



# Corporate Governance Development in Railway Companies



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## ABSTRACT

*In modern market environment efficiency of corporate governance is of particular importance for a company's activity to raise its competitiveness. It is completely true regarding foreign and Russian transport companies.*

*The Russian Railways holding company is among global leading transport and logistics companies. Considering the large scale activity of JSC Russian Railways particularly determined by the length and geographically extensiveness of its*

*network, its involvement in solution of large social and economic problems, and in the context of the study of the practices of world leading transport companies it is worthwhile to generalize the experience of development of corporate policy of JSC Russian Railways, and of processes of updating of its corporate governance system.*

*The article contains generalized reviewing and brief analysis of above topics based on published corporate documents and suggests a basis for further research.*

**Keywords:** *railways, corporation, corporate governance, features of business processes, efficiency, JSC Russian Railways.*

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## Background.

Currently, implementation of financial and economic activity by joint-stock economic entities in the highly competitive environment of the transport industry of the Russian Federation is associated with introduction of effective corporate governance tools disclosed in publicly published non-financial statements.

The introduction and further improvement of corporate governance in joint-stock companies in Russia allows the management of companies of the transport industry, JSC Russian Railways being the largest one, not only to improve the investment asset and human resources management, but also to build corporate governance based on the business goals, with respect to the stage of the company's development, and considering the opinion of stakeholders.

Corporate governance is a set of rules, laws and regulations which lay foundation of corporate activity and further regulate it [1]. Corporate governance is based on permanent monitoring and accounting of internal and external factors affecting the interests of the company's shareholders, as well as of customers, suppliers, and management bodies [2].

International practices show that it is the risk modelling of external factors, being a stage in creating an effective corporate governance system, that in most cases becomes the basis for improving the financial performance of corporations [3; 4].

The concept, essence, algorithms of corporate governance development are widely present in scientific sources. This is true for Russia as well where despite relative novelty of this research field it inspired a considerable number of developments. I. Yu. Bocharova, D. M. Mikhailov, L. N. Tepman, N. M. Rozanova, A. Yu. Rymanov and others scientists have made a significant contribution to identifying current role of efficient corporate governance in joint-stock companies.

Despite the substantial research and the significant contribution of researchers in that field, in the author's opinion, the issues of effective corporate governance in the transport industry are covered fragmentarily and require further study.

Considering transport sector of Russian economy, the system of corporate governance of JSC Russian Railways attract greatest interest as of the largest transport and logistics company in Russia.

The *objective* of the article is to proceed with a generalized review of published corporate documents and to compose, based on it, a brief analysis of development of fundamentals of corporate policy of JSC Russian Railways, of the structure and process of modernization of its corporate governance system. Such an analysis seems opportune as a basis for further study, particularly on the methods of enhancement of efficiency of transport companies, further comparison of best practices of global railway companies.

## Results.

Since its inception, even in an unstable market environment, JSC Russian Railways has consistently provided transport services to the country's economy and population [5; 6]. Today, JSC Russian Railways and its subsidiaries and dependent companies carry about 3,8 million tons of cargo and 3,2 million passengers daily.

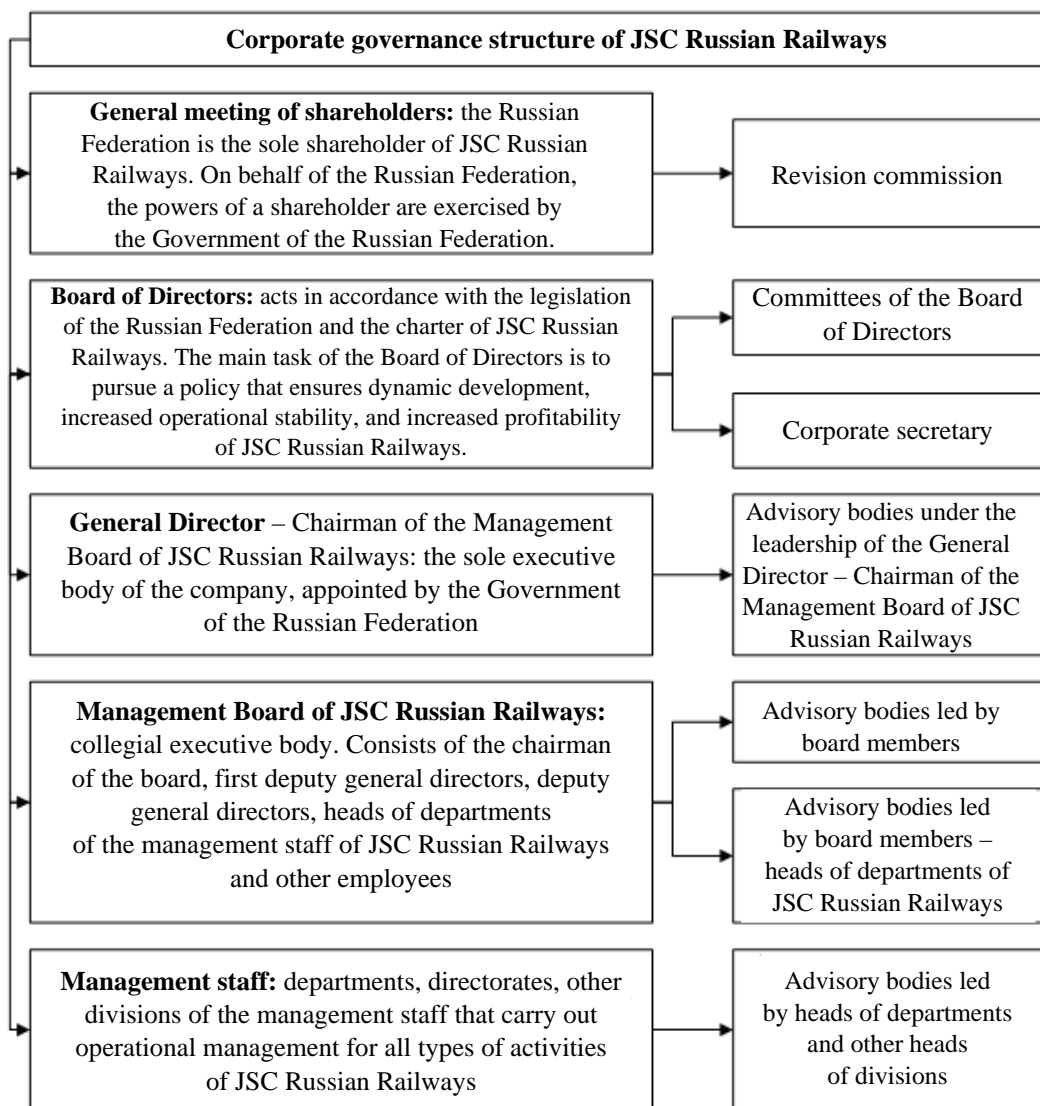
JSC Russian Railways is one of the largest investors in the Russian economy, investing 3 % of the total capital investment, making large-scale purchases of products, more than 80 % of which are produced by Russian companies.

JSC Russian Railways has adopted a Long-Term Development Program until 2025. Achieving the parameters of the baseline scenario of this program will almost double the contribution of railway transport to the Russian GDP by 2025 attaining so for railway transport 8,3 trillion rubles threshold.

The corporate governance system of JSC Russian Railways is carried out in accordance with the division of powers between the management bodies. JSC Russian Railways apply OECD principles of corporate governance, providing for corporate governance to be relationships formed by state corporation governing bodies, its management, shareholders, and other persons (stakeholders) interested in its activity [7].

The Pic. 1 shows the structure of the company.

The basis of the corporate governance system of JSC Russian Railways is provided by a process approach, in accordance with which management of activities is built as management of a set of processes (including end-to-end). The company also uses functional management, which allows for a clear delineation of



**Pic. 1. Corporate governance system of JSC Russian Railways [8].**

responsibility and for ensuring discipline control. The project approach is used for project-oriented activities, for example, research, construction, etc.

At the same time, the requirements for quality of corporate governance organization, due to the fact that JSC Russian Railways is a natural monopoly [2], have been strengthened.

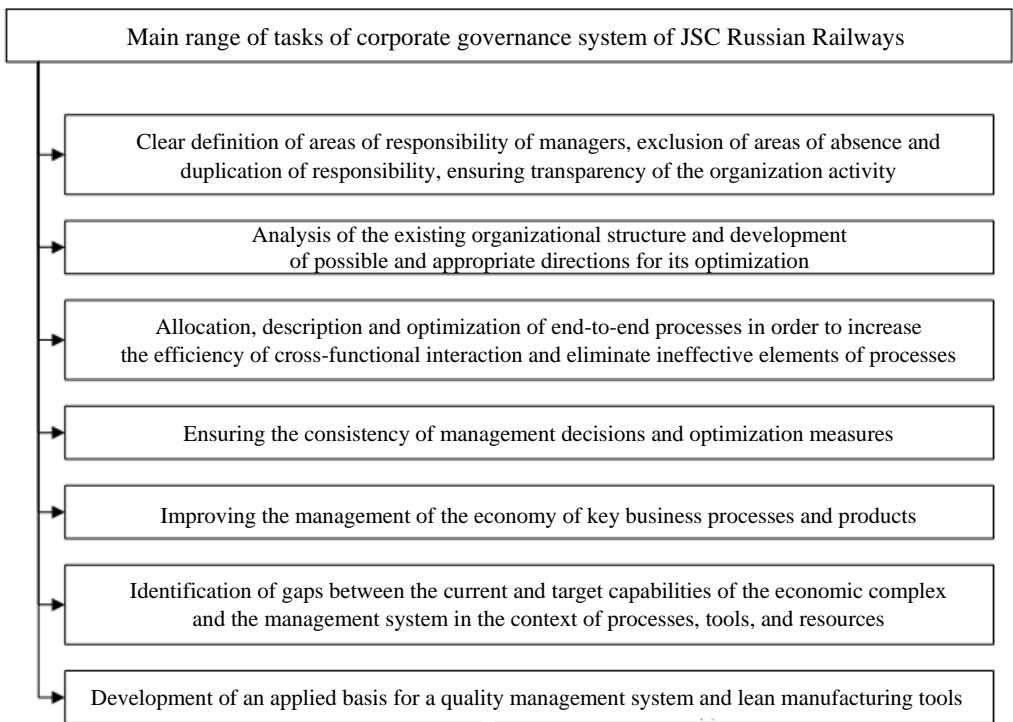
This fact is explained by the interests of the shareholder, represented by the Russian Federation, but also by commercial, operational, and financial relations between the shareholder and the company, as well as by potential probability of competition between modes of transportation.

In addition, the requirements stem from the high social significance of the products and services of JSC Russian Railways, which impacts the nature and contents of the information included into the corporate report.

The main approach to design processes is a top-downwards approach, which implies formation of an integrated process model of JSC Russian Railways by sequential decomposition of its upper-level elements into lower-level elements.

Deloitte, characterizing the process approach as the best corporate governance practice, emphasizes in its report that effective management is implemented through a





**Pic. 2. The main range of tasks of the corporate governance system of JSC Russian Railways [8].**

combination of structures and mechanisms that harmonize the interests of all parties involved (theory of agency relations), ensure that the views of all stakeholders are considered, and information is freely circulated (stakeholder theory). The above management variables have a scientifically proven correlation with corporate performance [4].

As part of expanded application of the process approach in management, the Russian Railways holding company focuses on fulfillment of the tasks presented in Pic. 2.

JSC Russian Railways is gradually transitioning to functioning in the form of a set of vertically integrated structure units specialized in specific types of activities. Simultaneously with the transition to an organization specialized in the types of activities, the organizational model being created at JSC Russian Railways is aimed at forming a matrix management structure, in which special attention is paid to creating and ensuring the high-quality functioning of structures responsible for effective interaction of JSC Russian Railways divisions across all verticals of management, including at the regional level.

It is important to note that it is impossible to completely abandon the territorial approach to governance of JSC Russian Railways: its property complex covers the entire territory of the Russian Federation and is a significant factor in the country's socio-economic development. Due to the geographic scale of this complex, the full-fledged implementation of the management functions of JSC Russian Railways without the presence of territorial management bodies is ineffective and will lead to the need to resolve issues by the corporate HQ.

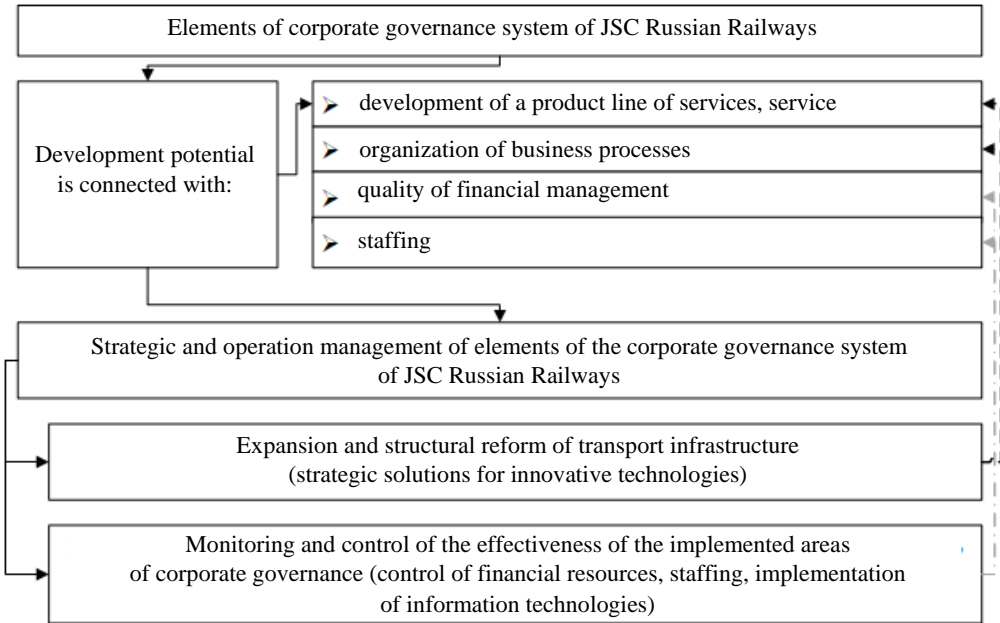
Matrix management is implemented through development of end-to-end horizontal links at all management levels, ensuring interaction of economic verticals responsible for coordinating the activities of divisions at the regional and line levels. Also, the matrix of management is enhanced by expanding application of project management principles at all levels of management.

Based on the close economic and financial dependence of the participants in the transportation process, united by a key asset which is railway infrastructure, it is planned to form a strategic management loop with enhanced planning and control functions,

Table 1

**Measures to implement the provisions of the Corporate Governance Code of JSC Russian Railways [8]**

Goal	Measure
Improving organization of the basics of combating corruption, as well as formation of a single approach to ensuring prevention of signs of corruption	A communication channel has been organized through which any interested person can inform about corruption actions of employees or third parties that have become known to him that can harm economic activity, image, and the business reputation of JSC Russian Railways.
Improving the risk management system	The Center for Risk Management and Outsourcing Development was established. The Regulation on the risk management system was approved. The Anti-Corruption Policy of JSC Russian Railways was approved.
Improvement of the corporate governance system	In accordance with the recommendations of the Code, the Regulation on the information policy of JSC Russian Railways was updated. Starting from 2015, the publication of the annual report of JSC Russian Railways is carried out before the annual general meeting of shareholders. In accordance with the recommendations of the Code, the provisions on the Human Resources and Remuneration Committee, the Audit and Risk Committee and the Strategic Planning Committee of JSC Russian Railways Board of Directors were updated. The new version of the Regulation on Organization of Internal Audit at the Russian Railways Holding Company was approved.
Improving the territorial corporate governance system	Simultaneously with implementation of the Code's recommendations in its activities, JSC Russian Railways is carrying out similar work in its subsidiaries, coordinating actions with the Expert Council under the Government of the Russian Federation.



**Pic. 3. Elements of the corporate governance system of JSC Russian Railways [compiled by the author].**







which determines the guidelines for organizational development of JSC Russian Railways. This is done to realize the synergy effect, ensure safety requirements and the continuity of the transportation process.

The implementation of the principles of specialization and matrix management will create sufficient conditions for JSC Russian Railways as a whole to remove a number of constraints and reduce risks, as well as to further unleash the potential for delegating authority.

Taking into account the joint character of tasks, technologies and additional synergistic effects from coordinated activities, the functionally responsible units organize bodies that ensure organization and control of management in units by functional verticals, taking into account the features of a particular direction of activity, in such areas as cost and efficiency management, human resource management, development, and others.

JSC Russian Railways has implemented a number of measures to implement the provisions of the Corporate Governance Code, presented in Table 1.

At present, JSC Russian Railways continues to implement the provisions of the Corporate Governance Code. The Articles of Charter of the Company were amended to provide for the right of the Board of Directors of JSC Russian Railways to include not only subsidiaries but also controlled companies in

the list approved by the Board of Directors annually. The Board of Directors of JSC Russian Railways, taking into account the recommendations of the Corporate Governance Code, amended the regulations on the committees of the Board of Directors of JSC Russian Railways, and also approved the Regulation on evaluating the activities of the Board of Directors, Committees of the Board of Directors and members of the Board of Directors of JSC Russian Railways.

Improving the efficiency of corporate governance at JSC Russian Railways is associated with ensuring progressive development and the potential for such development in the future [10]. In this case, the potential can be represented by the elements, visualized in Pic. 3 [3].

The goals of development of corporate governance include, firstly, implementation of its development capacity, provision of efficient governance in compliance with changing corporate and economic structure of JSC Russian Railways, and secondly, continuously improved quality of management. The corporate governance model implemented at JSC Russian Railways ensures the observance of rights and legitimate interests of shareholders, fair treatment, transparency in decision-making, information openness, professional and ethical responsibility of members of the Board of Directors, other company officials

and a shareholder, as well as development of the system business ethics.

The current efficiency should be assessed as high: there are tendencies to improve the work of its subjects, to increase financial results. Among the features of corporate governance, two main ones can be distinguished: specificity of the focus of activity and the presence of specificity of organizational and legal form. JSC Russian Railways works with a large number of counterparties, which are not only commercial organizations, but also socially significant institutions. Thus, JSC Russian Railways implements in its activities primarily important public, social and reputation objectives. To further improve efficiency of corporate governance it is necessary to permanently monitor economic conditions, other external risks and threats, external to the company. Risk analysis should be continuous. Currently those risks might include price competition in the transport industry; increased costs due to the increased influence of unfavorable factors and forecasts of a deterioration of the world market due to the growth of an unfavourable epidemiological situation.

### Conclusion

The problem of increasing the efficiency of corporate governance is quite relevant for the Russian economy. Summing up brief analysis of corporate governance in JSC Russian Railways, long-term positive factors should be noted. The development of corporate governance at JSC Russian Railways is based on the principles of the process approach and organizational development, building effective management of the economic complex, flexible improvement, development of a target model and organizational structure of the company in accordance with market changes and internal transformations, as well as ensuring long-term financial stability, economic efficiency, and competitiveness of JSC Russian Railways. The implementation of those trends can be positively influenced by improved quality of planning, forecasting and modelling of risk situations for the railway company's business.

Considering system nature, complexity, and multifactor character of the activity of big transport companies, and despite number of research publications and consulting reports, devoted to specific aspects of its components (e.g., financial management) further in-depth research is still of topicality. It might comprise

comparative study of methods and mechanisms of enhanced efficiency of corporate governance in the transportation sector.

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