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Rapprochement of long-term financial interests of the shareholder and the management of the company

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ABSTRACT

The author considers features of the economic nature of activity of the shareholder in corporate governance and in the control over management. The author offers the standard of the diligent shareholder and the standard of the diligent management as necessary condition for rapprochement of long-term financial interests. Reasonable and diligent realization of the corporate rights, display of interest to company activity will allow the shareholder to receive the information on the concluded transactions. The information on transactions will allow to protect the broken rights in the terms established by the law. The reasonable management within the limits of standard administrative practice should make the maximum efforts for achievement of firm wealth maximization and also consider factors which to a greater or lesser extent influence firm wealth maximization and can be considered as the independent purposes at a certain stage of activity of the company. The company it is necessary to implement the motivation program for rapprochement of long-term financial interests of the shareholder and the management. The motivation program means reception of property benefit from increase in a stock value (share) of the company which possibility of reception is the circumstance stimulating management to act in interests of the company. According to the best practice of corporate governance level of the compensation paid to management, should be sufficient for attraction, motivation and deduction of the persons possessing necessary for company professional skills and qualification, and the compensation system should provide rapprochement of financial interests of directors with long-term financial interests of shareholders. The clause is interdisciplinary, covering elements of corporate governance which are a part of the corporate finance as sciences, and also, the corporate right.

KEYWORDS:

corporate governance, long-term financial interests, long-term stimulation, shareholder activism, model of diligent behavior, managerial decision.

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1. INTRODUCTION

The principle of economic freedom predetermines constitutionally guaranteed powers, which are the main content of the constitutional right to the free use of one's abilities and property for entrepreneurial and other economic activities not prohibited by law. Realizing this right, enshrined in article 34, part 1, of the Constitution of the Russian Federation [Constitution of the Russian Federation, 1993], citizens have the right to determine the scope of this activity and carry out it individually or together with other persons through participation in business entities, partnerships or production cooperatives, that is, by creating a commercial organization as a form of collective entrepreneurship, to independently choose an economic strategy for business development, to use one's property taking into account guarantees of property rights established by the Constitution of the Russian Federation (Article 35, Part 3) and state support for fair competition (Article 8, Part 1; Article 34, Part 2).

The right to freely use their abilities and property for entrepreneurial and other economic activities not prohibited by law serves as the basis for the constitutional and legal status of participants (shareholders) of business companies (in particular, joint-stock companies and limited liability companies) that exercise their rights through the ownership of shares, which certify the obligations of the owner in relation to the business entity.

The status of a participant implies endowing him with wide discretion, which makes it possible, in order to achieve maximum efficiency of economic activity and the rational use of property, to appoint (choose) a head who is entrusted with property management under his own responsibility [Resolution of the Constitutional Court of the Russian Federation, 2005].

In fact, a legal entity (joint-stock company or limited liability company) as a legal abstraction, does not have any vested interests - as they are understood in relation to entities that have their own will. Any reference to the interests of a legal entity is nothing more than an imputed interest; in fact, the interests of a legal entity are identified with the interests of its participants (shareholders) [Resolution of the Seventeenth Arbitration Court, 2019b].

In other words, it is the participants (on their own or by choosing a leader), who determine the company's economic development strategy.

It is necessary to pay close attention to legal terminology (the interpretation of law taking into account law enforcement practices), which is used in the article.

The word "law" covers not only statutes, but also unwritten law, since ignoring the precedent law (judicial practice) would undermine the foundations of the state's legal system. The effectiveness of the law lies in its interpretation by judicial authorities in the light of new circumstances, and if the court did not take into account the judicial practice, it would undermine the legal system of continental states [Resolution of the European Court of Justice ..., 1990; 1996]. Many laws must have a general application, as a result of which their wording is not always accurate. The need to avoid excessive cruelty and to keep up with the changing circumstances means that many laws are inevitably formulated in concepts that are more or less vague. The interpretation and application of such regulations depend on law enforcement practices.

In the process of economic activity of a legal entity conflicts of interest may arise between participants and management. Usually, conflicts in the business environment are associated with management [Bebchuk, Hirst, 2019].

The purpose of the article is an attempt to bring together the long-term financial interests of the participant and the head (member of the board). The starting point for rapprochement is the implementation of the standards of good conduct of the participant and the head.

We will consider the algorithm of the long-term program of management stimulation taking into account the best corporate governance practices, including the

ones for forming a balance of multidirectional interests of the company's management and its participants [Hamdani, Hannes, 2019].

2. THE ROLE OF THE PARTICIPANT'S ACTIVITY (GOOD CONDUCT MODEL) IN CONVERGING HIS LONG-TERM FINANCIAL INTERESTS WITH THOSE OF THE MANAGEMENT

For the beginning it is necessary to consider the peculiarities of the legal nature of the activity of the company's participant, which predetermines his obligation to participate in the management of the company and to control the actions of management.

As noted by the Presidium of the Supreme Arbitration Court of the Russian Federation in the Resolution [Resolution of the Presidium ..., 2013], the person who made the investment has the expected desire to show his interest in the fate of his investments (directly or with the help of an appropriate consultant), that is, to receive information about the activities of the legal entity, to control his profit entitlements. Any reasonable investor who has invested his money and has ceased to receive invitations to general meetings, in such situation cannot help but be concerned about this, since financial interests of this person will be directly affected.

The participant in a business entity acquires the rights, including the choice of an economic strategy for developing this business entity [Decree of the Presidium ..., 2010]. Therefore, the participant in a legal entity has not only the right, but also the obligation to control the activities of the head of the company in which he is a participant. Moreover, the active position of participants (owners) involves actions with a proper degree of care and prudence in the exercise of their rights under the law, including the participation in managing the company's affairs, holding general meetings, familiarizing themselves with the documentation.

A reasonable and proper exercising of corporate rights, expressing an interest in the activities of the business entity will allow the participant who is interested in making a profit by receiving dividends from the ownership of shares to learn in a timely manner about the composition of shareholders (participants), about transactions concluded by the company, which, in turn, will provide an opportunity to protect the violated rights within the legal deadlines.

Therefore, the participant has economic interests that are common with the legal entity, since, on the one hand, he has the right to rely on dividends from the profits obtained from the business activities of the company, and on the other hand, he is responsible for the effectiveness of such activities, taking into account the possibility of influencing these decisions.

In this case, the judicial practice proceeds from the standard of a faithful and reasonable participant who takes an active position regarding the company's activities, which also implies the attention of minority participants to the activities of the legal entity. The expected behavior in this case is an active position of any participant, including the minority one, in the life of the company.

The author proposes to enshrine in the company's internal documents (in particular, the statute) the model of behavior of a faithful participant, using the comparative analysis mechanism proposed by the Supreme Court of the Russian Federation.

This model arises from the need to analyze the relationship of the participant, whose status has been called into question, with other participants in the legal entity and is aimed at studying how the behavior of the latter, taking into account the provisions of the corporate law, indicated that other participants perceived the subject as a full member of the company (the confirmation can be his participation in general meetings, voting for the adoption of certain management decisions, introducing initiatives related to the business development strategy, etc.).

Separately, it is necessary to pay attention to the fact that the company's participant has a substantive interest in relation to the transaction, the implementation of which may adversely affect (materially damage) the position of the participant [Determination of the Supreme Arbitration Court ..., 2011].

The corporate governance mechanism implies unequal opportunities of the participants (shareholders) to influence the decisions made by the company depending on the share of participation (block of shares), compensating this by the right of each participant (shareholder) to compensate for losses incurred by the legal entity (initiating legal proceedings).

In turn, the participant, applying to the court, is a representative of the company and acts not only in his own interests, but also in the interests of the legal entity [Determination of the Supreme Court ..., 2019_ Determination of the Supreme Court of the Russian Federation of August 26, 2019 No. 307-ES18-6923 [2]].

Let us give an example.

The second paragraph of article 109 of the Resolution of the Plenum of the Supreme Court of the Russian Federation "On the application by the courts of certain provisions of Section I of Part One of the Civil Code of the Russian Federation" [Resolution of the Plenum ..., 2015] contains an explanation according to which adverse consequences refer to the violation of the legitimate interests of the participant and the civil community, which may lead to losses, deprivation of the right to

receive benefits from the use of property of civil legal community, limiting or depriving a participant of the opportunity in the future to make managerial decisions or exercise control over the activities of the civil legal community.

The minority participant, going to court, must prove that the transaction made by the governing body (management, board of directors) was unprofitable, despite its approval by the majority of participants.

The situation related to the refusal of the judicial authority to challenge a loss-making transaction by small participants is unacceptable. Otherwise, the loss-making transaction may deprive minority members of the corporation of the right, subject to formal observance of the procedure for convening and holding the meeting, to challenge decisions against which they voted.

In the long term, the position of the participants' activity in relation to the company's management corresponds to the position of good corporate governance practice set forth by the Central Bank of the Russian Federation in paragraph 4 of the section "Introduction" of the Corporate Governance Code [Bank of Russia Letter, 2014]. In particular, it is noted that corporate governance should be based on the principles of sustainable development of the company and increase the return on investments in equity capital in the long term.

In addition, the Corporate Governance Code offers participants (shareholders) and investors clearly formulated approaches to what should be required of companies, and helps to increase the activity of participants (shareholders) and investors. Otherwise, it is the participants (shareholders) of the legal entity (legal abstraction) that bear the risk of negative consequences (for example, neglect of the principles of effective corporate governance: in particular, inaction regarding management) associated with the activities of the company.

Therefore, it is the active position of the participant (through the model of good conduct) of the company that lays the foundation for its development in the long term. It also is the starting point in the convergence of long-term financial interests of the owner and the manager.

3. THE SYSTEM OF MANAGEMENT STIMULATION: A TURNING POINT IN CONVERGENCE OF LONG-TERM FINANCIAL INTERESTS

The next feature of the convergence of long-term financial interests of the participant and the manager is the construction of an effective incentive system using the best corporate governance practices.

In particular, [Hamdani, Hannes, 2019], in the conditions when requirements of participants to managers for increasing shareholder value are presented, it is necessary to create a mechanism for effective management motivation in the company in order to avoid further costly lawsuits between the parties. Management is interested in stimulating their activities in order to be loyal to the company and implement its economic strategy [Beatty, 2017].

It is necessary to pay attention to the fact that management bodies (management, board of directors) have wide discretion in the business sphere, because there are business errors due to the risky nature of entrepreneurial activity, [Definition of the Supreme Arbitration Court ..., 2012].

In addition, the governing body is a commercial product of the company itself, its steps are measured and controlled by the participants (owners) of the legal entity. The balance of effective existence of the company is determined by the elements of teamwork (collective work).

In turn, the head of the company representing its interests and the interests of its participants (shareholders), must act in their interests in good faith and reasonably, since he is responsible to the company and its participants for losses caused by his wrongful actions (inaction), if other grounds and the amount of liability is not established by federal laws.

Pursuant to the above norms and legal position, which is set out in the Resolution of the Plenum of the Supreme Arbitration Court of the Russian Federation "On Certain Issues of Compensation for Losses by Members of the Legal Entity" [Resolution of the Plenum ..., 2013], holding the head of the company liable depends on whether he acted reasonably and in good faith in the performance of duties assigned to him, that is, whether he showed care and discretion and took all necessary measures for the proper execution of managerial authorities.

The letter of the Central Bank of the Russian Federation "On the Corporate Governance Code" [Letter of the Bank of Russia, 2014] introduced additional criteria of good business practice and reasonableness (in addition to the lack of personal interest, actions in the public interest, prudence and care that should be expected from a good leader in a similar situation under similar circumstances):

decision-making taking into account all available information in the absence of a conflict of interest, taking into account the equal treatment of shareholders within the framework of ordinary entrepreneurial risks (paragraph 2.6.1), the desire to achieve sustainable and successful development of society (paragraph 126). Inaction becomes unlawful only when the person has the obligation to act in a certain way in the relevant situation.

At the same time, the negative consequences that occurred for a legal entity during the period when the director was included in the bodies of the legal entity do not in themselves indicate dishonesty or unreasonability of his actions (inaction), since the possibility of such consequences is associated with the risky nature of entrepreneurial activity. Since judicial control is designed to protect the rights of legal entities and their founders (participants), and not to verify the economic feasibility of decisions made by directors, a director cannot be held liable for losses incurred by a legal entity in cases when his actions (inaction) entailed losses, when they did not go beyond the ordinary business (entrepreneurial) risks [Resolution of the Arbitration Court ..., 2019].

A reasonable head of company, within the framework of standard management practices, should make every effort to achieve a qualitative result of the work performed by the legal entity headed by him, of the services provided and, if there are objectively identified deficiencies in the work performed or the services rendered, take measures to eliminate them.

To exclude possible risks associated with the management of the company, the statute may additionally include a provision on the obligation of loyalty of the head, as well as specify the features of managerial decisions in the interests of the company and its participants.

The director's loyalty or his obligation of non-competition with the legal entity is a universally recognized standard of behavior in many developed countries, which assumes that the director is not entitled to commit, in his own interest or the interests of third parties, without the consent of the participants in the legal entity, the board of directors (or another body provided for by constituent documents), transactions that are homogeneous with those that constitute the subject of activities of the legal entity, to participate in another homogeneous legal entity, or act as a director there.

In turn, managerial decisions should be made primarily from the position of maximizing the value of the business, since not only the absolute financial result of the company's functioning (net profit), but also relative indicators (return on assets, investments, equity, indicators of turnover and liquidity, operational, financial and other risks specific to the enterprise, as well as indicators of the dynamics of the market share) to a greater or lesser extent affect the maximization of business value and may be considered as separate targets at a certain stage of the company's activity [Decree of the Fourth Arbitration, 2009].

It should be noted that a separate managerial decision cannot be considered in isolation from other decisions outside the economic strategy of the company, since making a profit can often be a long-term process. In order to maximize profits in the long run, decisions can be made that result in short-term losses in revenues. Therefore, the actions of the head of the company committed not in the interests of the legal entity, can be considered only when, in principle, there is no doubt that at the time of the decision (transaction), as a result of its execution, there was no probability of profits taking into account the strategy of the legal entity, including acceptable degrees of risk.

If at the time of making any managerial decision there was a likelihood of making both profits and losses, and the decision was made within the range of acceptable risks, then it should be recognized as reasonable and there should be no reason to impose property sanctions for a negative result due to the above explanations.

For example, changes in the objective macroeconomic environment (crisis phenomena that caused a significant decrease in the growth rates of the Russian economy) may be covered by entrepreneurial risk. [Resolution of the Seventeenth Arbitration, 2019a].

After considering the models (standards) of good conduct of the participant and the company's head, it is necessary to move on to building a program of motivation for the governing body to bring together long-term financial interests.

The goal of the long-term motivation program is to obtain material benefits from increasing the cost of the company's shares to act in the interests of the legal entity and to ensure profits, which in turn entails an increase in market capitalization.

To account for the assessment of managerial effectiveness, a program may include a variable that makes up the remuneration of the management body, which, in turn, can be made dependent on the profitability of the company. The formula for calculating this component includes the coefficients of dependence on net and gross profit, current liquidity, growth in sales volumes, weighted average share prices, etc. (such a mechanism has been developed in energy sector companies, in particular Kubanenergosbyt PJSC).

Let us give an example of long-term incentives for the management of large trading companies (in particular, Perekrestok JSC). The provision in relation to the program of long-term compensation for production results includes incentives for its participants to meet high business standards, to achieve high production results, to retain key employees with the necessary qualifications, skills and experience necessary to achieve the company's goals.

The purpose of the program is, in particular, to provide management with material stimulation and incentives in order to increase the efficiency of the legal entity in order to achieve the strategic, financial and operational goals of the company.

An interesting program is a long-term incentive for managerial personnel in the energy company (OJSC "SGC TGK-8").

It applied the procedure of settlements using "virtual shares" distributed among the participants (management), and established a mechanism for determining remuneration based on the size of the market capitalization of the company using the weighted average price of the company's shares on trading floors. In the program the amount of remuneration is directly dependent on the magnitude of changes in the weighted average price of one ordinary share in the company for a certain period. In other words, the amount of remuneration paid to members of the governing body is based on the dynamics of changes in the same economic value characterizing the dynamics of development and investment attractiveness of the company.

The current practice of corporate governance uses the division of remuneration of members of governing bodies into two parts: permanent and variable. The permanent (basic) part of the remuneration is a fixed part of the director's remuneration system, reflecting education, experience, qualifications, the level of tasks assigned to him and the level of authority corresponding to them. The variable part of the remuneration is not fixed and depends on work efficiency.

As the main tool for calculating the remuneration of members of the governing body it is possible to use the consolidated management reports in the form "Plan-actual budget of income and expenses for the year" in the column "Net profit (loss) of the reporting period" before the expenses of owners [Resolution of the First Arbitration, 2019].

In accordance with the best corporate governance practices, the level of remuneration paid by the company to the management should be sufficient to attract, motivate and retain people with the competence and qualifications necessary for the legal entity, while the remuneration system should ensure that the financial interests of directors are aligned with long-term financial interests of participants (shareholders).

4. ЗАКЛЮЧЕНИЕ

The article described an algorithm by which the convergence of long-term financial interests of management and the company's participants can be achieved. The starting point for the balancing of divergent financial interests is an active position of the participant (shareholder) regarding the exercising of rights associated with his participation in the company's management and control of the managerial body. Models (standard) of bona fide participants and bona fide heads of companies were considered. An important step in converging the long-term financial interests of the management and the company's participant is to build a long-term system of stimulation taking into account the best corporate governance practices.

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