

ORIGINAL PAPER



DOI: 10.26794/2304-022X-2022-12-3-106-113

UDC 33.027(045)

JEL M14

Institutional Opportunities for the Development of Option Programs for Top Management Remuneration in the Russian Federation

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ABSTRACT

In the context of the sanctions pressure on the economy of the Russian Federation and the opportunistic behavior of certain foreign members of the boards of directors, it is necessary to develop a national model of corporate governance in terms of remuneration of top management, the level of which in Russian corporations is currently focused on the practice of foreign companies, which entails significant overpayments and causes public complaints. Companies do not personalize the payments made, do not disclose the remuneration structure as a whole, nor do the criteria by which the amounts are determined, which are the overall performance of the company, generally, techno-economic. In the world practice, of remuneration of top managers there is a shift from direct cash payments to optional programs. In Russian practice, such programs are not sufficiently developed: there is a brief information about their use, but without explaining the details. The **purpose** of the article is to identify institutional opportunities for the development of options for the remuneration of managers of Russian companies, and its **tasks** – analysis of experience of application and possibilities of development of optional programs of remuneration of the top management of Russian companies, analysis of the legislative base for allocation of its shares. In the article applied **methods** of generalization, analysis and synthesis in the part of the study of methodical and legislative approaches to the identification of variants for the application of option programs. There has been shown that remuneration of stocks of top management in the Russian practice is possible through shareholder agreements.

Keywords: corporations; top management; remuneration; motivation; stocks; options; bonuses

For citation: Ordinartsev I.I. Institutional opportunities for the development of option programs for top management remuneration in the Russian Federation. *Management sciences*. 2022;12(3):106-113. DOI: 10.26794/2304-022X-2022-12-3-106-113

INTRODUCTION

Unprecedented anti-Russian sanctions contribute to improvement of corporate management mechanisms in Russia — many foreign members the boards of directors of domestic companies have effectively ceased their functions, which could significantly disrupt the activities of these organizations. Digitalization of the economy and related processes require major changes. In this situation, it is appropriate to raise the issue of remuneration of board members. The size and transparency of their compensation raises many questions for both minority shareholders and society as a whole. In Russian companies, compensation to labor of top management is focused on international experience and consists of constant (basic) and variable parts, but in the annual reports of corporations it is noted that their management is entitled to bonuses that lie outside these amounts. The practice of remuneration of board members in domestic companies is reflected in the reports of Korn Ferry [1]: the amount of the basic compensation in 2020 averaged from 2.2 to 36.4 mln rub. reaching 123.7 mln rub. (at the chairman of the board of directors of UC Rusal). There is a direct dependence of basic remuneration on the profitability of the industry in which the company operates. And in the sources considered by the author they are described, being expressed in monetary form, and the mechanisms of remuneration the top management options on the stock of the company are poorly developed.

In this study, the author considers the institutional possibilities for the development of options for the remuneration of managers of Russian companies.

DISCUSSION

There is considerable disagreement over the permissible transparency of compensation

to labor for higher management. Some researchers think that such disclosures are necessary only in companies with state participation, while in private — management remuneration is determined by shareholders and is a commercial secret. Proponents of this approach argue that those owners who disagree with the remuneration of senior managers may not vote on these issues at the general meeting of shareholders. The following arguments are used to justify extremely high payments to board members:

- the level of their remuneration is determined by international practice, including in the US and Europe. Such high fees are universal for top managers invited from abroad;
- they are, for the most part, employees with high managerial qualifications who are able to perform the most difficult tasks;
- remuneration policy is determined by the public joint stock company itself and is not subject to state regulation.

These issues are constantly analyzed both in Russia and abroad. Research of methodical bases of remuneration of top managers of both public joint-stock companies and companies with state participation¹ are devoted to research of B. Bataeva, M. Kuznetsov, O. Fedorov, A. Mikheev [2, 3]. Features of motivation of top management are devoted to the work of D. Evgenova [4], mechanisms for its stimulating described Yu. Aleshina [5]. In the research of M. Kuznetsov et al., Yu. Aleshina, I. Bocharova and A. Rymanov show that the amount of remuneration of top managers of Russian companies is poorly

¹ Letter of the Federal Property Management Agency No. GN-13/3802 from 15 February 2011 “On recommendations for determining the amount of remuneration of employees of state companies”. URL: http://www.consultant.ru/document/cons_doc_LAW_193313/96c60c11ee5b73882df84a7de3c4fb18f1a01961/

oriented for the long term and reflects mainly economic indicators achieved by organizations in the previous period [3–6]. At the same time, it has long been noted, in particular, Yu. Petrova, that in Russian practice, high management costs are not justified [7]. There is also an opinion that the most important disadvantages of the mechanisms applied in Russia for remuneration of top managers are orientation on the practice of the Western labor markets, short-term motivation, as well as a weak, unclear relationship of compensation with the results achieved. Taking into account the recommendations of the Corporate Governance Code on equal payments to all board members (except the Chairman),² the trend to follow international standards leads to cost overruns by overstatement, and short-term motivation encourages opportunistic management actions to increase remuneration.

The question of the criteria for determining the latter remains poorly studied: they are a commercial secret and are not disclosed, as is the very amount of income of each top manager.³ It is generally accepted to be defined on the basis of profit/profitability or selected performance indicators (such criteria are corporate –wide and determine 70–80% of its size). The features of the remuneration methods include the fact that the executive members of the Board of Directors are not performed,⁴ and the non-executive receive additional payment for work in the committees of the Board of Directors.

Digitalization of the economy leads to increase of intangible assets and

development of ecosystems outside the organization, which reduces the role of profit (profitability) in calculation of labor compensation. One specific feature of intangible assets is that they increase as they are used, as opposed to physical assets that are amortized. Recognizing the benefits of increased intangible investment is currently difficult. Physical companies are becoming increasingly digital, and profit and loss reports are less relevant to investors' decisions [8]. Profit loses its value as an indicator of efficiency and, consequently, as a criterion for calculating the remuneration of the top management; the same applies to the income of the organization. World's leading companies reduce cash premiums based on profits and move to share-based payment. Such mechanisms reduce the risk of valuable investment by opportunistic managers to generate higher returns and higher compensation [9].

The remuneration of top management, defined in this way, can be carried out under several options, which apply to the variable part of income of top managers, leaving the basic unchanged. The simplest method — is to determine its size based on the increase in the value of shares during the reporting period. The reward is paid, which effectively turns the optional program into a bonus system. This approach does not motivate senior managers in the long term and creates risks of their opportunistic behavior to increase the one-time payment.

The long-term motivation is created by optional compensation programs, providing incentives to managers by shares of the company (the so-called “administrative option” [further — option]). In general, an option — is an agreement to buy/sell an asset at a certain price within a specified period. Administrative option is an additional promotion from management: each employee has the right

² Corporate Governance Code. URL: <https://nand.ru/professional-information/corporate-governance-code/?ysclid=l58bw3rn7h593236442> (accessed on 01.07.2022).

³ In annual reports for 2020–2022, individual companies, such as RUSAL, disclose the personal compensation of board members. URL: <https://rusal.ru/> (accessed on 01.06.2022).

⁴ The focus — is people. Report on sustainable development for 2021 (RUSAL). URL: <https://rusal.ru/> (accessed on 01.06.2022).

to repurchase a certain number of shares of the company at a certain price (usually lower than the market) over a certain period of time [10, p. 267]). Execution of an administrative option results in the issuance of shares and changes in the ownership structure of the organization, potentially creating a conflict of interest. The value of the shares is set either on the date of the option announcement or at the offering price; managers acquire them on their own funds and, according to the contract, have no right to sell for a certain time (2–3 years). Monetary reward can be received once or in parts for a specified optional period of time. Income is generated either as dividends to the shareholder or when the latter are sold at the option price at the time of sale. It is obvious that if worsening the efficiency of the organization, the share price may decline, and the managers, accordingly, will not receive income. An important condition of the option is the ban on the sell or transfer it to another person: they have both advantages and disadvantages, but generally increase the long-term motivation of top management to work to increase the efficiency of the organization and, as a result, increase the value of its shares. In foreign companies, optional programs are widespread, facilitated by an appropriate legislative framework: companies can issue a portion of the reserved stock or buy their own in the market to form special funds under options.

In the Russian practice in the methodological plan of variants of options are studied in depth enough, their advantages and disadvantages are revealed, conditions of their application are considered,^{5,6} motivating effect [11,

12]. Recommendations on the criteria for granting shares⁷ to company employees [13], have been developed, proposals on formation of compensation plans for the top management have been known [14]. However, most developments note that the possibilities of using administrative options in Russia are limited by the legislative framework. However, M. Kuznetsov, O. Fedorov and A. Mikheev showed [3], that optional long-term management compensation program is used in Russian companies with government participation. As a shortage the authors noted that the use of bonuses based on “phantom” shares (PJSC “Aeroflot”, PJSC “SCF Group”). In such cases, they are paid in cash, depending on the development of the capitalization and the stock price. In some cases (PJSC “Rosseti”) provides a two-stage option in two stages: on the first — for an equity stake of PJSC “Rosseti”, on the second — for an equity stake of subsidiaries and dependent companies. In general, in the article [3] options are recognized as a promising mechanism of remuneration both for Russian companies with state participation and for private firms.

The main problem with the application of administrative option in Russia is the absence of an explicit mechanism of giving managers shares at a discount price, unlike the Western practice, which provides for the issuance of shares under administrative options.

For the latter, the institutional environment can be considered at three levels. First level — federal — includes the Federal Law No. 208 from 26 December 1995 “On Joint Stock Companies” (further — Law on JSC), the

⁵ Options for employees — principle of motivation. Information and analytical portal ForexCity. URL: <http://www.forexcity.ru/traders/articles/84660.html>

⁶ What are the options for employees in Russian companies. HR-Portal. 09.06.2011. URL: <http://hr-portal.ru/article/>

[kak-vyglyadyat-opciony-dlya-sotrudnikov-v-rossiyskih-kompaniyah](#) (accessed on 18.05.2022).

⁷ Option ripe: how to distribute business shares to employees of the company. TheVillage. URL: <https://www.the-village.ru/village/business/management/149583-optsiyony-v-startape> (accessed on 16.04.2022).

Table

Options and the effect of motivating the allocation of shares to top management

No.	Method of provide the manager stocks of the company	Necessary conditions	Motivating effect	Risk of interest conflict of shareholders
1	Free purchase on the market	Free sale of shares in the market	Weak	Low
2	Sale of shares to shareholder managers	Owners' desire to sell shares	Medium	Low
3	Distribution between managers of additional issue of shares	Consolidation of possibility of additional issue of shares in documents of a company. Concurrence of existing shareholders. Top managers have a stake	High	High
4	Sale to managers of shares purchased by the company on the market	Stock available on the market. Concurrence of existing shareholders. Top managers have a stake	Medium	High
5	Any distribution of shares to top managers at reduced cost as per shareholder agreement	Presence of a written shareholder agreement. Presence of conditions p. 1–4	High	Low

Source: compiled by the author.

provisions of which regulate the mechanisms of work with shares of the company.⁸ Let's consider possible mechanisms of granting shares to top managers:

A. Purchase shares in the market. In this case, managers buy shares at the market price and regardless of the option. No motivating effect is achieved.

B. Sale of shares by majority (less often – minority) shareholders. It is obvious that it is possible at a price not less than the share

price at the placement. Owner–seller share in equity decreases. The mechanism is possible either with a large share in one hand or in preparation for sale.

C. Issue and distribution of additional shares is allowed by the Law on JSC (par. 1 art. 39): Placement of additional shares is possible through open or private subscription or by conversion – in case of closed subscription they can be offered to a limited, predefined circle of persons. At the same time, art. 40 Law on JSC provides that these shares shall be distributed to all shareholders and at market price, but not below nominal value (in order to protect shareholder rights). Under

⁸ Federal Law No. 208 from 26 December 1995 (ed. from 02.07.2021) "On Joint Stock Companies" (amend. and supplement. into 13.07.2021). URL: <https://base.garant.ru/10105712/?ysclid=150w4u95he435777442>

such a method of placement, as a subscription, the amount of the authorized capital and the number of shares of a company changes, so for its implementation it is necessary to have in the Charter a sufficient number of declared shares of the appropriate category (type) [15]. Consequently, a number of conditions must be met in the implementation of this mechanism.

- Top-managers should already have enough shares in the company.
- The issue of additional must be provided in the constituent documents of a company.
- Most shareholders need to agree on the allocation of management shares, which is unlikely in companies with a large number of participants.

The serious obstacle to the application of such a mechanism is its tendency to increase the authorized capital of a company, not to remuneration the top management, and its use to compensate the work of the management of the company may entail a conflict of interests within the JSC and regulatory claims.

D. Repurchase of shares by a company, which is possible under restrictive conditions. Within one year from the moment of acquisition of shares the company is obliged to make a decision on reduction of the authorized capital or to realize them at a price not lower than their market value. If the shares will not be realized during this period, the “company is obliged to make a reasonable decision on reduction of its authorized capital by repayment of such shares”.⁹ The use of this mechanism is possible, but the mandatory condition of the sale of shares at a price below the market reduces the motivating effect and requires the consent of shareholders.

All the options considered for long-term remuneration with the company’s top management shares either do not form an

appropriate economic motivation or may lead to a conflict of interests of shareholders. Law “On Joint Stock Companies”¹⁰ provides for the avoidance of conflicts of interest through written equity agreements to determine the voting in a certain way or the acquisition/alienation of the share at a certain price or in certain circumstances, as well as to carry out other coordinated actions related to the management of the company.

Options for the allocation of shares to top management reviewed in the *Table*, should be considered as an interim solution. To develop optional remuneration programs, it is necessary to improve the legal framework of the Russian Federation.

CONCLUSION

In the current economic environment, it is necessary to develop domestic mechanisms of remuneration of the top management of corporations and to abandon the practice of focusing on the experience of foreign companies in matters of payment, but at the same time keep a constant part of the latter to those members of the board of directors for whom they are provided in accordance with the documents of the organization. Gradual transition from direct cash compensation to optional 3–5 – year programs is recommended to increase management’s motivation for long-term and effective work. As intermediaries, you can use any options provided by the Federal Law “On Joint Stock Companies”, but with the mandatory conclusion of an agreement of shareholders to avoid conflicts of interests. Understanding the opportunities and mechanisms of using existing options to reward top management will enable owners to increase long-term motivation and executive responsibility for corporate value; and for their development requires improvement of the national legislative framework.

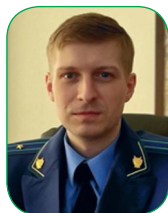
⁹ See *ibid*.

¹⁰ See *ibid*.

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Conflicts of Interest Statement: The author has no conflicts of interest to declare.

The article was submitted on 27.04.2022; revised on 01.06.2022 and accepted for publication on 04.07.2022.

The author read and approved the final version of the manuscript.