CORPORATE GOVERNANCE SCORECARD FOR UZBEK JOINT STOCK COMPANIES BASED ON OECD PRINCIPLES

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Abstract: This article addresses the issues of corporate governance questionnaire currently used to assess the system of corporate governance in Uzbek Joint-stock companies and proposes a new Corporate Governance Scorecard based on OECD principles to fulfill the requirements of the "Roadmap" for the implementation of the Capital Market Development Program in 2021 – 2022.

Key words: *OECD corporate governance principles, scorecard, Uzbekistan.*

Аннотация: Ushbu maqolada hozirda O'zbekiston aksiyadorlik jamiyatlarida korporativ boshqaruv tizimini baholashda foydalaniladigan korporativ boshqaruv savolnoma masalalari ko'rib chiqilgan va 2021-2022 yillarda Kapital bozorini rivojlantirish bo'yicha "Yo'l xaritasi" talablarini bajarish uchun IHTT tamoyillariga asoslangan Korporativ boshqaruv tizimini baholashning yangi kartasi taklif qilingan.

Калит сўзлар: *IHTT korporativ boshqaruv tamoyillari, baholash kartasi, O'zbekiston.*

Аннотация: В данной статье рассматриваются вопросы анкеты корпоративного управления, которая в настоящее время используется для оценки системы корпоративного управления в узбекских акционерных обществах, и предлагается новая оценочная карта системы корпоративного управления, основанная на принципах ОЭСР для выполнения требований «Дорожной карты» для реализации Программы по развитию рынка капитала на 2021-2022 годы.

Ключевые слова: *Принципы корпоративного управления ОЭСР, оценочная карта, Узбекистан.*

Introduction

In 2016, the State Competition Committee of the Republic of Uzbekistan jointly with the Scientific and Educational Center for corporate governance developed a questionnaire to assess the corporate governance system in Uzbek joint-stock companies. The questionnaire consists of nine sections and one hundred questions. The main purpose of the questionnaire was to assess how closely the joint-stock companies in Uzbekistan were following the recommendations of the corporate governance code, which was developed by the commission to improve the efficiency of joint stock companies and the corporate governance system in the country.

Although the questionnaire included such important sections as;

1. Assessment of preparation procedures for the implementation of the Corporate Governance Code

2. Assessment of compliance with the recommendations of the Corporate Governance Code
3. Conformity assessment of the organizational structure of JSC
4. Evaluation of competitive selection
5. Assessment of the transition to publication in accordance with IFRS and International Standards on Auditing
6. Assessment of the implementation of modern management systems (ISO, ERP, R&D, etc.)
7. Information Policy Assessment
8. Assessment of financial results
9. Assessment of other directions,

some of the sections of the questionnaire are either outdated or are not directly related to corporate governance issues. For example, questions in section 1 are no longer applicable, since their main purpose was to assess the preparedness of JSCs for the implementation of the Corporate Governance Code at the early stage of its development. Questions in section 5 are also outdated because they assess the transition to publication of financial results in accordance with IFRS, while according to the new presidential resolution PR-4611 dated 24.02.2020 “On additional measures for transition to International Financial Reporting Standards”, all Joint-stock companies, commercial banks and insurance organizations must organize accounting from January 1, 2021 and, starting from the results of 2021, prepare financial statements based on IFRS. Other than that, questions in section 6 (Assessment of the implementation of modern management systems) and 8 (Assessment of financial results) are out of scope of Corporate Governance issues.

Therefore, in order to fulfill the requirements of the "ROADMAP" for the implementation of the Capital Market Development Program in 2021 – 2022 given in the presidential decree “On Measures for further development of the Capital Market” PD №-6207 dated 13.04.2021, it would be expedient to replace the current corporate governance questionnaire with a new, updated scorecard that is based on OECD principles of corporate governance.

Literature review

Stakeholder theory explains that a company is obliged to a group of people who influence and are influenced by the company’s activities. One way to fulfill these obligations is by voluntary disclosures outside of the mandatory disclosures to fulfill the company’s obligations to all stakeholders (Freeman, 1984). Sustainability reporting is a way to reduce information asymmetry between companies and investors (Gavana et al., 2017), reduce conflicts with shareholders (Becchetti et al., 2012; Harjoto & Jo, 2011), and as a way for companies to promote corporate governance. Effective business sustainability by encouraging accountability and transparency. (Jo & Harjoto, 2011). The influence of corporate social responsibility and corporate governance on firm value increases among shareholders, practitioners, and regulators (Jo & Harjoto, 2011). Sustainability disclosure is very much determined by corporate governance (Harjoto & Jo, 2011; Kend, 2015; Kolk & Pinkse, 2010). It is effective as a legal mechanism to protect and improve relations between outside investors/minority shareholders of the majority shareholders and company management (Adel et al., 2019; Jo & Harjoto, 2011; La Porta et al., 2000; Michelon & Parbonetti, 2012; Naciti, 2019). In addition, corporate governance plays an important role in ensuring that legalization has been implemented by companies through disclosure of social responsibility (Khan et al., 2013; Michelon, 2011).

Development and importance of Corporate Governance Scorecards

A scorecard is a quantitative tool to measure the level of compliance with a code and/or a standard of corporate governance. Scorecards compare governance practices to a benchmark. Typically, the benchmark is a national code of corporate governance or an international code or standard. Scorecards are not used principally to measure regulatory compliance. Rather, scorecards measure the observance of a voluntary code of best practice. Scorecards are used to assess a company's governance practices, show progress over time, and compare different companies and even groups of companies within or across countries. The history of corporate governance scorecard goes back to the early 1990s when the International Finance Corporation (IFC), a member of the World Bank Group, was developing codes of corporate governance, more and more countries have adopted governance codes. By the late 1990s, the revolutionary recommendations on good corporate governance of the OECD (Organization for Economic Co-operation and Development) became a major trend. IFC encouraged this trend by helping a large number of developing and emerging markets develop their own codes. The intention was that codes and better governance would boost the development of capital markets, help companies perform better, and make them better members of society.

In 2005, the then IFC Global Corporate Governance Forum published a toolkit, “Developing Corporate Governance Codes of Best Practice”, and began using it widely to help countries develop their own codes and create their governance standards. Many countries drafted codes, and the understanding of governance and its impact on companies, markets, and societies grew significantly in all of the world's regions.

Despite these advances, the mere existence of a local corporate governance code did not automatically translate into better practice. Regulators, stock exchanges, and other organizations often put considerable effort into code development, only to face the new challenge of how to make good governance practices a working reality. Their work was often complicated by the limited experience most developing countries and emerging markets have with voluntary tools as a means of changing corporate behavior.

Something was needed to encourage best practice in governance, but without the intrusiveness of legislation. Part of the answer was scorecards, which had been inspired by the experience of private sector investors assessing compliance with national codes. Later, institutes of directors, stock exchanges, and regulators used scorecards to assess and promote governance reform. IFC has used them as tools to help a variety of users identify weakness in governance and alert them to areas that require reforms.

The original source of inspiration for many scorecards was the one developed by the German Financial Analysis and Asset Management Association (DVFA). The purpose of the DVFA scorecard was to provide financial analysts and investors with a practical tool to evaluate the governance of listed German companies. In addition, the DVFA scorecard served as a tool to measure the level of compliance of listed companies with the German Corporate Governance Code.

Scorecards have goals at both the market level and the company level. At the market level, the overarching goal is the development of safer and more efficient capital markets. One way to strengthen capital markets is to improve the implementation of the governance framework. Governance codes and standards are an important part of this framework. Scorecards encourage implementation of codes and standards by benchmarking companies and countries over time. Scorecards set expectation levels, generate incentives for reform, help direct change, and can set in motion a process of continual improvement. At the company level, these goals begin with providing companies with a powerful analytical tool. Scorecards are a useful basis for companies to start an analysis of their governance practices. Scorecards help identify shortcomings against locally defined standards and/or generally accepted international standards of good practice. The findings of a scorecard can be used to help the company develop a corporate governance improvement plan. The ultimate outcome should be better operational performance and lower risk because of better governance practices.

Scorecards generate important information on the quality of governance practices. They can tell whether companies ignore codes or follow code recommendations. They provide information on the impact of governance codes. They can be used to compare practices between companies and between countries.

• **Scorecards encourage companies to improve their governance**. Comparisons to other companies provide an important indicator on how the company stacks up against a peer group and can motivate companies to improve their governance. Scorecards are particularly useful when a (new) code of corporate governance is introduced in a country.

• **Companies want concrete and useful information**. Most companies want quantifiable and comparable information on the quality of their governance practices. Companies want to know when and where they fall short so that they can act.

• **The main beneficiaries of scorecards are companies and their stakeholders.** Scorecards can help companies improve their strategy, decision making, risk management, control, and organization.

• **Anybody can initiate a scorecard project.** Scorecards are of interest to companies, regulators, stock exchanges, institutes of directors, chambers of commerce, investors, academics, and more.

It has been shown repeatedly that scorecards educate companies on good governance practices and on local codes. Iterative scorecard assessments can create a virtuous cycle by which companies assess, reform, and ratchet up their governance practices.

Potential users of scorecards include companies, regulators, stock exchanges, institutes of directors, and development finance institutions (DFIs). Each is likely to have somewhat different goals. Companies tend to be more interested in addressing the concrete day-to-day issues they face in their governance. Regulators and stock exchanges tend to be more interested in measuring code compliance and drawing conclusions about the effectiveness of the regulatory framework. DFIs are usually interested in encouraging market-level change in corporate governance practices and transferring knowledge and skills to local counterparts.

Each user will likely play a different role in the development of a scorecard. It is useful to distinguish between the roles of different users to see how and what each contributes.

Below are three main user roles:

1. ***Initiator:*** The initiator is the institution that suggests undertaking the development of a scorecard. The initiator will typically seek to test the concept with a number of local stakeholders, establish whether a scorecard has utility, and encourage implementation. The initiator’s role is to catalyze action. It may seek other institutions to lead and implement. IFC often finds itself in the role of initiator.

2. ***Owner:*** The owner of a scorecard project is the institution that takes a leadership role and primary responsibility for implementation. Ideally, the owner is a local institution. Ownership with a local institution promotes sustainability through a knowledge transfer to local partners.

3. ***The beneficiary:*** All the institutions involved in the development of a scorecard will derive some benefit. A regulator may extract information important for the development of sound policy, a stock exchange may enhance its image as a trading location, and a business association may provide a valuable service to its members. The ultimate beneficiaries are the companies whose governance practices are being assessed.

Though scorecards are often initiated by regulators, anybody can initiate or own a scorecard. In practice, institutions may play multiple roles.

Methodology

The evaluation basis of the corporate governance scorecard for Uzbekistan that we are suggesting in this article is built around the G20/OECD Principles of Corporate Governance, which are the globally accepted benchmark for corporate governance. While applying the G20/OECD Principles, we also considered the issues related to the Uzbek context and the regulatory framework.

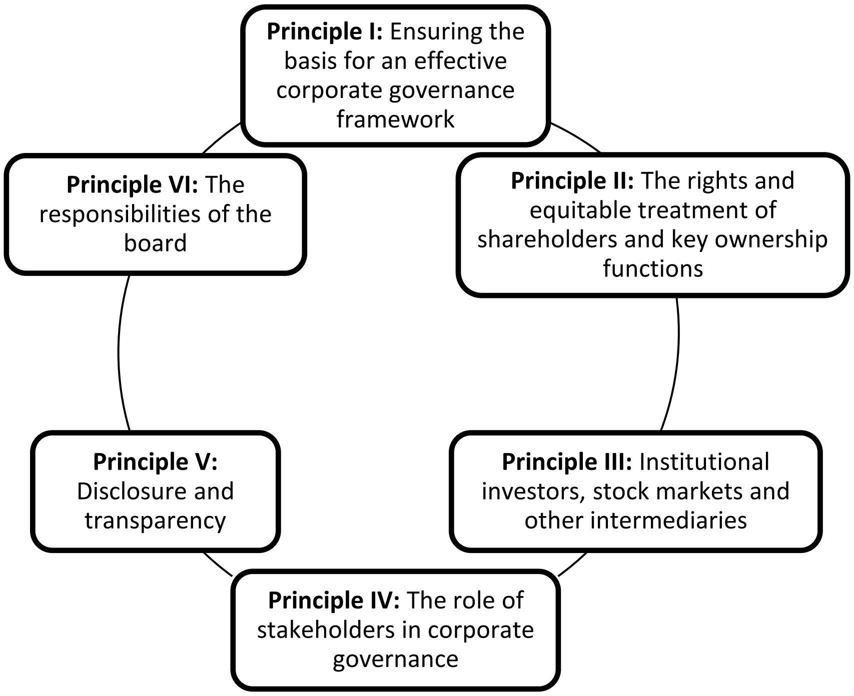

Illustration 1. G20/OECD Principles of Corporate Governance

The principles capture the essential elements of corporate governance:

• **Principle I:** Ensuring the basis for an effective corporate governance framework

The corporate governance framework must help promote transparent and fair markets, and the efficient allocation of resources.

• **Principle II:** The rights and equitable treatment of shareholders and key ownership functions

The corporate governance framework must identify basic shareholder rights and provide equitable treatment of all shareholders.

• **Principle III:** Institutional investors, stock markets and other intermediaries

The corporate governance framework must disclose and minimize conflicts of interest of market participants.

• **Principle IV:** The role of stakeholders in corporate governance

The corporate governance framework must encourage active co-operation between companies and their stakeholders.

• **Principle V:** Disclosure and transparency

The corporate governance framework must facilitate disclosure of material information to aid in informed decision-making.

• **Principle VI:** The responsibilities of the board.

The corporate governance framework must ensure effective supervision by the board and enhance the board accountability to stakeholders

Uzbekistan CG scorecard

A few facts about the G20/OECD Principles of Corporate Governance's popularity can be listed as following; The G20/OECD Principles of Corporate Governance have been adopted as one of the Financial Stability Board’s (FSB) Key Standards for Sound Financial Systems serving FSB, G20 and OECD members, they have been used by the World Bank Group in more than 60 country reviews worldwide, and finally they serve as the basis for the Guidelines on corporate governance of banks issued by the Basel Committee on Banking Supervision.

It is required that the evaluation to be conducted only on publicly available data. Sources of information will primarily include official company documents on the company website, regulator’s official database (openinfo.uz) and stock exchange website. Some specific questions may be sought in regulatory orders and media reports.

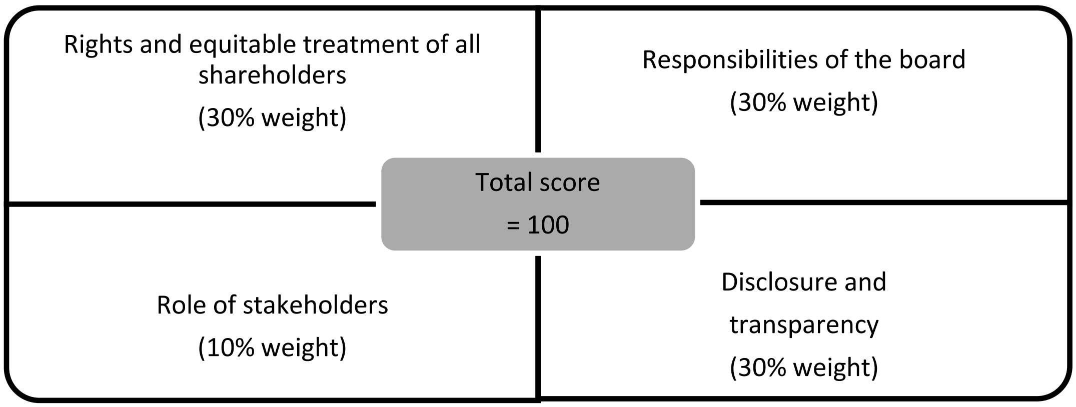

Illustration 2. Methodology of the scorecard.

The questions in the scorecard have been grouped into four categories – each category corresponding to one of the principles recognized in the G20/OECD Principles as a measure of good corporate governance:

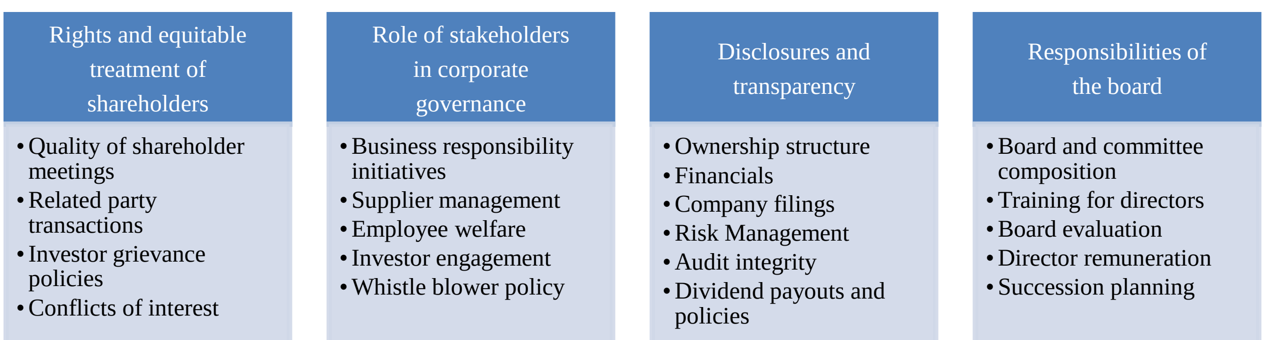

Illustration 3. Corporate Governance principles included in the scorecard.

The Scorecard has been developed considering four of the six G20/OECD Principles (Principle II, IV, V, and VI), which focus directly on the company’s governance practices. G20/OECD Principles I and III have been dropped, as they deal with the overall regulatory environment and the role of market participants in corporate governance – factors, which are not in the control of the company.

The scorecard consists of 70 questions, which are divided into four categories corresponding to the respective G20/OECD principles. Each category has a different number of questions that address the relevant issues related to the specific G20/OECD principle. The weights assigned to each category are based on the number of questions in the category and the relative importance of the questions in that category in the Uzbek corporate governance framework.

The quality of corporate governance practices referred to in each question are marked as following:

• **2 points:** If the company follows global best practices for that element of corporate governance

• **1 point:** If the company follows reasonable practices or meets the Indian standard for that element of corporate governance

• **0 point:** If the company needs to improve in that element of corporate governance

Some questions do require a more limited ‘yes’/‘no’ response. In such cases, 2 points are awarded for a positive response and zero points for a negative response. If information is not observable through publicly available relevant information, the question will not be awarded any points.

Some questions may also provide for a “not applicable” option. If the assessors select this option, the question will be excluded while applying the scoring formula.

Each question has a detailed response key, which underlines the best practice. The assessors need to strictly adhere to what is mentioned in the response key for scoring on each question.

Table 1. Corporate governance scorecard structure

Category	Number of questions	Maximum attainable score	Category weight
Rights and equitable treatment of shareholders	19	38	30
Role of stakeholders in corporate governance	9	18	10
Disclosure & Transparency	23	46	30
Responsibilities of board	19	38	30
Total	**70**		**100**

To calculate the final score for a company, the assessors need to:

a. Add the scores for all responses under a category and divide it by the maximum attainable score for the category. This may need to account for questions that are not applicable for the company.

b. Multiply the ratio so obtained by the total category weight to give a weighted score for that category.

c. Sum all weighted scores across all four categories. The final score will be rounded up or down to the nearest integer.

$$Category\ Score = \frac{Aggregate\ score\ of\ all\ questions\ under\ category}{Number\ of\ applicable\ questions\ in\ category \times 2} \times Category\ Weight$$

(1)

$$Total\ Score = Category\ score_1 + Category\ score_2 + Category\ score_3 + Category\ score_4 \quad (2)$$

Table 2. Corporate governance scoring example

Category	Total score (A)	Maximum attainable score (B)	Category weight (C)	Weighted score (A/B)*C
Rights and equitable treatment of shareholders	30	38	30	24
Role of stakeholders in corporate governance	12	18	10	7
Disclosure & Transparency	38	46	30	25
Responsibilities of board	28	38	30	22
Final score			**100**	**77**

Based on the final score, companies will be grouped into the following groups:

Table 3. Score groups

Final score	Level of corporate governance
> = 70	**Leader**
60 - 69	**Good**
50 - 59	**Fair**
< 50	**Basic**

Conclusion/Recommendations

Perspectives of being ranked in accordance with the new Corporate Governance scorecard will push the joint-stock companies in Uzbekistan to develop written policies and procedures. It will enhance transparency toward all shareholders and the markets. Once the companies are ranked, there will be a competition among the companies to be in line with governance leaders and the leaders companies will be recognized as quality investment companies among potential investors. Written policies and procedures of good corporate governance will develop commitment to good governance at board and executive levels. It will also create better understanding of governance and how it affects company operations. Enhanced protection of minority shareholders will boost the image of a company, which will lead to higher stock prices in the capital markets.

The new Corporate Governance scorecard will raise awareness of corporate governance issues, since in the beginning many joint-stock companies will have difficulty to score high, until they develop their policies and procedures of good corporate governance and start scoring higher. Publicly available scores will generate real-time information that allows comparison of any company to a peer group. Once the score gains popularity and joint-stock companies will want to boost their CG scores, there will be more demand for a network of consultants to advise enterprises on their governance. This in turn will lead to the development of many governance action plans developed at the company level. The developed plans will lead to actual changes in governance practices and allows generation of aggregated data on governance practices, categorized by sector, size, region, and the quality of governance.

Uzbekistan does not have the institute of directors, but as the economic reforms continue, the institute will eventually evolve, and the development of corporate governance scorecard will be of very high importance for its functioning. For the institute of directors, the new corporate governance scorecard will raise awareness of corporate governance and maintain public attention over years. This will lead to the development of governance action plans within the listed companies and to measurable improvement in governance practices of companies over time. Awards programs and disclosure will incentivize for better governance. Uzbekistan’s reputation will be improved for its corporate governance practices and will generate useful information to policymakers on the governance practices of listed companies, state-owned enterprises, and banks.

Using the new corporate governance scorecard will help the stock exchange to measure changes in governance practices among listed companies overtime. The scorecard can also be used by the stock exchange as one of the qualifying requirements for companies to be listed in the exchange. Companies to be listed will be incentivized to improve governance through competition with other companies. Collected data will generate useful information for the stock exchange, regulators, and policymakers and enhance the reputation of the stock exchange and the country as an investment destination.

From the regulator’s perspective, the new corporate governance scorecard will permit verification of levels of implementation of national code of corporate governance as well as legal compliance. It will provide indications of the effectiveness of codes and the degree of implementation of the law on joint-stock companies and protection of shareholders’ rights. The regulator will be able to identify corporate governance practices where companies are relatively strong or weak. Generated data on governance practices over time will let detect trends and that will force companies to conduct severe self-checking of their governance practices.

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