its board, whereas current success may originate from the previous board's decisions or, alternatively, an unsuccessful SOE has a successfully performing board that is arranging for future success of the SOE.

Similarly, no internal scorecard or peer assessment undertakings are being used in the boards of SOEs in Uzbekistan, and such practices remain a subject of discussion stage among relevant domestic academic institutions.

Overall, the current approach to the board's success evaluation and comparison of SOEs of Uzbekistan, although this approach lacks some important features needed for effective measurement, still lays the potential for further comprehension and evolvement of a systemic methodology.

2.5 Concluding Observations and Implications for Empirical Study

Historically, CG-related matters in Uzbekistan originated and evolved closely with the privatization of state property. In particular, some 6600 enterprises were incorporated (incorporation was regarded as one of the privatization methods), turning into joint-stock companies with state shares in charter capital; these shares were then gradually sold to the public (legal and physical entities, both domestic and foreign). Over the years, most of these entities initially incorporated as joint-stock companies, then changed their form to limited liability companies. However, the remaining 1100 joint-stock companies have, in total, more than 1 million shareholders, mostly due to privatization specifics that ascribed 10% of shares to be distributed among employees.

Such a background affected the shaping of the CG framework in Uzbekistan and defined regulatory objectives in related spheres.

The 10 major milestones of CG-related matters are the following:

- creation of the first joint-stock companies in Uzbekistan in late 1980s, based on a special provisional statute;
- adoption of a law that introduced shares as instruments allowed for issue in Uzbekistan – in 1992, the law on securities and the stock exchange was adopted;
- due to evolvment of operations with shares, the need for regulation of the market and its participants coerced the adoption of a special law – in 1996, the law on the mechanism of functioning of the securities market was adopted;
- creation of a new class of owners compelled the adoption of the law on joint-stock companies and protection of shareholders rights in 1996;

- in order to assure proper protection of shareholders rights, a new law was adopted in 1999 on depositories and depository activity in the securities market, setting the detailed regulatory framework for securities custody, registrars, and accounting;
- acute interest in investor protection-related matters led to adoption of a law on protection of investor's rights in the securities market in 2002;
- minimum charter capital requirement of USD 50,000 was set for joint-stock companies in 2003, after which their number dropped in the subsequent two years, from 4500 to 2000, as a result of transformation to limited liability companies;
- the need to unify complex legislation on the securities market led to adoption of a comprehensive single law on the securities market in 2008;
- a minimum charter capital requirement of USD 400,000 was set for joint-stock companies in 2010, after which their number decreased to 1100 as a result of transformation to limited liability companies;
- adoption of a new edition of a law on joint-stock companies and shareholders rights in 2014, foreseeing major improvements in protection of minority shareholders, regulation of a company's transactions with its affiliates, issue and circulation of shares, disclosure, and other areas.

In 2012, the specific agency for state assets management was established (Centre for state assets management), under the newly reorganized State Committee for privatization, de-monopolization and promotion of competition (which was formed through a merger of the state antitrust authority and the state property committee). Additionally, the market regulator was reorganized to become the Centre for coordination and

development of securities market (formerly known as Centre for coordination and control over functioning of securities market).

The legal and institutional framework in Uzbekistan that regulates SOE CG is gradually evolving since the country's independence.

Although the matter of CG is discussed among academicians and business practitioners, subjects related to SOE specifics are often beyond the scope of such discussions; however, there is a clear anticipation among field experts that such a discussion and thorough studies of matters related to SOE CG are coming soon, as there is a growing sentiment towards development and room for improvement in CG of large Uzbek companies, which are predominantly represented by SOEs.

In this regard, a special empirical study was designed to address experts with questions of utmost importance for further development of CG of SOEs in Uzbekistan; this empirical study and its findings are presented in chapters below.

General empirical section

3. General empirical section

In this section of the work, a developed concept for Uzbek SOEs will be tested through interviews based on open-ended questions with leading experts. The outcome of the empirical study is new insights and knowledge of CG in Uzbek SOEs and new evidence that the business world should not be neglected by introducing and/or improving CG practices.

The structure of this chapter includes an update on objectives, description of sampled experts, presentation of open-ended questions with a detailed interview process, and the results of the study under the defined limits of current empirical research.

The concluding part of the empirical research shows the main findings and facts to be considered for developing recommendations towards the academic and business worlds.

3.1 Empirical objectives

The objective of the empirical research is to observe the CG of SOEs in Uzbekistan and to propose an approach for continuous review, assessment, and identification of the barriers and problems in CG.

In the long term, this study should contribute to better understanding of the essential importance of CG and therefore to overall improvement of the CG and Management practices of SOEs.

In the medium and short terms, the research aims to enable all types of interested parties to recognize and to develop own governance framework.

The users will start by assessing the situational context, in which their enterprises act towards the more deep-rooted entrepreneurial dimensions.

3.2 Empirical sample of participants

To get more comprehensive knowledge and professional opinions, the selection and nomination of experts was carefully planned and interviews were held.

The following criteria were defined and nomination of experts followed by step-by-step approach:

1. Institutional aspects
 - State policymakers: parliament, central and local government, state organizations, those responsible for providing state policy in the CG area;
 - Managers in state corporations: state-owned enterprises, state commercial agencies, state natural monopolies, state non-profit organizations;
 - Academics and researchers: schools, research institutes, training centers, specialized journals and publications.
2. Criteria for personalities
 - Proven track record in the area of CG and state ownership;
 - Educational background and continuous self-improvement and/or teaching activities;
 - Publications and participation in research projects.

Nomination of experts was followed using a step-by-step approach; each nominated expert was asked to recommend at least 3 other well-known specialists from the area of CG. As a result, the experts listed in Attachment 3 were selected for further interviews:

Nominated experts represented different institutions and interests, thus the pool of these specialists is well-diversified and their responses covered each aspect of the CG of SOEs in the Republic of Uzbekistan.

Experts acknowledged that all information gathered during the interviews was used only for research purposes and will not be provided to the third parties without their advance agreement.

3.3 Research methodology

The research procedures and methodology have been described in this chapter. Procedures are divided into steps, which are built on the logical chain of actions and opportunity to cover the whole research scope.

3.3.1 Procedures

Procedures consisted of the steps illustrated in Chart 4 (Research procedures).

3.3.2 Interviews

Interviews were conducted in several sequences, depending on the time availability of experts. Each interview was carefully planned and conducted according to the agreed rules. Interview questions were distributed one day in advance, the minutes of interview were taken by interviewer, and both the interviewer and expert have signed the end version of the protocols in a table format sent by email.

Interviews were held in the office premises of experts, in their usual working environment, without any disturbances from other people.

The interview time varied but was, on average, 90 minutes. The open-ended questions listed in Attachment 4 were directed to experts.

3.4 Limits of empirical results

The current research has its own limits:

- the research concentrates primarily on Uzbekistan, but the validity of the findings could be extended into countries with a similar situational context;
- this is a research on CG of state companies, hence the proposed concept could be applied, with various adjustments, to other types of enterprises, like family business, non-profit organizations, private companies, etc.;
- the success and effects of the proposed concept depend on whether it would be enforced on a continuous basis, otherwise it would become only a static snapshot of CG;
- since the current research is explorative, it could be considered an invitation for future studies that focus on specific elements of governance in state companies.

3.5 Empirical results

The purpose of the questionnaire was to initiate links with respondents, to introduce and awaken their interest in the research, and to screen their views regarding the central points of the concept. The questionnaire covers the points of board staff, management, and performance evaluation processes and practices in SOEs. Qualitative research is an iterative process in which data collection, data recording, intermediary data analysis, reflections, and generation of new questions are part of continuous efforts.

All interviews were standardized and contained open-ended questions, so that the results of interviews could be structured and analysed on comparable basis. The details of questions reviewed during the interviews were highlighted in the general theoretical section of the dissertation.

The process of analysing the experts' opinion and comparing it with the concept of CG of SOEs will fulfil the main objective of the research. The summary of the conducted survey is reflected below, structured by the consequence of experts' opinions on prepared open-end questions.

- On the question № 1.1. Which external factors (such as: culture and mentality of nation, institutional and legal norms of country, etc.) are influencing or could impact the successful engagement of the BoDs of SOEs in Uzbekistan?

The majority of experts agreed that the listed factors affect the successful formation of the supervisory board of a SOE and the arrangement of its activities.

In this case, according to most experts, the legal norms and institutional framework have the greatest effect on formation and organization of the BoD.

Each surveyed expert identified law as a key factor in determining the successful formation of a BoD of a SOE and the arrangement of its activities. Two experts detailed their answers more specifically, noting that the law must first provide a clear distinction between the rights and duties of the BoD and of the functioning of its individual members, while the lack of clarity on these issues abolishes the practical need for a BoD, as such.

Other factors, such as culture, mentality and the system of social values are also important and determine the effectiveness of the supervisory board.

- On the question of 1.2. Which internal factors (such as conflicts of interest of different state organizations represented in the BoD, complexity of corporation, industry-specific regulations, the level of foreign business relations, clear separation of functions on the top management and BoD levels, etc.) are influencing or could impact the successful engagement of the BoDs of SOEs in Uzbekistan?

Most experts think that conflict of interests and industry specifics largely affect operations of the BoD. In some cases, along with the traditional understanding of a conflict of interest, situations may arise when representatives of different departments hold opposing views on the development of the SOE, particularly when distributing its profits.

Additionally, the definition of a conflict of interest as an important factor in successful operation of the company's management prevails

among the expert community and has already been reflected in changing the rules of company law, which now outlines the rules relating to situations in which conflict of interest is possible and regulates the actions of the company's management in such cases (the study of transactions, their audit, prior and subsequent approval, and challenge and responsibility for such transactions).

- On the question № 2.1. In your opinion, to which extent is the diversity based on age, nationality, sex, educational background, and professional track record, important for selecting and/or nominating board members in Uzbek SOEs?

Almost all interviewed experts noted the professionalism of candidates for the election of the supervisory board. Results of the survey on the subject indicate that factors such as gender, age, and nationality are not considered by experts as having decisive importance in the formation of the BoD.

On the contrary, recognizing the importance of diversity, some experts point out that diversification should be considered as an approach in which the BoD includes members who have professional experience in each area of the company's activity that will collectively contribute to the company's activities as a whole.

- On the question № 2.2. How open should board members be to each other, to allow constructive criticism regarding the governing of SOEs?

All experts noted the need for BoD (and its members) openness; however, the vast majority of experts say that an appropriate framework is required within which activities must be open - legislation is cited as bounds for openness (in particular, the prohibition on disclosure of

information, which is recognized by law as guarded secrets – trade secrets or confidential information).

Thus, the unanimous opinion of experts was to ensure that members of the BoD shall be as open as possible without compromising privacy.

As interpretation and perception of “being constructive” can be quite blurred, the generalized opinion of experts is to ensure that the framework is difficult to determine and shall be dealt with individually in each case.

- On the question № 2.3. How should the BoD of Uzbek SOEs be structured and organized with the purpose of facilitating the working atmosphere?

This question had the greatest variation in expert opinions; at the same time, the experts' responses complemented each other. Summarized answers are such that the working atmosphere should be professional and based on the following approaches:

- BoD members supervise individual activities of the company;
- the BoD meeting should be carefully prepared to assist the chair (a corporate consultant may be hired for this purpose);
- the work of the BoD shall be in accordance with the approved plan;
- appointment of BoD members at a fairly long-term;
- discussions and meetings should be once a month but not less than once in 2 months, quarterly meetings should not be confined only to the reconciliation of budget execution, which, in terms of absentee voting, can become a formal procedure;
- relevance of guidelines for the organization of the BoD and its committees, based on international experience;

- the working atmosphere should provide each member of the board with an option to express views on subjects under discussion and take the most constructive solution;
- BoD members shall be able to listen to the other members and respect each other;
- evaluation criteria should help achieve the result in a harmonious and constructive setting.

- On the question № 2.4. In your opinion, what is the optimal number of board members in Uzbek SOEs?

Interviewed experts indicated that the optimal quantity of BoD members ranges from 5 to 11 members. The overwhelming majority of experts believed that the members of the BoD should be not less than 5 and not more than 9. Moreover, most experts believed that 5-7 members is best.

**Expert opinions on optimal number of board members
(survey results)**

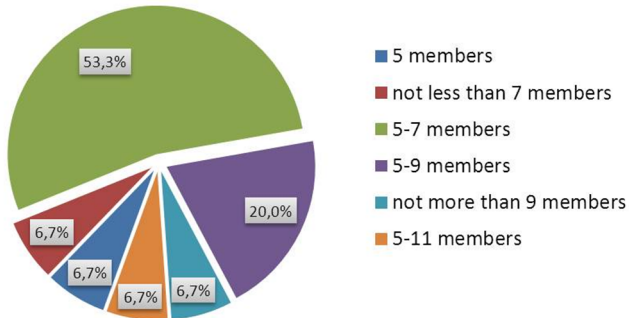


Figure 26: Expert opinions on optimal number of board members (survey results).

- On the question № 2.5. In your opinion, which criteria should be applied to measure and evaluate the success of the BoD in the development and realization of the strategy of SOEs?

The overwhelming majority of experts expressed the view that the most important criterion for evaluating BoD activities is business plan execution and assessment of how its parameters and targets were realized in practice.

Among other factors which can serve to evaluate the BoD performance, experts noted:

- demand for manufactured products, profits, changes in turnover, and the operating environment of the company;
- improvement of financial and economic indicators and compliance with corporate governance principles: fairness, transparency, accountability;
- enforcement of legislation in production and economic activity, the presence of substantial intervention strategies and their publicity, the construction of a rational system of CG in SOEs, an objective assessment of their performance, the formation of a system for the management of motivations, and constraints on hidden lobbying of the interests of various departments and individuals;
- income diversification, maintenance of permanent enterprise competitiveness, and work to ensure the financial success of the company for the long term;
- lack of consumer complaints and low record of walking orders for company personnel.

- On the question № 2.6. How should duties and functions between the executive team and the BoD of SOEs be split to elaborate the strategic plan of the SOE?

A. Who has to develop the action plan to achieve those objectives?

The majority of interviewed experts noted that the executive body and the BoD must both be engaged in development of ways to achieve company objectives.

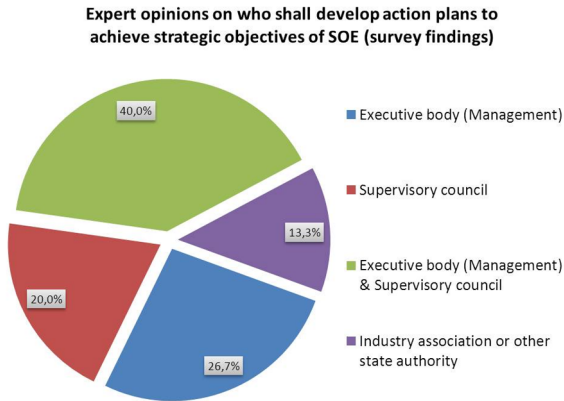


Figure 27: Expert opinions on who shall develop action plans to achieve strategic objectives of SOE (survey findings).

B. Who has to confirm and approve the strategy of SOEs?

Expert opinion was equally divided – one half believed that the strategy must be approved by a general meeting of shareholders, while the other half believed that it is the prerogative of the BoD. Some experts believe that this should be done jointly by the general meeting of shareholders and the BoD. Only one expert mentioned that it is the function of the executive body.

C. Who implements / executes strategic development plans?

Experts unanimously stated that it is the responsibility of the executive body to implement and execute strategic development plans. In one case, the expert noted that implementation of the strategic development plan should be carried out by the executive authority together with the BoD.

D. Who has to control the implementation of approved corporate strategy of SOEs and how?

Each interviewed expert believed that implementation of corporate strategy is the function of the BoD. Some experts believed that such control is exercised together by the BoD and the general meeting of shareholders.

On the question of how such controls should be carried out, most experts answered that control is exercised through the regular hearing of reports of the executive body and comparison of indicators (with projected values and values for previous periods).

This approach is reflected in the legislation, including the updated rules of company law, according to which the BoD is authorized to hear the reports of the executive body and take action when it is inefficient, including changing the CEO.

- | |
|--|
| <ul style="list-style-type: none">• On the question № 3.1. In your opinion, what is the best way to select and nominate the members for the BoD of Uzbek SOEs? |
|--|

Interviewed experts expressed, if not unanimity, considerable similarity of views. So, the answers to this question can be roughly grouped into the following approaches:

- selection of members by industry departments and approval by a general meeting of shareholders;

- it is advisable to conduct competition tenders in selecting members of BoD, as the legislation does not contain specific requirements for the performance standards of BoD members (except for state trustees, who become BoD members without election);
- it is necessary to include independent directors on the BoD.

- On the question № 3.2. Is it possible to make targeted evaluation of the activity of the entire board? How is it possible to evaluate the individual contribution of the board member? Is it worthwhile to introduce such an evaluation system to Uzbek SOEs?

Interviewed experts agree that it is necessary to first to identify the areas of responsibility of each BoD member, and then, on the basis of performance in the context of each of the attributed areas, determine the efficiency and effectiveness of each BoD member.

- On the question № 3.3. What should the remuneration system of Board members look like? Could a combined system like monetary and non-monetary incentives be applied or a fixed and performance-dependent system? What is the optimal tenure for service on the board?

Most experts stated that the system of remuneration of BoD members should be in direct proportion to the effectiveness of the company's business.

In this case, for businesses that are unprofitable, it is advisable to provide for a fixed wage.

- On the question № 3.4. What is the non-monetary reward system for the activities of the members of the supervisory board in SOEs (respect, recognition, personal development programs, insurance, etc.)?

The majority of experts primarily state personal satisfaction of supervisory board members as a non-monetary reward and recognize that the non-monetary reward system is certainly important. The most important aspect in this regard, as experts identify, is motivation in the form of recognition, respect, and acceptance.

- On the question of 4.1. Would it be right to claim that the work of the BoD of SOEs should be organized according to its strategic obligations and functions?

A. Functions of financial control - audit committee

Experts note that this function is carried out by the internal audit (under the law such a service should be created if the assets of the company amount to 1 billion UZS (Uzbek currency) or more).

B. The evaluation function and risk prevention - Risk Management Committee

Experts note that although such a committee does not exist in practice, it can be viewed as a part of the BoD, especially when lending or investing significant equity.

C. Communication functions with external stakeholders

Expert opinion is that the communication should be carried out by specially-created press service and should serve to ensure transparency and accessibility of information on the company within the law.

Especially important is the effective implementation of this function in public companies (listed on the Stock Exchange).

A similar approach is reflected in the updated version of the Companies Act, which obliges companies listed on the stock exchange to disclose additional information on the exchange website.

D. Evaluation of Executive Body

Interviewed experts unanimously agreed that this role is assigned to the BoD and its effective implementation is achieved through regular (at least one per quarter) hearing of reports of the executive body.

- On the question № 4.2. What are main strategic functions of the BoD of SOEs?

Interviewed experts, although they used different wording, nevertheless agreed that such functions include:

- participation in the development strategy, operational monitoring, and advisory assistance in resolving operational issues of the executive body;
- enforcing the business plan of the company, including the analysis of financial and economic activities, the effectiveness of management, and introduction of quality standards;
- definition of a vector for sustainable development of the company, control over activities of the executive body, preventing / reducing the risks of the company, and ensuring transparency of the company and its management bodies.

- On the question № 4.3. Are the following functions of the BoD of a typical commercial private organization, such as financial control function, risk management, communication, and performance evaluation of the executive team, applicable to Uzbek SOEs?

All experts note that this shall apply in full. At the same time, some experts admit that industry specifics may also be important.

- On the question № 4.4. How many committees should be established in the BoD of SOEs?

Interviewed experts indicated 1 to 5 committees, with most experts stating that the specific number of committees will depend on the nature of the SOE's business and market capitalization, as well as the number of BoD members.

3.6 Conclusion on specific empirical section

The approach described in the study by Professor Hilb (2008) served as the main objectives stated in this thesis and:

- **first**, encouraged the interest of the expert community to further research issues related to CG of SOEs in Uzbekistan;
- **second**, represented the first attempt to cohesively study various parameters of BoD activity in SOEs of Uzbekistan through the prism of situational, strategic, integrated measurement and control;
- **third**, served as a useful tool in addition to the widely used traditional theories, which often omit practical aspects of companies, especially SOEs;
- **fourth**, allowed the development of concrete, practical recommendations for action-oriented SOEs and further improvement to CG in Uzbekistan;
- **fifth**, allowed initial exploration of the effect of qualitative factors, as opposed to solely focusing on quantitative evaluation of the BoD, company, and its activities;
- **sixth**, provided additional feasible tools, described by Hilb (2008), such as diversity cards; informal interviews when selecting and evaluating the board may serve to improve CG practices of SOEs in Uzbekistan.

Conducting research is an innovative approach that primarily emphasizes practical usefulness and focuses on aspects that are often ignored in research based on traditional approaches (agency theory, etc.).

In terms of emerging, and thus frequently changing, institutional and legal environments, Hilb's (2008) approach allows practical and useful insights for effective organization of SOE activities.

The present study also addressed such important practical aspects as finding a balance between executive and independent board members of SOEs.

Among the innovations of the conducted empirical research is that the expert survey addressed issues such as the importance and significance of the mentality and cultural environment for the efficient operation of a BoD in Uzbekistan - and it seems that the study has awakened the interest of the expert community in Uzbekistan to this subject and will foster further academic and practical study of the issue.

The empirical analysis of this paper finds that, instead of falling on the measurable, other important aspects shall be taken into account when evaluating management/BoD and company performance.

The results of this paper support the theory of M. Hilb (2008) that independent directors positively contribute to BoD activities, given that proper member selection, evaluation, and remuneration procedures are implemented throughout the organization.

The dissertation also discusses the contextual differences between SOEs and private firms with regard to decision making and the state's involvement in managing enterprises. While there is compelling evidence that successful governance of SOEs can be achieved via legislative reform, SOEs in Uzbekistan have yet to undertake practical efforts for corporate reform internally and draw valuable lessons from the best practices of SOEs from developed countries, keeping contextual differences in mind.

This paper investigates the impact of individual executives and directors on firm performance. In Uzbekistan's two-tier system of CG, the tasks of running and monitoring the SOE can be clearly assigned to the members of the executive and the supervisory board.

Henceforth, the effect of management & board members is equally important in explaining SOE performance and assists in explaining the observable qualities of the manager, board, and company. Moreover, combining these effects, rather than dispersing them between management and the BoD, will unlock existing alternatives for better performance of SOEs in Uzbekistan.

Concluding section

4. Concluding section

It is very important to note that definitions in CG tend toward either one of the two orientations in business: shareholder value and stakeholder interest. The approach of New CG, where principles of good CG applied in a firm should be kept situational, strategic, integrated, and controlled (Hilb, 2008), attempts to achieve a balance between both value-orientations. This approach is emerging and, in fact, shows evidence of becoming the main principle for defining CG. The emphasis of this definition attempts to cover the value-orientations of both the shareholder and stakeholder perspectives. Particularly important in the definition is its emphasis on taking into account a particular context when applying CG principles.

In such a context, it is crucial to find a balance in managing SOEs in the course of parallel pressure from shareholders and stakeholders. Such a balance shall be achieved primarily via investments by the state, which plays the role of strategic investor and reformer and manages its SOEs under the structure of a holding company to make strategic investments in various sectors and regions, as mapped-out in the government's plan. The research findings indicate that applying a new, holistic approach will best serve the needs of adequately evaluating the existing framework and improving CG practices of SOEs in Uzbekistan.

This section offers recommendations both for further academic research and business practice.

4.1 Recommendations for further research and academic discussions

It is surely a challenge to find a way to solve the problems of CG in SOEs. The agency theory perception of SOEs has been very pessimistic, especially with regard to conflicting interests that may arise in the monitoring and controlling by government institutions.

The analysis of best foreign practices in CG of SOEs indicate that, in relation to government-linked companies, it does not necessarily make it unable to practice good CG (Wicaksono, 2008:238). Indeed, in many spheres, where state participation, if not inevitable is perceived as most effective (such as utilities, railroads, postal service, strategic industries), Hilb's (2008) approach presents most relevant and practicable theory to date.

Unlike agency theory and other traditional approaches, the KISS framework allows one to overcome the following main weaknesses of traditionally applied methods:

- majority of national CG principles use a “one size fits all” approach, which is risky, as it may sustain sound governance but not guarantee that managing a company will be good;
- selection of executives, their evaluation, remuneration, and development frequently lack integrity and professionalism;
- lack of all-round know-how in audit and risk alert systems (risk management), communication, and evaluation of governance structures.

There is a serious lack of integrated enterprise management concepts. Analysis of the development stage of training showed that the future academic research of CG will depend on how effectively researchers pay attention not to the construction of analytical frameworks focused

on the firm level, but to elaboration of adequate comparative research of CG.

Most theories do not provide a holistic view, as they address specific angles of the CG relationship in an isolated manner. However, exploring this issue in the SOEs of Uzbekistan, a qualitative balance between monitoring and mentoring is yet to be achieved in relationships between the BoD and the management.

As the study by Hilb (2008) represents a new, holistic approach to CG, it simultaneously adds value to the shareholders, customers, employees, and society. This new approach to the direction and management of companies unites the components of CG that have historically been isolated from each other in research, teaching, and practice, and presents empirical results on CG practices in SOEs of Uzbekistan.

Theoretical and practical significance of the results of the study is a scientific justification for choosing a mechanism for improving CG in SOEs. Theoretical principles concerning the nature of CG and the factors affecting its quality and organizational structure may be implemented in SOEs in Uzbekistan based on the specifics of each enterprise.

The materials of the work and its theoretical and practical provisions, in their substantial part, may be used in educational processes for courses on management and CG.

The validity and reliability of the conclusions reached by the research are based on modern methods of analysis and comparison, as well as large factual material collected by the author via study of domestic and foreign literature and literature on practices of CG in SOEs.

One major issue in the CG practice of SOEs in Uzbekistan is ensuring integrity when BoD members execute their functions. Along with that, management and the BoD shall communicate with each other and remain committed to the company. These two points remain as major challenges for CG reform in Uzbekistan and shall serve as topics for further academic research.

For further research, it would be of interest to study the behavioural aspects of BoD performance, and especially useful for this would be to actually attend the board meetings. Such future research shall focus on integrating practically-derived assumptions into empirical analysis, while taking into account the motives of different stakeholder groups.

Among the most demanded topics for further research is finding a balance between the competencies, duties, remuneration, and powers of the BoD and its members – this issue has yet to come into the focus of academic strata in Uzbekistan, especially with regard to SOEs.

Another important issue brought up by the research shall be addressing mutual integrity of management and the BoD, concerning their interactions, not only on regular matters (as prescribed by law) but also on day-to-day tactical issues.

Understanding that this new holistic approach accentuates the importance of increased transparency and accountability, further academic research in this regard is expected among Uzbek scholars.

The utmost goal of this dissertation was to promote academic and practical understanding that a holistic and integrated approach to CG reform of SOEs in Uzbekistan will have long-term positive effects.

4.2 Recommendations for business practice

Aspects of the present research relevant to business practices of SOEs in Uzbekistan indicate several issues important both for their day-to-day routine and long-term-oriented framework.

First of all, as indicated in the empirical research, the issue of utmost importance is the need to establish a remuneration committee and improve the corresponding framework for SOEs in Uzbekistan.

Current practice, where no legal or internal documents address in detail matters such as the size of remuneration and its composition and terms, only state agencies direct the SOE on whom to pay remuneration and in what amounts and terms. Therefore, a separate committee within each SOE board in Uzbekistan would best serve the needs of elaborating criteria and terms for remuneration and propose, to the shareholders' meeting, a transparent and sound remuneration policy. Improving this aspect will serve the interests of shareholders as well as improve the stakeholders' perception of the SOE's efficiency.

A majority of surveyed experts indicated that mentality and cultural framework, to a large extent, define the board's effectiveness; the research suggests including independent directors to the boards of SOEs in Uzbekistan, including foreign experts in the field of CG (i.e. senior expert service, Germany, various international associations of professionals in CG, renowned academicians etc.).

Such a practice will serve to boost diversity, as professional members with differing, yet relevant, backgrounds will positively contribute to board performance and SOE efficiency.

Another insight emerging from the research emphasizes the need for the BoD to work as a group – although this seems evident enough, it still remains a difficult undertaking in practice. Currently observed “group-think” behavior implies informed consensus and reflects passive agreement within the BoD of most SOEs in Uzbekistan – to tackle this issue, boardroom discussions shall be constructed in an open manner, involving each member. Such an approach will improve the board’s effectiveness, create synergy, and ensure better execution of its monitoring function. Ultimately, better BoD performance will better serve the interests of investors, stakeholders, and management.

The research findings suggest that the BoD shall take a more active stance in designing the company’s strategy. Both shareholders and management expect the board to be active in elaborating ideas, scrupulous review of existing options, making informed strategic decisions, and guiding the process of their practical implementation.

Presuming that the BoD and management are both entangled in the CG structure of the respective SOE, the real CG improvement is only possible if the BoD and management are both reform-minded and committed to change.

To undertake successful CG reform in Uzbekistan, relevant state agencies acting as both shareholders in SOEs and corporate sector regulators need to approach this process systematically and pay attention to special issues, such as:

- fostering competition in the corporate sector;
- explicitly separating the purposes of the state when acting as a shareholder and as a regulator;
- clearly informing all stakeholders about interests pursued by the state as a shareholder;

- enhancing strategy development procedures together with other shareholders;
- forming specialized committees within the BoD to specifically address such issues as member selection, evaluation, remuneration, and risk management;
- rating the board of directors across SOEs;
- improving transparency of SOEs.

Additionally, as legal acts and company statutes leave substantial areas of uncertainty on important CG matters, special guidelines and codes are necessary in the practice of SOEs in Uzbekistan and the academic and business community could work together to elaborate those guidelines, based on the best foreign and domestic practices.

As giving all stakeholders a formal role in decision-making currently seems neither feasible nor desirable, it still may be advantageous to stimulate such groups in other ways, such as expanding their participation in negotiation of important aspects (significant transactions of the SOE, deciding on strategic matters and long-term business plans); relevant ideas in this regard are to be developed through discussions with practitioners and further implementation into legal framework.

Finally, it can be recommended that quarterly or annual performance appraisal of board members – a peer and external review – can be instrumental in the case of SOEs in Uzbekistan, as it increases the accountability of individual board members.

4.3 Recommendations for implementation of the efficient Public Governance

Summing up the above indicated findings and recommendations, further concrete actions are required in order to ensure an efficient implementation of Public Governance:

1. Recommendation to legal framework in Uzbekistan

It is recommended to State Property Committee (main reformer of Corporate Governance in Uzbekistan) to enlist and classify legislation in the area of Public Governance into hierarchical norms as per regulative power chronology. In terms of four aspects – direction, supervision, efficiency and transparency – the entire legal environment should be structured as proposed by Mueller (Hilb et al., 2013: 58).

2. Recommendations to strategy of SOEs

2.1 Policies on owner's strategy and objectives should be developed. The State (legislatives and executives), as an owner, should take more active role and create a framework conditions for strategic leadership and management groups of Uzbek SOEs. As mentioned in chapter 2.2.4, a separate pilot workshop to be held between owner and BoD of SOEs.

2.2 In case if interests of executive state bodies (regulators and owners at the same time) are conflicting, executives have to prioritize the main objectives of State as an owner of SOEs.

2.3 Strategy of SOEs should be regularly reviewed, adjusted as required.

2.4 Strategic leadership level of SOEs (BoD) should keep Government bodies informed on all strategic development of SOEs, as well as post official releases to the stakeholders (including the employees of SOEs).

3. Recommendations to strategic leadership level of Uzbek SOEs (BoD)
 - 3.1 Profile of requirements to the strategic leadership level of Uzbek SOEs should be developed. Sample of requirements profile is available in Attachment 7.
 - 3.2 Strategic leadership group of Uzbek SOEs (BoD) should have a clear organizational structure, including committees within BoD responsible for (a) nomination and compensation, (b) strategy and (c) audit and risk management. To ensure the integrity the common committees between BoD and Top Management of Uzbek SOEs should be established in specific areas such as Strategy, Investments, Monitoring etc.
 - 3.3 Members of BoD should take part in educational trainings and workshops with regards to specific Corporate Governance topics of SOEs on the regular basis.
 - 3.4 It is crucial that each member of BoD of SOEs should have enough time to execute his duties as a member of strategic leadership group. In case if some of the members could not participate in more than half of the meetings of BoD during the year, it should be fixed in the annual report of SOEs.
 - 3.5 The management of BoD meetings and hearings should be conducted in a professional way, i.e. a dedicated person should be assigned as a Board secretary (not a member of BoD), a proper preparation, execution and recording of all hearings of BoD should be filed.
 - 3.6 The compensation to members of BoD of SOEs should be developed and implemented as a separate policy. A sample compensation regulation of BoD members is available in Attachment 8.

- 3.7 In case of conflict of interests, member of strategic leadership group should disclose the matter and communicate it further to the members BoD of Uzbek SOEs.
4. Recommendations to operational leadership level of Uzbek SOEs (Management)
 - 4.1 BoD of Uzbek SOEs should be in charge for comprehensive and in-time succession planning for members of operational leadership group.
 - 4.2 Appointment and contracting of top management personnel should be within the competence of members of BoD of Uzbek SOEs only. Employment contract duration of management personnel should not exceed four calendar years. No termination fee should be foreseen in employment contract.
 - 4.3 Compensation to members of operational leadership should be aligned with normal market salaries and based on individual and team performance.
 - 4.4 In case of conflict of interests, member of operational leadership group should disclose the matter and communicate it further to BoD of Uzbek SOEs. No secondary employment of members of operational leadership group should be permitted.

List of abbreviations

| | |
|---------|--|
| BoD | Board of Directors |
| CEO | Chief Executive Officer |
| CER | Centre of Economic Research |
| CFO | Chief Financial Officer |
| CG | Corporate Governance |
| EBRD | European Bank for Reconstruction and Development |
| HR | Human Resource |
| JSC | Joint-Stock Company |
| KISS | Keep it Integrated, Strategic and Situational |
| LLC | Limited Liability Company |
| NGS | National Governance Systems |
| OECD | Organization for Economic Cooperation and Development |
| SOE | State Owned Enterprise |
| UN DESA | United Nations Department of Economic and Social Affairs |
| USA | United States of America |
| USD | United States Dollars |
| UZS | Uzbek Soum |

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List of figures and tables

A. Figures

| | |
|--|-----|
| Figure 1: Alternative model for State companies..... | 3 |
| Figure 2: Research approach..... | 30 |
| Figure 3: The KISS-Model | 31 |
| Figure 4: Research procedures..... | 32 |
| Figure 5: Criteria for choosing respondents..... | 33 |
| Figure 6: Qualitative research process..... | 34 |
| Figure 7: List of discussed topics..... | 35 |
| Figure 8: Illustration of the “KISS-Framework” | 41 |
| Figure 9: Determination of firm’s success..... | 42 |
| Figure 10: Value orientation of boards by M. Hilb (2008)..... | 46 |
| Figure 11: Dimensions of normative context by M. Hilb (2008:27)..... | 49 |
| Figure 12: Quality of Corporate Governance Legislation: Uzbekistan (EBRD, 2005)..... | 50 |
| Figure 13: Representation of state ownership throughout different institutions..... | 59 |
| Figure 14: Different developments in boards by Hilb (2008)..... | 60 |
| Figure 15: Board systems by M. Hilb (2008) | 61 |
| Figure 16: Competitive positions of a firm across life cycle | 64 |
| Figure 17: Stages in multicultural board and management development by Hilb (2008)..... | 68 |
| Figure 18: Colonial approach..... | 69 |
| Figure 19: Bilateral approach..... | 69 |
| Figure 20: Regional approach..... | 70 |
| Figure 21: Glocal approach..... | 70 |
| Figure 22: main functions of the board..... | 71 |
| Figure 23: The directing and controlling board (Hilb, 2008:88)..... | 82 |
| Figure 24: Classification of “Owner’s strategy” in Public Corporate Governance overview (adopted from Schedler et al., 2013:127)..... | 86 |
| Figure 25: Contrasting requirements of board members..... | 91 |
| Figure 26: Expert opinions on optimal number of board members (survey results)..... | 128 |
| Figure 27: Expert opinions on who shall develop action plans to achieve strategic objectives of SOE (survey findings)..... | 130 |

B. Tables

| | |
|---|-----|
| Table 1: Representation of historical influence | 47 |
| Table 2: Elements of culture | 48 |
| Table 3: Comparison of main SOE forms in Uzbekistan..... | 57 |
| Table 4: Number of SOEs in Uzbekistan..... | 58 |
| Table 5: Number of board members in different organizations by M. Hilb (2008)..... | 62 |
| Table 6: Situational dimension: summary of findings for SOEs in Uzbekistan | 74 |
| Table 7: Decisions on strategic matters: W-shape roles in strategizing process (SOEs in Uzbekistan)..... | 85 |
| Table 8: Comparison of board member selection process | 93 |
| Table 9: Summary of findings with regards to controlling function of the board of SOEs in Uzbekistan..... | 114 |

Attachments

Attachment 1: Underlying CG legislation in Uzbekistan (selected main acts)

| Nr. | Name in English (unofficial translation) | Name in Original | Date of adoption |
|--------------|--|---|--------------------------|
| 152- XII | Law of the Republic of Uzbekistan «On ownership in the Republic of Uzbekistan» | Закон Республики Узбекистан «О собственности в Республике Узбекистан» | 31.10.1990 |
| 425- XII | Law of the Republic of Uzbekistan «On denationalization and privatization» | Закон Республики Узбекистан «О разгосударствлении и приватизации» | 19.11.1991 |
| 223-I 370 | Law of the Republic of Uzbekistan «On joint-stock companies and protection of shareholders' rights» and its news edition | Закон Республики Узбекистан «Об акционерных обществах и защите прав акционеров», а также его новая редакция | 26.04.1996 06.05.2014 |
| 609-I | Law of the Republic of Uzbekistan «On foreign investments» | Закон Республики Узбекистан «Об иностранных инвестициях» | 30.04.1998 |
| 611-I | Law of the Republic of Uzbekistan «On guarantees and actions to protect the rights of foreign investors» | Закон Республики Узбекистан «О гарантиях и мерах защиты прав иностранных инвесторов» | 30.04.1998 |
| 719-I | Law of the Republic of Uzbekistan «On | Закон Республики Узбекистан «Об | 24.12.1998 |

| | | | |
|-------------------|---|--|------------|
| | investment activity» | инвестиционной деятельности» | |
| 811-I | Law of the Republic of Uzbekistan «On assessment activity» | Закон Республики Узбекистан «Об оценочной деятельности» | 19.08.1999 |
| 260-II | Law of the Republic of Uzbekistan «On exchanges and exchange activity» (new edition) | Закон Республики Узбекистан «О биржах и биржевой деятельности (новая редакция)» | 29.08.2001 |
| 310-II | Law of the Republic of Uzbekistan «On companies with limited and additional liability» | Закон Республики Узбекистан «Об обществах с ограниченной и дополнительной ответственностью» | 06.12.2001 |
| 163 | Law of the Republic of Uzbekistan «On securities market» | Закон Республики Узбекистан «О рынке ценных бумаг» | 22.07.2008 |
| “Soft Law” | | | |
| UP-3202 | Decree of the President of the Republic of Uzbekistan «On measures for cardinal raise of share and significance of private sector in the economy of Uzbekistan» | Указ Президента Республики Узбекистан «О мерах по кардинальному увеличению доли и значения частного сектора в экономике Узбекистана» | 24.01.2003 |
| PP-424 | Resolution of the President of the Republic of Uzbekistan «On approving board composition of selected large shareholder | Постановление Президента Республики Узбекистан «Об утверждении составов советов отдельных крупных акционерных | 24.07.2006 |

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|--------------|--|--|------------|
| | companies with state assets» | компаний с государственными активами» | |
| PP-475 | Resolution of the President of the Republic of Uzbekistan «On measures to further develop securities market» | Постановление Президента Республики Узбекистан «О мерах по дальнейшему развитию рынка ценных бумаг» | 27.09.2006 |
| PP-672 | Resolution of the President of the Republic of Uzbekistan «On measures to further deepen the processes of privatization and active attraction of foreign investments in the years 2007-2010» | Постановление Президента Республики Узбекистан «О мерах по дальнейшему углублению процессов приватизации и активному привлечению иностранных инвестиций в 2007-2010 годах» | 20.07.2007 |
| 361 | Resolution of the Cabinet of Ministers of the Republic of Uzbekistan «On measures for improving system of management of joint-stock companies» | Постановление Кабинета Министров Республики Узбекистан «О мерах по совершенствованию системы управления акционерными обществами» | 22.08.1998 |
| 361, Annex 1 | Standard statute for shareholders meeting | Типовое положение об общем собрании акционеров | 22.08.1998 |
| 361, Annex 3 | Standard statute for management body of a joint stock company | Типовое положение об исполнительном органе акционерного общества | 22.08.1998 |
| 189 | Resolution of the Cabinet of Ministers of the Republic of Uzbekistan | Постановление Кабинета Министров Республики Узбекистан «О мерах по | 19.04.2003 |

| | | | |
|---------------|--|---|------------|
| | «On measures for improvement of corporate governance of privatized enterprises» | совершенствованию корпоративного управления приватизированными предприятиями» | |
| 189, Anne x 1 | Standard statute for supervision board of a joint stock company | Типовое положение о наблюдательном совете акционерного общества | 19.04.2003 |
| 189, Anne x 2 | Statute on state trustees in joint-stock-companies | Положение о государственных поверенных в акционерных обществах | 19.04.2003 |
| 189, Anne x 3 | Statute on trust managers of investment assets | Положение о доверительных управляющих инвестиционными активами | 19.04.2003 |
| 215 | Resolution of the Cabinet of Ministers of the Republic of Uzbekistan «On measures for ensuring effective governance of enterprises with state share in charter capital and proper account of state property» | Постановление Кабинета Министров Республики Узбекистан «О мерах по обеспечению эффективного управления предприятиями с государственной долей в уставном фонде и надлежащего учета государственного имущества» | 16.10.2006 |
| 215, Anne x 1 | Statute on state enterprises | Положение о государственных предприятиях | 16.10.2006 |
| 215, Anne x 2 | Statute on internal audit service on enterprises | Положение о службе внутреннего аудита на предприятиях | 16.10.2006 |

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| 215, Annex 3 | Regulation on the procedure for transfer of the trust management of state shares (shares) | Положение о порядке передачи в доверительное управление государственных пакетов акций (долей) | 16.10.2006 |
| 304 | Resolution of the Cabinet of Ministers of the Republic of Uzbekistan «On creation of the Center for corporate governance» | Постановление Кабинета Министров Республики Узбекистан «О создании Центра корпоративного управления» | 04.07.2003 |
| 1394 | Statute on the order of monitoring the efficiency of state trustees on managing state shares | Положение о порядке ведения мониторинга эффективности деятельности доверительных управляющих по управлению государственными долями | 30.07.2004 |
| 1473 | Statute on the order of state assets management in corporate structures | Положение о порядке осуществления деятельности по управлению государственными пакетами акций (долями) в уставном фонде хозяйственных обществ | 27.04.2005 |
| 2263 | Statute on remuneration for services of state asset management and state trustees on special participation right in governance of joint-stock companies (“golden share”) | Положение о порядке оплаты услуг доверительного управления государственными долями и представителей государства по специальному праву | 09.09.2011 |

| | | | |
|--|--|--|--|
| | | участия в управлении акционерными обществами («золотая акция») | |
|--|--|--|--|

Sources: National legislation database of Uzbekistan (www.lex.uz); legal database “Norma“(www.norma.uz), and official website of the State competition committee of the Republic of Uzbekistan (www.gki.uz).

Attachment 2: Comparison of main theories in corporate governance

| Theory | Main idea | Level of analysis | Originating author(s) |
|--------------------|--|-------------------|---|
| Agency theory | Efficiency, alignment of interests, risk sharing, successful contracting | Individual, group | Alchian and Demsetz (1972), Eisenhardt (1985, 1989), Jensen and Meckling (1976) |
| Stewardship theory | Corporation is managed by directors who are hired by shareholders and are accountable to them | Individual, group | (Hoste KISSion et al. 2000; Blair 1995; Perrow 1986) |
| Stakeholder theory | Addresses morals and values in managing an organization, identifies and models the groups which are stakeholders, describes and recommends methods by which management can give due regard to the interests of those groups. | Firm | Freeman (1984) |

| | | | |
|---------------------------|---|--|--|
| Institutional theory | Attempts to develop a unified theory of institutions, of the mechanisms of their reproduction over time, and of the drivers of their change. | Firm, Industry, Society | Aoki (2001) |
| Evolutionary theory | Survival, organism form and function, organizational growth and survival | Individual, Group, Firm, Industry, Society | Darwin (1859); Dawkins (1989); Eldredge and Gould (1972); Gould (1982); Gould (2002); Mayr (1982); Nelson and Winter (1982); Beinhocker (2007) |
| Resource-dependent theory | Explores how the external resources of organizations affect the behavior of the organization | Firm, Industry, Society | (Pfeffer, 1972), Hillman et al. (2000); Davis and Cobb (2010) |
| Resource-based theory | Basis for the competitive advantage of a firm lies primarily in the application of a bundle of valuable tangible or intangible resources at the | Firm | (Penrose, 1959; Barney et al. (2001); Wernerfelt, 1984). |

| | | | |
|--|--|--|--|
| | firm's disposal. | | |
| Organizational theory | suggests that most organizational structures are weakened by the behavior of senior management | Group, Firm | (Cyert, March and Simon, 1963) |
| Public as Principal and New Public Management theory | Holds that market-oriented management of the public sector will lead to greater cost-efficiency for governments, without having negative side-effects on other objectives and considerations | Firm, Industry, Society | (Lane, 2003). (Schedler in Noetzli, 2004) (Hood, 1991; Osborne and Gaebler 1992; Hughes, 1998) (Frey, 2003). |
| New corporate governance theory | Promotes holistic approach to corporate governance, embracing its critical dimensions and encompassing interests of all stakeholders. | Individual, Group, Firm, Industry, Society | (Hilb, 2008) |

Source: own depiction, based on literature review.

Attachment 3: Curriculum of experts

| # | Name | Institution and title |
|---|------------------------------|--|
| 1 | Barno Kazakbaeva | Chief lawyer at the Center for state assets management |
| 2 | Samidullo Mahmudov | Ex-Congressman of the Parliament (Oliy Majlis), chairman of the committee for corporate affairs and entrepreneurship |
| 3 | Ziyedulla Ubaydullaev | Congressman, expert for legal issues in CG |
| 4 | Gulnara Urmanova | Chief Editor of the journal “Management of corporation” and lead expert in CG. |
| 5 | Alexander Tsoy | lawyer and national expert in CG |
| 6 | Alexander Kairlapov | Board member in Stock Exchange, leading expert |
| 7 | Askar Obidov | Deputy director of Center for Coordination and Development of Securities market |
| 8 | Shahobiddin Inamov | General Director and Founder of Consulting Company “Rithm plus”, specialized on CG questions |
| 9 | Bakhodir Bekov | Lead expert of UN Development programme, Tashkent office |

| | | |
|----|-----------------------------|---|
| 10 | Bakhtiyor Khaydarov | Chief of rule-making department of the Center for Coordination and Development of Securities market |
| 11 | Valeriy Djuraev | Counselor of the “Tashkent” stock exchange |
| 12 | Shavkat Mamatov | First deputy chairman of the “Tashkent” stock exchange |
| 13 | Sherali Abdujabbarov | General Director of the State central securities depository |
| 14 | Igor Boutikov | General Director of the Center for researches of issues in privatization, development of competition and corporate governance |
| 15 | Valentin Kotov | Dean of securities market faculty at the Banking and Finance academy of Uzbekistan |

Attachment 4: Questionnaire for survey

1. Situational dimension

- Which external factors (*such as: culture and mentality of nation, institutional and legal norms of country etc.*) are influencing or could impact the successful engagement of BoD of SOEs in Uzbekistan?
- Which internal factors (*such as interest of conflicts different state organizations represented in BoD, complexity of corporation, industry specific regulations, the level of foreign business relations, clear separation of functions on the Top Management and BoD level etc.*) are influencing or could impact the successful engagement of BoD of SOEs in Uzbekistan?

2. Strategic dimension

- In your opinion, to which extent is the diversity based on age, nationality, sex, educational background and professional track record, so much important by selecting and/or nominating of Board members in Uzbek SOEs?
- How open should be Board members to each other, would constructive critics allowed by governing of SOEs? How BoD of Uzbek SOEs should be structured and organized with purpose to facilitate of working atmosphere? In your opinion, what is the optimal number of Board members in Uzbek SOEs?
- In your opinion, which criteria should be applied to measure and evaluate the success of BoD in the development and realization of strategy of SOEs? How duties and functions between Executive team and BoD of SOEs should be split to elaborate of strategic plan of State Corporation? (*Who*

should define the strategic objectives? Who has to develop action plan to achieve those objectives? Who has to confirm and approve the strategy of SOEs? Who and how has to control the implementation of approved corporate strategy of SOEs?)

3. Integrated dimension

- In your opinion, what is the best way to select and nominate of members for BoD of Uzbek SOEs?
- Is it possible to make targeted evaluation of the activity of an entire Board? How is it possible to evaluate the individual contribution of the Board member? Is it worthwhile to introduce such an evaluation system to Uzbek SOEs?
- What should the remuneration system of Board members look like? Could an applied combined system like monetary and non-monetary incentives work or is a fixed and performance-dependent system preferable? What is the optimal tenure for service in the Board?

4. Controlling dimension

- Would it be right to claim that the work of BoD of SOEs should be organized according to its strategic obligations and functions?
- What are main strategic functions of the BoD of SOEs? Are the following functions of the BoD of a typical commercial private organization, such as financial control function, risk management, communication and evaluating performance of the executive team, applicable to Uzbek SOEs?
- How many committees should be established in the BoD of SOEs?

Attachment 5: List of institutions dealing with matters related to SOE corporate governance in Uzbekistan

| N | Organization | Activity | Contacts |
|---|--|------------|--|
| 1 | Oliy Majlis – Parliament of the Republic of Uzbekistan | Parliament | Legislative Chamber of the Republic of Uzbekistan 100035, Tashkent, Uzbekistan, 1, Bunyodkor Street. E-mail: info@parlament.gov.uz Website: www.parlament.gov.uz |
| 2 | Ministry of Economy | Ministry | Address: 45A, Uzbekistan avenue, Tashkent, Uzbekistan, 700003 Tel: (998) +71 239-6320 Fax: (998) +71 232-63-72 Email: mineconomy@mmes.gov.uz Website: www.mineconomy.uz |
| 3 | Ministry of Finance of the Republic | Ministry | Address: 5, Mustaqillik square, Tashkent, Uzbekistan, 700008 Tel: (998) +71 233-70-73 Fax: (998) +71 244-56-43 Email: info@mf.uz ; press-service@mf.uz Web site: www.mf.uz |
| 4 | Ministry of Justice | Ministry | 5, Sayilgokh str., Tashkent, 100047 Phone: (+998 71) 233-13-05 Fax: (+998 71) 233-48-44 E-mail: info@minjust.gov.uz Website: www.minjust.uz |

| | | | |
|----|--|------------------|---|
| 5 | State Committee for Privatization, Demonopolisation and Development of Competition (formerly known as State Committee for State Property Management) | State Committee | Address: 55, Uzbekistan Ave., 700003 Telephone: (998) +71 239-44-46 Fax: (998) +71 239-14-84 e-mail: info@spc.gov.uz Website: www.gki.uz |
| 6 | Center for management of state assets | State agency | Address: 55, Uzbekistan Ave., 700003 Telephone: (998) +71 259-21-51 Fax: (998) +71 239-83-90 |
| | State Corporations and major banks | | |
| 7 | "O'zdonmahsulot" State Joint Stock Corporation | Agriculture | 36, Shakhreizabskaya Str., Tashkent Telephone: 56-46-26 |
| 8 | "Qizilqumredmetoltin" State Concern of Rare Metals and Gold | Mining | 27, Navoiy Str., Navoiy Telephone (436) 574-15-00 www.ngmk.uz |
| 9 | National Television and Radio Cast State Company | Mass-media | 69, Navoi str., Tashkent tel. (998 71) 214 12 50, 233 81 06 Fax: (998 71) 244 13 32 Website: www.mtrk.uz |
| 10 | "Uzbekkino" State National Company | Movie production | 98, Uzbekistan avenue, Tashkent Tel: +998 371 2446753, 244-67-72 Fax: +998 371 1206398 Website: www.uzbekkino.uz |
| 11 | "Uzbekenergo" State | Energy | 6, Khorezm str., Tashkent |

| | | | |
|----|---|-----------------------------------|--|
| | Joint Stock Company | | Tel: 233-36-65, Website: www.uzenergy.uzpak.uz |
| 12 | "O`zkimiyosanoat " State Joint Stock Company | Chemistry | 38, Navoi str., Tashkent Tel: 244-90-87 Website: www.uzkimiyosanoat.uz |
| 13 | "O`zqishloqkimiyosanoat" Joint Stock Company | Agricultural chemicals production | 62, A. Temur str., Tashkent Tel: 235-43-36 |
| 14 | "Tosh shahar yo`lovchi trans" Joint Stock Company | Transportation | 6 , Amir Temur Passage 1, Tashkent, Telephone: 233-58-50, 237-56-81, Website: www.tgpt.uz |
| 15 | "Uzagromashservis" Joint Stock Company | Agricultural machinery services | 4A, Abay Str., Tashkent Tel.: 244-61-94 Website: www.uzagroservice.com |
| 16 | "Uzavtosanoat" Joint Stock Company | Car industry | 30, Khabib Abdullaev str., Tashkent Tel.: 267-71-63, fax: 267-71-69 Website: www.uzavtosanoat.uz |
| 17 | "Dori-Darmon" Joint Stock Company | Medicine | 1a, Mirpulatov str., Tashkent Tel.: 244-00-97 |
| 18 | "O`zavtoyol" Joint Stock Company | Construction | 68a, Pushkin str, Tashkent Tel: 236-10-88, 239-43-08 Website: www.uzavtoyul.uz |
| 19 | "O`zbekiston havo yo`llari" National Air Company | Transportation | 41, Movarounnahr str., Tashkent Tel: 254-72-20, info@uzairways.com Websites: |

| | | | |
|----|--|--------------------------------|--|
| | | | www.uzairways.com, www.airways.uz, www.airport-tashkent.uz |
| 20 | "O'zbekiston Temir yo'llari" State Railway Joint Stock Company | Transportation | 7, T. Shevchenko str., Tashkent Tel: 233-40-90 Website: www.uzrailway.uz |
| 21 | "O'zqishloqxo'jalikm ashling " Joint Stock Company | Agricultural machinery leasing | 4a, Abay str., Tashkent Tel: 244-61-81, 244-51-03 Website: www.uzagroleasing.uz |
| 22 | "O'zbekiyengilsanoat " State Joint Stock Company | Textile | 45, Bobur str., Tashkent Tel: 256-51-41, info@legprom.uz Website: www.legprom.uz |
| 23 | "Fayz" State Holding Company | Furniture production | 1, Masson str., Sergeli district, Tashkent Tel: 258-08-05 Website: www.fayzholding.uz |
| 24 | "O'zqishloqxo'jalikm ashholding " State Holding Company | Agriculture | 2, Mustakillik square, Tashkent Tel: 239-46-24, info@selkhoz mash.uz Website: www.selkhoz mash.uz |
| 25 | "O'zmevasabzavotuzumsanoatxolding " State Holding Company | Food processing | 6, Abay str., Tashkent Tel: 244-18-17, 244-27-56 Website: www.uzvinprom.com |
| 26 | "O'zqurilishmaterial" State Holding Company | Construction materials | 68a, Mirokilov str., Tashkent Tel: 252-60-39 |
| 27 | "Uzbekneftgaz" National Holding Company | Oil & Gas | 21, Istiqbol str., Tashkent Tel: 232-05-28, kans@uzneftgaz.uz Website: www.uzneftgaz.uz |

| | | | |
|----|--|------------------------------|---|
| 28 | "O'zneftmahsulot" Joint Stock Company | Oil & Gas | 143, F.Khodjaev str., Tashkent Tel: 269-19-71, fax: 269-16-35 Website: www.uzoilproduct.uz |
| 29 | "Uztransgaz" Joint Stock Company | Gas transportation pipelines | 31a, Yusuf Hos Khojib str., Tashkent Tel: 262-58-83 |
| 30 | "O'zbekneftgazqurilish" Joint Stock Company | Oil & Gas | 98, Mukimi str., Tashkent Tel: 120-73-48 |
| 31 | "Uzneftgazishchitaminot" Joint Stock Company | Oil & Gas | 21, Okhunboboev str., Tashkent Tel: 233-58-14 |
| 32 | "O'zneftniqaytaishlash" Joint Stock Company | Oil & Gas | 21, Okhunboboev str., Tashkent Tel: 232-00-48 |
| 33 | "O'zbektourizm" National Company | Tourism | 47, Khorezm str., Tashkent, 100047 Tel: 233-54-14 fax: 239-41-43, 236-79-48 Website: www.uzbektourism.uz |
| 34 | "O'zbeksavdo" Joint Stock Company | Trade | 25, Navoi str., Tashkent Tel: 232-60-28 Website: www.uztrade.uz |
| 35 | "O'zbekbirlashuv" Joint Stock Company | Trade | 60a, A. Temur str., Tashkent Tel: 234-10-21, fax: 234-00-41 Website: www.uzbekbirlashuv.sk.uz |
| 36 | "Uzulgurjirsavdo" Joint Stock Company | Trade | 7, Navoi str., Tashkent Tel: 41-14-60 |
| 37 | "Uzbekinvest" Export-Import Insurance National Company | Insurance | 49, Khadicha Suleymanova str., Tashkent Tel: 233-05-56, 233-08-54 Web-site: http://www.uzbekinvest.gov.uz |

| | | | |
|----|--|------------------------|---|
| 38 | "O'zinvestloyiha" State Company | Finance | 88, Pushkin str., Tashkent Tel: 236-78-12 |
| 39 | "Uzagrosurguta" State Joint Stock Insurance Company | Insurance | 13, Movarounnakhr str., Tashkent Tel: 233-30-08 Website: www.agros.uz |
| 40 | "Kafolat" State Joint Stock Insurance Company | Insurance | 13a, Movarounnakhr str., Tashkent Tel: 233-27-93, 233-26-98, 233-38-49 Website: www.kafolatdask.uz |
| 41 | "Sharq" State Publishing Company | Print media | 41, Buyuk Turon str., Tashkent Tel: 233-09-57 Website: www.sharq.uz |
| 42 | "O'zvtorranglimetall" JS Company | Mining | Southern Industrial Zone, Sergeli distr., Tashkent Tel: 258-82-91 |
| 43 | "Ko'mir" JS Company | Mining | TS-14, 27, Tashkent Tel: 244-36-23 |
| 44 | "Tashkent Aviation Industrial Union named after Chkalov" JS Company | Airplane production | 61, Elbek str., Tashkent Website: www.lochin.uz |
| 45 | "Maxsusqotishma" State Company | Metal industry | 59, Pushkin str., Tashkent |
| 46 | "Uzmetcombinat" JS Company | Metal industry | Bekabad city, code 291 (Int: 10 – 99871 – 91) Tel: 2–24–23, 2–37–84, info@uzbeksteel.com Website: www.uzbeksteel.uz |
| 47 | "Almalyk Metallurgical Plant" JS Company | Metal industry | Almalyk town, Tel 261-120-20-60 Website: www.agmk.uz |
| 48 | «Uzvneshtans» SJSC | Transportati | Bldg. 75, Buyuk Ipak Yuli St., |

| | | | |
|----|---|----------|---|
| | | on | Tashkent city, Republic of Uzbekistan Tel: (998 712) 268 74 76,(998 71) 238 53 46 Fax: (998 712) 268 73 37. E-mail: info@uzvt.uz Website: www.uzvt.uz |
| 49 | "Ozsanoatqurilishbank" JSC | Bank | 3, Shakhrisabz str., Tashkent Tel: 120-45-05 Website: www.uzpsb.uz |
| 50 | "Agrobank" JSC | Bank | 43, Mukimi str., Tashkent Tel: 120-88-01 Website: www.pakhtabank.com |
| 51 | Uzbek National Bank JSC | Bank | 101, A. Temur str., Tashkent Tel: 237-59-5 Website: www.nbu.uz |
| 52 | "Xalq Banki" JSC | Bank | 46, Katartal str., Tashkent Tel: 273-66-16 Website: www.xalqbank.com |
| 53 | "Qishloq qurilish-Bank" JSC | Bank | 36, Shakhrisabz str., Tashkent Tel: 236-11-05 Website: www.gallabank.com |
| 54 | "Asaka" State Joint Stock Commercial Bank | Bank | 67, Nukus str., Tashkent, 700015 Tel: 998 71 120-81-11, Email: contact@asakabank.com Website: www.asakabank.com |
| 55 | "Ipoteka-Bank" JSCIB | Bank | 17, Pushkin str., Tashkent Tel: 233-11-22, 233-29-57, fax: 233-03-53, info@ipotekabank.uz Website: www.ipotekabank.uz |
| | Other institutions | | |
| 56 | Center for researches | Research | Address: 55, Uzbekistan Ave., |

| | | | |
|----|---|-----------------------------|--|
| | of issues in privatization, development of competition and corporate governance | institute | 100003 |
| 57 | Center for corporate governance | Research institute | Address: 42, Shakhrisabz str., Tashkent, 100060 Tel. +998 (71): 2338288; 2338630; 2338171, Fax +998 (71): 2338635 Website: http://www.hsb.uz/korporativ |
| 58 | The Center for economic research | | 5, Usmon Nosir str., 1 tupik. Phone: (998 71) 150-02-02 Fax: (998 71) 281-45-48 Website: www.cer.uz Email: info@cer.uz |
| 59 | The Chamber of Commerce and Industry of the Republic of Uzbekistan. | Chamber of commerce | Uzbekistan Tashkent 700047 6, Bukhara street, Phone: +998 71 132-09-01 Fax: +998 71 132-09-03 E-Mail: info@chamber.uz Website: www.chamber.uz |
| 60 | The Center for Coordination and Development of Securities Market | Securities market regulator | 10, Bukhoro Str., Tashkent Republic of Uzbekistan, 100047 Tel: +998 (71) 236-0635 Fax: +998 (71) 232-0731 www.csm.gov.uz info@csm.gov.uz |

Sources: Government of the Republic of Uzbekistan (official website www.gov.uz) and State Competition Committee of the Republic of Uzbekistan (official website www.gki.uz).

Attachment 6: A sample structure of Owner-Strategy

- I. General terms
 1. Objective of owner-strategy
 2. Definitions
 3. Validity
 4. Relations to the legal acts and corporate bylaws

- II. Objectives of owner
 1. Entrepreneurial targets
 - a. Representation of shareholder
 - b. Growth/Acquisitions
 2. Economic targets
 - a. Shareholding structure
 - b. Growth in earnings
 - c. Payment of dividends
 - d. Development of shareholder value
 3. Political targets
 - a. Engagement in the local and regional area
 - b. Products
 - c. Behaviour in marketplace
 - d. Profile of risks
 4. Social targets
 - a. HR Policy
 - b. Social benefits

- III. Requirements to leadership
 1. Strategic leadership
 - a. Election and deselection of BoD
 - b. Composition of BoD
 - c. Limitation of BoD

- d. Compensation of BoD
 - 2. Operating leadership
 - a. Election and deselection of company management
 - b. Compensation of company management
- IV. Requirements to supervision
- 1. Reporting
 - a. Annual reporting
 - b. Semi-annual reporting
 - c. Quarterly reporting
 - d. Extraordinary reporting
 - 2. Controlling
 - a. External and internal audit
 - b. Owner's right to demand information
 - c. Regular debates
 - d. Insider trading
 - 3. Company report
 - a. Financial statement
 - b. Requests and approvals
 - c. Discharge of strategic leadership
- V. Requirements to efficiency
- 1. Organisational aspects
 - a. Committees
 - b. Signature authorisation
 - c. ICS and Risk Management
 - 2. Managing of meetings
 - a. Meeting's calendar
 - b. Keeping of the minutes
 - c. Regulation of absences
 - 3. Public information

- a. Publication of company reports in extracts
- b. Guidance in the particularly events
- c. Public communication

VI. Requirements to transparency

1. Strategizing process
 - a. Procedures for finding of strategy
 - b. Realisation of the Owner-Strategy
 - c. Informing of Owner about strategy
2. Obligation to confidentiality
 - a. Banking confidentiality
 - b. Obligation to secrecy
 - c. Obligation to return the files

VII. Final clause

1. Deviations and exceptions
2. Amendment statements
3. Legal validity

Source: adopted by Mueller in Hilb et al., 2013: P. 94-96

Attachment 7: A sample of requirements profile to strategic leadership level

Requirement Profile of the Board of Directors of **Muster Produktion AG**

(as amended on 1 April 2014)

I. Basics

1. Objective of the Requirement Profile

The definition of the requirement profile in hand is intended to ensure that the board of directors (BD) of Muster Produktions AG (MPA) on the whole as a strategic management level disposes of the professional, personal and social skills necessary to carry out the tasks assigned to the body to their full extent owing to a composition that is as ideal as possible.

At the same time, the requirement profile specifies how the search for new members of the strategic management level is to be carried out and how an assessment of compliance with the profile could be performed.

And finally, the document serves to inform possible BD candidates about the statutory provisions, the general financial circumstances of MPA, liability and compensation issues, etc.

The requirement profile describes an ideal state. It will be inevitable to depart from it if not all criteria can be completely fulfilled by the nominated members of the board of directors despite the efforts made.

2. Relevant Statutory Provisions

2.1 Swiss Code of Obligations

MPA is a joint-stock company under private law. For that reason, Art. 707 et seqq., OR are relevant for the board of directors in particular.

2.2 Precious Metal Control Act and Money Laundering Act

MPA mainly produces and sells bars of gold and platinum. For this reason, the special regulations of the Federal Act on the Control of the Trade in Precious Metals and Precious Metal Goods (Precious Metal Control Act, EMKG) apply for this field. This regulations also have to be strictly observed by the members of the board of directors.

Ultimately, the complete legislation in connection with protection against money laundering has to be observed as far as transactions involving bars of gold and platinum are concerned.

3. General Financial Circumstances of the Joint Stock Company

In order to understand the tasks and competencies of the strategic management level, it is indispensable to be informed about of the general financial circumstances of the company.

The data below are based on the annual report 2013.

| | | | |
|-----------------------|------------------|-----------------|------------------|
| Total assets | 17.1 million CHF | | |
| Equity capital | 13.5 million CHF | | |
| | | | |
| <i>Expenditures</i> | | <i>Proceeds</i> | |
| Personnel expenditure | 7.4 million CHF | Proceeds | 25.6 million CHF |
| Merchandise expenses | 14.8 million CHF | Commissions | 1.6 million CHF |

| | | | |
|-------------------------------|-----------------------------|------|--|
| Other expenditure | 0.2 million CHF | | |
| <i>Total expenditure side</i> | <i>22.4 million CHF</i> | | |
| | | | |
| Staff | 78/full-time equivalents | 72.4 | |

II. Challenges and Profile for the Future Board of Directors

1. Current and Future Challenges

After a five-year build-up process, it is now a matter of consolidating MPA and ensuring attainment of the long-term goals (strategy). MPA aims at supplying European banks with bars of gold and platinum. Accordingly, the exposure of MPA is very high at home (customers, financial intermediaries, associations, public authorities, etc.) as well as abroad (customers abroad, regulatory authorities abroad and international bodies). The expectations of the different stakeholders, whose interests may vary, are exacting accordingly.

For the future, the goal-oriented, strategic management of MPA is to be regarded as the challenges for the board of directors. As a result of the change of the international setting in the field of finances, a clearly defined, long-term orientation of Muster Produktion AG is absolutely central. With the request for more and more transparency and an efficient exchange of information (especially in the field of administrative assistance), the setting changes very much in the direction of international compliance. It is foreseeable that a financial centre has to be internationally compatible in all areas. International recognition will be central for the success of MPA.

In addition, the acceptance of MPA at home has to be improved. The services for the financial intermediaries have to be optimized. In the scope of the owner strategy, the board of

directors of MPA is responsible vis-à-vis the shareholders for the working out and fixing of realistic goals commensurate with the available funds.

2. Importance and Assessment of the Requirements

| <i>Requirement</i> | <i>low</i> | <i>moderate</i> | <i>high</i> | <i>Comment</i> |
|------------------------|------------|-----------------|-------------|---|
| Strategy | | | X | <ul style="list-style-type: none"> - Definition of the corporate strategy in the scope of the owner strategy; market observation and identification of strategic fields of action; - Strategy – controlling |
| Financial service | | | X | Market and international regulatory development, supervisory instruments |
| Organization | | X | | Definition of the managerial organization: definition and fixing of the tasks, competencies and responsibility for board of directors and executive board |
| Finances / Controlling | | | X | <ul style="list-style-type: none"> - Definition of financial goals - Decision budget - Monitoring of goal attainment; - Supervision of bodies. |
| Risk | | | X | <ul style="list-style-type: none"> - Definition of risk policy - Monitoring of risk management |
| Staff | | | X | Staff approx. 100 people, |

| | | | | |
|--|--|--|--|------------------|
| | | | | highly qualified |
|--|--|--|--|------------------|

3. Professional and Personal Requirements

3.1 Requirement Profile for the Body as a Whole

The strategic management level should, as a body as a whole, contribute the following expert know-how and the following social skills as far as this is possible:

- *General knowledge*
 - o Strategy process
 - o Company organization
 - o Finance and accounting / controlling
 - o Legal (in particular financial market legislation)

- *Industry-related knowledge*
 - o Banking
 - o Asset management
 - o Processing of precious metals
 - o Due diligence

- *Social skills / Role in the team*

| | |
|-------------------------------|---|
| - Leadership / Role model | Manages the operative level in a manner that is appropriate for the level and is a role model for coworkers; |
| - Coordination / Organization | Ensures a systematic and well-structured discharge of tasks and assigns responsibilities and competencies in a suitable manner; |

| | |
|--------------------------|--|
| - Inspiration | Regularly gives new impetus for the further development of the company and ensures the necessary innovation; |
| - Constructive criticism | Scrutinizes applications and specifications of the operative level consistently, only makes decisions when disposing of the necessary understanding, is self-critical with himself/herself; |
| - Integration | Makes sure that the teamwork within the strategic management level on the one hand and within the operative management level on the other hand as well as the cooperation of the two bodies are purposeful and task-oriented, avoids stalemates, identifies and settles differences of opinion in the bodies as quickly as possible. |

The specified social skills and/or team roles are intended to ensure that the members of the strategic management level are in accordance with each other as a body despite different characters of the individual members and that decisions are not made unilaterally. In addition, this promotes a greater diversity of points of view and provides more latitude with regard to constructive and critical ways of thinking and/or ways of behaving.

3.2 Requirement Profile for Each Member of the Board of Directors

Each individual member of the strategic management level has to fulfil the following requirements:

- Good reputation and flawless character (no pending debt enforcement, no entry in the criminal records, no criminal convictions and no pending criminal proceedings)
- Place of residence: Switzerland
- Able to work in a team and to deal with conflict
- Goal, solution- and result-oriented
- Great social skills and good communication skills
- Identifying with and committing to the owner strategy (still to be resolved);
- Identifying with MPA (in particular regarding strategy, market and products)
- No conflict of interests with MPA
- No substantial business relations with MPA
- Readiness and ability to acquire a profound knowledge concerning upcoming strategic decisions within a short period of time
- Time-wise availability every year in the scope of
 - o 6 to 8 days for BD meetings, preparations and teleconferences
 - o 1 to 2 days further training

3.3 Requirement Profile for the Chairman in Particular

A special position befits the chairman, which is why the following conditions have to be fulfilled in addition to the requirements applicable to all members:

Personality

- Upright, loyal and representative personality

- Deep commitment and high degree of self-initiative
- Keen perception and analytical way of thinking
- Mature personality appropriate for the assignment
- Place of residence and good network in Switzerland
- Time-wise availability in the scope of
 - o 6 to 8 days for BD meetings, preparations and teleconferences
 - o 4 to 5 days further training
 - o Monthly work meetings with the operative management level
 - o Taking on of individual special tasks

Social and leadership skills

- Excellent integration and motivation ability
- Excellent conflict management skills
- Performance record in business management
- Decisiveness and assertiveness

Professional requirements

- Very good knowledge of the financial and legal setting in Switzerland
- Very good knowledge of the financial center and its international setting
- Familiar with strategic leadership tasks

3.4 Remuneration

The remuneration of the members of the board of directors is currently determined as follows:

a) Lump sums

| | |
|-------------------|---------------|
| BD president | CHF 50,000.00 |
| BD vice president | CHF 25,000.00 |
| BD members | CHF 10,000.00 |

b) Attendance fees

Lump sum for attendance (incl. preparation) CHF
2,500.00

3.5 Liability

The liability of the BD of MPA is determined by the statutory provisions, in particular Art. 752 et seqq., OR. For the members of the BD and the executive board, a D&O insurance for 25 million CHF for each event with reinsurance for 10 years after separation from MPA was taken out.

3.6 Requirement Matrix for Profile Compliance

Ideally the competencies of the potential members of the body cover *as many fields as possible* of the following matrix with *as few overlaps as possible*, and naturally one member can cover several fields. Consequently, the matrix is also the central assessment tool for the persons charged with the search for candidates.

| Role in team / Specialist role | Leadership/ Role model | Organizer | Critical thinker | Integrator | Inspirator |
|--------------------------------|------------------------|-----------|------------------|------------|------------|
| Strategy | | | | | |
| Finance / Controlling | | | | | |
| Leadership / Organization | | | | | |
| Legal / Taxes / Compliance | | | | | |
| Industry-specific knowledge | | | | | |
| Banking / Asset management | | | | | |
| Entrepreneurship / HRM | | | | | |

4. Implementation of the Requirement Profile

In order to make compliance with the profile possible to the greatest possible extent, it is necessary for shareholders and BD to agree on who is to focus on which professional and personal competencies during the search for candidates.

With a view to an optimum composition of the board of directors, the analysis of the requirement profile should be accompanied by a recognized consulting firm and repeated every four years.

Zürich, 1 April 2014

On behalf of the board of directors of Muster Produktion AG:

Source: **Müller, R., Lipp, L. and Plüss, A.** (2014): Der Verwaltungsrat, 4 Aufl. P. 772-778

Attachment 8: A sample compensation regulation of BoD members

Regulations for the Remuneration of the Board of Directors of Muster AG

1. Basis

The regulations in hand are based on the organization regulations of Muster AG. They specify and complement the general guidelines for the remuneration of the board of directors in the organizational regulations.

2. Purpose

In outline, these regulations define the complete compensation of the board of directors. They settle the structure of the remuneration and the allowance rate conclusively.

3. Competence and Transparency

3.1 The board of directors make their decision in the scope of their own competence as long as the company has not been listed.

However, the following requirements have to be considered:

- a) The members of the board of directors may only receive BD fees and/or salaries and allowances that are adequate for the importance of the company and are usual in the industry.
- b) No termination pay and/or golden parachutes may be provided for members of the board of directors.

3.2 As a non-listed company, Muster AG discloses only the total amount of the BD remuneration in its annual report.

4. Basic Remuneration and Allowances

- 4.1 All BD member shall be entitled to an annual basic remuneration that will be transferred to their accounts in monthly instalments. The amount of the basic remuneration is fixed by the board of directors by means of a majority decision until cancelled and recorded in the BD minutes.
- 4.2 Different amounts can be fixed for the basic remuneration for individual members if special circumstances, such as experience or reputation, justify that. As a matter of principle, however, all BD members shall receive the same basic remuneration.
- 4.3 The obligatory social security contributions will be deducted from the basic remuneration insofar as the fee is transferred to the account of a BD member personally. If a legal person states accounts for a BD member, no deduction for social security contributions will be necessary, but possibly a deduction for value-added tax.
- 4.4 For the expenses incurred in the exercise of their BD activities, the BD members shall be entitled to reimbursement upon presentation of the respective sales slips. As for the rest, the allowance arrangement for the members of the executive board of Muster AG shall apply.

5. Attendance Fee

- 5.1 In addition to the annual basic remuneration, members of the board of directors shall receive, independently of their function, a remuneration for the attendance of each BD meeting or a committee meeting (so-called attendance fee). There shall only be an entitlement to an attendance fee if the meeting is actually attended physically. Teleconferences and video conferences shall be classed with physical meetings

insofar as the requirements for a meeting according to Section 5.3 below are fulfilled for the rest.

- 5.2 The amount of the attendance fee is fixed by the board of directors by means of a majority resolution until recalled and recorded in the BD minutes.

Different amounts are fixed for the attendance fee for half-day (up to 4 hours) and whole-day (over 4 hours) meetings.

- 5.3 There shall only be an entitlement to payment of the attendance fee if the respective meeting was officially convened by the respective president (BD president, BD vice president, committee president).

A gathering of BD members or committee members without an appropriate meeting arrangement shall not be deemed a meeting.

- 5.4 The minutes of the respective meetings shall be deemed evidence of the fact that the meeting was held and that the meeting was attended. There shall be no entitlement to payment of the attendance fee when there are no minutes of the meeting.
- 5.5 The attendance fees shall be paid out by the semester in each case.

6. Function Allowance

- 6.1 Additional functions such as BD president, BD vice president, BD delegate or president of a BD committee will be remunerated in addition unless these functions are remunerated in the scope of an employment contract. The amount of such function allowances will be fixed by the board of directors by means of a majority resolution until revoked and recorded in the minutes. The function allowances

will be paid out on a cumulative basis (e.g. BD vice president and at the same time president of a committee).

- 6.2 The function allowances shall be fixed with an annual lump sum and remitted together with the BD basic fee every month on a pro-rata basis.
- 6.3 Membership in committees is not to be remunerated with a fixed annual lump sum, but with attendance fees. Only the president of the committee shall be paid a fixed annual lump sum in addition.

7. Additional Remunerations

- 7.1 If a BD member takes over special tasks, namely a consulting mandate for Muster AG, in addition to his/her regular BD function, he/she shall only be entitled to a suitable additional remuneration if this was expressly agreed beforehand.
- 7.2 The written form requested by the organization regulations regarding self-dealings shall also be observed if the terms of the special tasks and/or the respective additional remuneration are recorded in the BD minutes.
- 7.3 The additional remuneration may be fixed by the board of directors in the form of an hourly wage or a per-diem allowance. The additional remuneration is to be invoiced by the respective BD member on the fixed basis every month.
- 7.4 As far as the assignment of special tasks is concerned, the board of directors shall fix a budget insofar as this is possible.

8. Inadmissible Remuneration

- 8.1 Independently of any additional functions, no commencement or termination pay must be provided for or paid the BD members. Bonuses for the purchasing and sale of companies

or additional remunerations under the title of compensation for post-contractual non-competition are prohibited as well.

8.2 This prohibition shall also apply if BD members have a double role as body and employee and are consequently bound by an employment contract.

9. Commencement and Application

9.1 The regulations in hand were approved by the board of directors during its meeting in 02/2014 and become effective with immediate effect.

9.2 The BD fees already fixed shall remain valid with the amounts unchanged until recalled.

Musterhausen, 1 April 2014

The President of the BD

The Secretary of the BD

Source: **Müller, R., Lipp, L. and Plüss, A.** (2014): Der Verwaltungsrat, 4 Aufl. P. 850-853