APPLYING THE RESULTS OF THE EU CORPORATE GOVERNANCE HARMONIZATION IN THE DEVELOPING COUNTRIES: THE CASE FOR KAZAKHSTAN'S BOARD STRUCTURE

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Abstract: *Kazakhstan is a rapidly developing economy, which is actively interacting with the global world community. A highly competitive global market strongly demands further steps to improve the Kazakhstan's corporate law and, in particular, its corporate governance framework. At the heart of this article is one of the most important and problematic aspects of the corporate governance system of Kazakhstan - the board structure. The author establishes a link between the agency problem in domestic companies in Kazakhstan and the appropriate board structure, which could replace the existing one, which is ineffective. The article provides for a new insight into how the permission to make choice between one-tier and two-tier board structures can be useful in Kazakhstan and in countries that have the similar corporate governance systems.*

Keywords: *corporate governance, board structure, agency problem, optional approach, concentrated ownership, state ownership.*

1. INTRODUCTION

Kazakhstan is a country that has set the ambitious task of positioning itself among the top 30 economically advanced countries of the modern world (Note 1). Achieving this goal largely depends on the success and stable development of large companies, engaged in the solution of priority economic tasks. It is fair to say that the success and especially the stability of companies depend to a certain extent on the structures and processes of the corporate governance adopted by them.

This article deals with the issue of the development of corporate governance legislation as an important area of improving the national law of Kazakhstan. The Kazakhstan national legislation on corporate governance is characterised by a number of shortcomings. Fortunately, the need for development has been recognised. For example, at the time of writing this

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article, a broad reform of Kazakhstan's corporate governance framework, including amendments to the legislation, was being implemented on the initiative of the European Bank for Reconstruction and Development. The author of this article believes that the EU regulatory framework must be an important reference point for such reform and for all other initiatives in the field of corporate governance in Kazakhstan. In particular, the experience of harmonisation of corporate law of the EU should be taken into account.

At the heart of this article is one of the most important and problematic aspects of the corporate governance system of Kazakhstan - the board structure. The author is of the opinion that one of the main focuses of further developments should be on the board structure. It is important, however, that such developments are based on relevant local research. Meanwhile, the bulk of research in the field of corporate governance is focused on developed countries (Peter Wong, 2011, pp. 14-27, at 22. Stijn Claessens and Burcin Yurtoglu, 2012, p. 2). This fact may adversely affect the establishment of corporate governance systems in developing countries, and may indeed appear to be the reason for blind copying of the institutions of 'best practices' and their implementation into the national legislation of developing countries without considering their economic and legal differences. Often these institutions do not fit with the specificity of the national systems of corporate governance and cannot function effectively in the absence of an appropriate context. Moreover, such arrangements are often distorted after their transfer as a result of the system errors which arise from the lack of the legislator's understanding of the purpose of such mechanisms. The board structure prescribed by Kazakhstan law, as examined in this article, is an example of such an inconsistent transfer. It is hoped that this article will be useful as a contribution to the study of corporate governance in developing countries, in particular, the CIS countries. It is worth mentioning that the findings put forward in this article can be projected, to a certain extent, onto other CIS countries, due to the similarity of corporate governance systems in general and the board structures in particular.

This article attempts to establish a link between the agency problem in domestic companies in Kazakhstan and the appropriate board structure, which could replace the existing one, which is ineffective. For this purpose, the board structure, which exists under Kazakhstani law, will be described first. Second, the severity of the principal agency problem of 'shareholders-managers' within the domestic companies of Kazakhstan will be explored. Finally, the author will show which kind of board structure is appropriate for Kazakhstan and will try to elaborate a way to solve the problem of

inefficiency of the board structure. The proposed approach could, to some extent, bring the corporate legislation of Kazakhstan closer in line with the developed regulatory framework of the European Union.

In this article, the term 'companies' refers to Kazakhstani domestic joint-stock companies, both exchange-listed and unlisted, as legal entities, which are corporations in the classical meaning of the term - as a corporate form possessing the following fundamental legal features: legal personality, limited shareholder liability, transferable shares, centralised (and delegated) management, and investor ownership (Reinier Kraakman *et al.*, 2009, pp. 5-16). In this article, a controlling shareholder will be referred to as a sole shareholder or a shareholder owning shares that allow such a shareholder to elect all or most of the members of the board of directors, to determine their remuneration and terminate their powers regardless from the will of other shareholders.

The term 'state-owned company' refers to a company where the state has significant control, through full, majority or significant minority ownership. For the purposes of this article, the above definition used in the OECD Guidelines on Corporate Governance of State-owned Enterprises is supplemented with the feature of the 'lack of significant private control'. The term 'privately-owned enterprise' refers to an enterprise where an individual or a legal entity has significant control, through full, majority or significant minority ownership.

2. KAZAKHSTAN BOARD STRUCTURE

2.1 General features

Kazakhstan board structure is prescribed by the Law of the Republic of Kazakhstan No. 415-II dated 13 March 2003 "On Joint Stock Companies" (the "JSC Law") (Note 2) and provides for mandatory establishment of a board of directors and a executive body.

The institution of the board of directors was introduced into the legislation of Kazakhstan in 1998 (Note 3). From that time on, every company incorporated in Kazakhstan has been obliged to have a board of directors (Art. 33 of the JSC Law).

Board members are elected and may be removed from office prematurely by decision of the general meeting of shareholders. The latter also determines the remuneration of the board members (Art. 43 of the JSC Law). Decisions of the general meeting of shareholders on election of board members are

adopted based on the results of cumulative voting, when each share participating in the vote has the number of votes equal to the number of members of the board of directors being elected (Art. 50 of the JSC Law). The term of office of the board of directors is not limited by law and is established by the general meeting of shareholders. In addition, directors may be re-elected an unlimited number of times (Art. 55 of the JSC Law). That comfortable position of members of the board of directors is, to some extent, counterbalanced by the authority of the general meeting of shareholders, which at any time and without any explanation may terminate the powers of board members (Art. 43 of the JSC Law).

Only individuals can be members of the board of directors. The number of board members cannot be less than three. Independent directors in any company must make up at least 30% of the total number of members of the board of directors (Art. 54 of the JSC Law).

In order to deal with the four issues - strategic planning, human resources and remuneration, internal audit, and social issues – committee (committees) of the board of directors must be set up (Art. 53-1 of the JSC Law). It is interesting that all these issues may lie with only one or two committees. In other words, there is no requirement that each issue must be addressed by a separate committee. The goal is that all these issues are addressed by at least one committee. The board of directors may also create other committees to deal with issues that are not listed above. The function of the board committees is to prepare recommendations for the board of directors. Apart from the general awkwardness of the legal regulation on the committees, the JSC Law has nothing to say on the control function of the board committees. Although the JSC Law requires that the committees, which deal with the issues listed above, are headed by independent directors, the impression is that the legislator does not understand the meaning of the board committees as instruments to minimize risks in the areas where the potential for conflict of interests of managers is especially high. Such misunderstanding manifests itself, for example, in the fact that the head of an executive body and persons who are not board directors could be members of a board committee (Art. 53-1 of the JSC Law).

The board of directors is headed by the chairman, who is elected by other members of the board of directors via a secret ballot, unless a different procedure for electing the chair is established by the charter of the company. The chairman organizes the work of the board of directors and, if provided for

by the articles of association of the company, has a casting vote (Art. 56 of the JSC Law).

The JSC Law establishes the exclusive competence of the board of directors and determines its function as governance of the company. The exclusive competence of the board of directors covers broad powers to manage the company. This includes, for example, such strategic issues as determination of the primary areas of the company's development and its strategy or decisions regarding placement of authorized shares (Art. 53 of the JSC Law). Meanwhile, the supervisory function of the board of directors is almost ignored. This problem will be discussed in more detail later.

The board of directors is obliged to establish a body, which is responsible for the day-to-day running of the company (Art. 33-1 of the JSC Law). Under the JSC Law, it is called the 'executive body' ('ispolnitelniy organ'). The executive body could be either individual and consist of one person, or collective and consist of several persons. In the first case, the executive body is usually called the 'general director' or 'president'. In the second case, the most common name is the 'management board'. The power to represent the company lies with the general director or president in case of an individual executive body, or with the head of the management board in case of a collective executive body. They are both also called the 'head of the executive body'.

The statutory exclusive competence of the executive body is quite broad. It has the right to act on behalf of the company without a power of attorney in relations with third parties. In addition, its powers are formed according to the residual principle (Art. 59 of the JSC Law). This means that the executive body has the right to make decisions on all matters, which are not recognized by legislation, or internal documents of the company, which are within the competence of other bodies of the company.

2.2 Supervisory function of the board in Kazakhstan

The author agrees that the major structural mechanism to curtail managerial opportunism is the board of directors (Tricker, 1994, p.125). Consequently, one of the focuses of this article is on the supervisory role of the board of directors within the legislation of Kazakhstan. As noted before, the board of directors in the Kazakhstani context is recognized as a governance body in the sense of strategic management. Indeed, the board of directors has a substantial decision-making authority, but has almost no tools to control the management of the company. Regarding the control powers of the board of

directors, the JSC Law only provides for termination of the powers of the executive body, preliminary approval of the financial statements and making decisions on entering into major transactions and related party transactions (Art. 53 of the JSC Law). Such important aspects of management control as the right of the board of directors to require reports (both financial and non-financial) from the executive body and to carry out audits of the executive body at any time, the right to appeal against decisions of the executive body, the right to initiate legal proceedings against members of the executive body, etc. are missing in the JSC Law.

It is interesting that the JSC Law, as noted above, provides for a number of mechanisms, the main goal of which is to strengthen the supervisory role of the board. Such mechanisms are: independent directorship, board committees and strict limitation of managerial participation on the board. However, the impression is that the legislator did not fully understand the meaning of these institutions as mechanisms of supervision while implementing them into the legislation of Kazakhstan. The main problem is that these mechanisms are not empowered with proper auxiliary instruments. The lack of supervisory powers of the board of directors has already been pointed out in this article. Apart from this, there are deeper issues. For instance, the simple requirement of having not less than 30% of independent directors on the board is not sufficient for the board to become really independent. First of all, as explored above, the board committees which could be a source of influence of independent directors, are not recognized as such under the JSC Law. Second, real independence as a state of mind is rather questionable within the systems of corporate governance with an excessively high concentration of ownership. Independent directors of most companies in Kazakhstan are appointed and can be dismissed (at any time without giving any reason) by the whim of the controlling shareholder alone. Thus, independent directors have to make great efforts to maintain their independence. In this regard, the personal liability of independent directors plays a great role and may inspire them to stand up to abusive controlling shareholders (Kraakman, *et al.*, 2009, p. 310).

However, apart from the general weakness of regulation of directors' duties and liabilities and absolute lack of the relevant court practice, the JSC Law does not provide for directors' personal liability for inadequate control over the management. In general, new instruments are to be implemented into the JSC Law to ensure the independence of the board from the controlling shareholders.

Thus, unfortunately, form prevails over substance. The simple sketchy copying of some elements of 'best practices' is obvious. So little attention is paid to the control functions of the board of directors over the activities of the executive body in the legislation, that it could be seen as one of the main disadvantages of Kazakhstan's corporate governance framework.

The author is of the opinion that the control function of the board of directors should be exhaustively regulated by law. The need for such an approach is justified by the fact that post-Soviet states do not yet have the traditions of developed corporate governance, typical of countries with centuries-old experience of a market economy. Therefore, the legislation, should foster through detailed rules the emergence of modern enterprises which will be run by responsible managers (Chanturia, 2007, p. 73).

2.3 One-tier or two-tiers?

In the theory of corporate governance, there are two main types of board structure: one-tier and two-tier (Kraakman, *et al.*, 2009, p. 310. Berghe, 2003, p. 71. Karagussov, 2011, p. 216).

In one-tier jurisdictions, such as the US and the UK, one board exercises the legal power to supervise and manage a corporation (Kraakman, *et al.*, 2009, p. 56). For example, according to Article 8.01 of the Model Business Corporation Act, all corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed by or under the direction of, its board of directors. The second example is Section A.1 of the UK Corporate Governance Code, which provides that every company should be headed by an effective board, which is collectively responsible for the long-term success of the company.

In contrast, in two-tier jurisdictions, such as Germany and The Netherlands, the central feature of internal corporate governance lies in the organisational and personal division of management and supervision by a two-tier structure (Kopt & Leyens, 2004, p. 56). Supervisory powers are allocated to an elected supervisory board of non-executive directors, which then appoints and supervises management board that include the principal executive officers who design and implement business strategy (Kraakman, *et al.*, 2009, p. 56). Membership of the supervisory board and membership of the management board are incompatible (Article 105 of the German Stock Corporation Act, Article 2:160 of the Civil code of The Netherlands).

Of course, there are other differences between one-tier and two-tier boards. However, there is only one basic criterion, which divides the board structure into two types above - the separation of management and supervision. Such a separation involves an organisational division – the mandatory existence of two corporate bodies, and the personal division – positions in these two corporate bodies are incompatible. If separation is required under the applicable legislation, there is a two-tier board. If separation is not required, the board has a one-tier structure.

Therefore, the question could be posed as to whether the board structure prescribed by the JSC Law is one-tiered or two-tiered. The above-mentioned main features of the Kazakhstani board structure are quite sufficient to realize that it cannot be definitely categorized as a one-tier board structure, or a two-tier board structure.

Despite the fact that formally there are two structural levels – a board of directors and an executive body – Kazakhstan board structure cannot be classified as two-tier. First of all, this is due to the fact that Kazakhstan board structure is not aimed at separation of control and management, neither organizationally nor individually. Instead, the mandatory existence of two bodies is aimed at separating strategic management from day-to-day management. At the same time, Kazakhstan board structure cannot be considered to be one-tier, since the board of directors cannot independently manage and supervise the company and the creation of an executive body is mandatory. Further, Kazakhstan board structure does not imply a strict prohibition of combining positions both on the board of directors and in the executive body: the head of the executive body may, by decision of the general meeting of shareholders, be included on the board of directors (but not as chairman). This circumstance does not allow classifying Kazakhstan board structure as two-tier. At the same time, the significant limitation on the combination of positions, when only the head of the executive body can simultaneously be a member of the board of directors, is not peculiar to a one-tier board. In professor Karagusov's opinion, the board structure chosen by Kazakhstan tends to be more one-tiered than two-tiered (2010, pp. 226-227). Indeed, such features of the Kazakhstani board structure as the combination of control and management functions within the board of directors, the possibility for the head of the executive body to be a member of the board of directors, the requirement to have independent directors and board committees, suggest that the aim of the legislator was to transfer the Anglo-American board model (which is one-tiered) into the corporate governance

system of Kazakhstan. However, such a transfer was carried out inconsistently, and the result is a hybrid and deformed board structure, which has neither the structural flexibility of a one-tier board, nor the strict separation of control and management of a two-tier board - the main advantages of the two models of the board. Based on the above, it can be concluded that mistakes were made in structuring the Kazakhstan model of the board, resulting in a defective board structure. The question could be posed as to whether it is possible that Kazakhstani board structure does not correspond to the international models because it has been specially adapted to the realities of Kazakhstan. It will be further shown that this is not the case, and that the lack of compliance with conventional models is closely related to the fact that Kazakhstan board structure does not fully meet the objective needs of Kazakhstan companies.

The afore-mentioned identifies the main features of Kazakhstan board structure. The aspects of particular interest are the supervisory weakness of the upper tier (board of directors) and the lack of flexibility. In addition, it was established that the Kazakhstan board structure is neither one-tier, nor two-tier. A further goal of the article is to explore whether the board structure, established in the legislation of Kazakhstan, meets the particular needs of the companies. However, before that, the source of such needs, the agency problem, will be analysed.

3. THE AGENCY PROBLEM: KAZAKHSTAN'S CASE

3.1 The agency problem: the fundamentals

Each form of jointly owned enterprise, especially large-scale corporations, must expect conflicts between its owners, managers and third-party contractors (Kraakman, *et al.*, 2009, p. 2). Such conflicts arise when the well-being of a 'principal' depends on the activities of an authorized 'agent'. In the theory of corporate governance, such specific problems are referred to as the 'agency problem', which is a subject of the agency theory. The latter is often regarded as the dominant issue in the modern theory and practice of corporate governance (Thomsen & Conyon, 2012, p.32).

The basic prediction of the agency theory is that if the two parties of agency relations (e.g. the shareholder-principal and the manager-agent) are focused on maximization of their benefits, there is sufficient reason to believe that the agent will not always act in the interests of the principal (Jensen & Meckling, 1976, pp. 305-360). The core of the difficulty is that, because the agent commonly has better information about the relevant facts than the

principal, the principal cannot easily assure himself that the agent's performance is precisely what was promised (Kraakman, *et al.*, 2009, p. 36). Therefore, the problem lies in motivating the agent to act in the principal's interests rather than simply in the agent's own interests (Kraakman, *et al.*, 2009, p. 35). It is believed that the agency problem can be solved in two main ways: by creation of appropriate incentives for the management and the establishment of control over the activities of the management (Jensen & Meckling, 1976, p. 19).

Academic literature explores three types of the agency problem between the following constituents: (i) the firm owners and hired managers, (ii) owners who possess the majority or controlling interest and the minority or non-controlling owners, and (iii) the firm itself – including, particularly, its owners – and other parties with whom the firm contracts, such as creditors, employees, and customers (Kraakman, *et al.*, 2009, p. 36).

Recognising the importance of the other two types (ii and iii) of the agency problem, this article will focus on the first type of agency problem, that of 'shareholders-managers' as the main type of the agency problem and its link with the ownership structure and the role of the corporate boards.

3.2 Ownership structure in Kazakhstan

One of the main implications of the agency theory is that the agency problem is determined by the ownership structure (Jensen & Meckling, 1976, p. 19). The correlation between ownership structure and corporate law has been a common theme in academic literature for the past three decades, if not since the publication of Berle and Means' celebrated book (Kraakman, *et al.*, 2009, p. 306). Two components of the ownership structure are of particular interest here: ownership concentration and ownership identities. They largely determine the peculiarities of systems of corporate governance in any country of the world. Kazakhstan is no exception.

According to the list of issuers maintained by the Integrated Registrar of Securities as of August 1, 2015, the total number of companies in Kazakhstan is 1071 (Note 4). At the Kazakhstan Stock Exchange 108 companies are listed. 46 of them have a sole shareholder. In 42 companies, the largest shareholding ranges from 50 to 99.9%. In 20 companies, the largest shareholding ranges from 10 to 48%. Unfortunately, information on shareholders of companies, which are not exchange-listed, is not published anywhere. However, it is logical to assume that in the companies which are not exchange-listed, the ownership concentration is still higher or at least comparable to that of the exchange-listed companies.

To understand how high the concentration of ownership in Kazakhstan is, the statistics of the Chinese public companies (as compared with Kazakhstan companies) will be presented. Among the shareholders of such companies, as a rule, there is one major shareholder (the state or a private individual). In 2005, the largest block of shares held by one shareholder of a Chinese public company amounted to 43% (Thomsen & Conyon, 2012, pp. 273-275). This comparison is impressive in the sense that in Kazakhstan, a country with a market economy, the level of concentration of ownership is much higher than in socialist China.

As to ownership identities, the main feature of Kazakhstan's system of corporate governance is the significant proportion of state shareholding. In accordance with the Register of State Enterprises and Institutions, Legal Entities with State Participation in the Charter Capital, the state directly or indirectly owns shares in 385 companies. The state directly or indirectly is the sole shareholder in 263 companies. In 60 companies, the state owns a block of shares ranging from 50 to 100%; in 48 companies, a block of shares of 10 to 50%; in 14 companies, a block of shares less than 10% (Russian version is available at https://gr5.gosreestr.kz/p/ru/gr-search/search-objects). The state is a shareholder in 40% of companies incorporated in the territory of Kazakhstan. The share of the state-owned companies in the economy of Kazakhstan is excessive. According to a representative of the top management of the National Chamber of Entrepreneurs of Kazakhstan, who also quoted other experts' estimates, the share of the state-owned companies in Kazakhstan's GDP is between 40 and 60% (Jannat Yertlessova, Deputy Chair of the National Chamber of Entrepreneurs of Kazakhstan. The Russian version of the summary of the cited speech is available at <palata.kz/ru/news/9502-9502>). Many of the key industries are under state control (Note 5).

Thus, the main economic characteristics of Kazakhstan's system of corporate governance are: (1) high concentration of ownership where an overwhelming majority of both exchange-listed and unlisted companies have a sole or controlling shareholder, and (2) a significant proportion of state shareholding. The latter influences companies in different ways and leads to the appearance of different issues that are not typical of privately-owned companies. The OECD Guidelines on Corporate Governance of State-owned Enterprises provides that state-owned enterprises face distinct governance challenges, in particular, with regard to the agency problem and the role of corporate boards. Below, privately-owned companies and state-owned companies will be considered separately.

3.2 Agency problem in privately-owned companies

Most of the privately-owned companies in Kazakhstan have an excessively high concentration of ownership. The question then arises as to how this correlates with the agency problem in the privately-owned companies. As described above, the agency problem arises from separation of ownership and control. In companies with dispersed ownership, shareholders are hardly able to exercise direct efficient control over the managers' activities (Jensen & Meckling, 1976, p. 6). However, a controlling shareholder, unlike minority shareholders, has the resources and incentives to monitor the activities of the management (Kraakman, *et al.*, 2009, p. 307. Berghe, 2003, p. 55). Moreover, the controlling shareholders often participate directly in the management of the firm (Thomsen & Conyon, 2012, p.124).

Therefore, the agency problem is not an issue for most privately-owned companies in Kazakhstan. The controlling shareholder usually interacts with the management, scrutinizes its activities and directly supervises it on a day-to-day basis.

3.3 Agency problem in state-owned companies

The theory of corporate governance provides that a significant proportion of the state shareholding entails a potential conflict between the state as the controlling shareholder and minority private shareholders (Thomsen & Conyon, 2012, p.124). However, a more problematic aspect of the state-owned companies is that, despite the concentrated ownership with the state as a controlling shareholder in place, the agency problem between shareholders and the management is not minimized. Therein lies the difference between state-owned companies and privately-owned companies, despite the fact that in Kazakhstan both types of companies have a high concentration of ownership. This is because, in spite of the presence of a controlling shareholder, ownership and control remain separated. In this respect, state-owned companies face the same problem as the companies with dispersed equity. Some authors argue that the agency problem of 'shareholders-managers' in the companies, where the largest block of shares belongs to the state, is more serious than in companies with dispersed ownership (Tomasic & Fu, 2006, pp.123-131, at p.127).

In the view of the author of this article, the emergence of an acute agency problem in the state-owned companies is primarily due to two factors. Firstly, where there is such a high degree of state participation in the share capital, as is the case in Kazakhstan, the state, as a single entity, does not

have sufficient resources to carry out effective monitoring of all such companies. In this regard, the OECD Guidelines on Corporate Governance of State-owned Enterprises consider that fundamental corporate governance difficulties stem from the fact that the accountability for the performance of state-owned enterprises involves a complex chain of agents (management, board, ownership entities, ministries, the government) without clearly and easily identifiable, or remote, principals. This problem is intensified by the fact that Kazakhstan state-owned companies are combined into large corporate groups where there are up to seven corporate levels. The lower the level, the stronger is the separation of ownership and control. Second, what is more important, the state, as a legal fiction, in fact, does not have its own will to exercise control over the activities of the management in the companies in which it is a shareholder. Such control is carried out on behalf of the state by the members of the board of directors, who themselves are agents of the state. This problem is referred to in academic literature as the 'absence of principal' (Howson, 2005, pp. 193-254, at 200). Thus, in state-owned companies, conflict between the state as a shareholder and the management is inevitable, even with a high concentration of ownership.

Therefore, the ownership structure determines the severity of the agency problem in Kazakhstan companies. Both privately-owned companies and state-owned companies share an excessively high concentration of ownership. However, this feature leads to two different consequences. While the privately-owned companies usually do not suffer from conflict between shareholders and managers, the agency problem in the state-owned companies could be a serious issue. Such a difference obviously calls for a certain differentiation in the regulation of corporate governance of privately-owned companies and state-owned companies. In particular, this refers to the central corporate governance mechanism, the corporate board.

4. BOARD STRUCTURE REFORM

4.1 What do privately-owned companies need?

Most privately-owned companies in Kazakhstan do not face the basic agency conflict between shareholders and managers. It is logical to assume that a controlling shareholder in most cases is involved both in the governance and day-to-day management of privately-owned companies. Consequently, the need for a board of directors as a mechanism for monitoring and control is usually low. Thus, the requirement to have two separate corporate bodies - a board of directors and an executive body - does not seem rational. In most

cases, the board of directors may itself control and manage the company efficiently. The second implication is that independent directorship, board committees, restrictions for the executive managers to be on the board, including the prohibition of the CEO duality, may not be useful for most privately-owned companies. This calls for a more flexible and dispositive board structure, where shareholders are able to independently decide what governance mechanisms would be appropriate in a particular privately-owned company.

The legislation, however, provides for a rigid board structure, identical in all companies, regardless from the severity of the agency problem. Such a board structure requires the mandatory existence of two bodies (a board of directors and a management body), as well as such complex and burdensome control mechanisms as the independent directorship and board committees. Such mechanisms are neither effective, due to the weak regulatory framework, nor necessary in the vast majority of privately-owned companies. This inevitably involves a box-ticking approach to the use of these tools, complication of the board structure, unnecessary expenses, and eventually, an obstruction to the development of the privately-owned companies. Such an opinion is not can be met in the Kazakhstan corporate governance debate. For instance, N. Sarsenov believes that in many Kazakhstan companies with concentrated ownership the board structure that involves two bodies - a board of directors and a management body - is not practicable and effective. The point is that the board of directors in such companies is an 'empty box' and is created only because the law requires it, and in such a case, the one-tier board is more preferable (Sarsenov, 2009).

The author believes that the one-tier board structure could be more suitable for privately-owned companies. This means that the board of directors would have the legal power to supervise and manage a company on its own. The existence of an executive body should not be mandatory. At the same time, a board of directors would have the authority to delegate its powers to executive directors. Furthermore, no legal requirements for independent directors, board committees, and limitation of managerial participation on boards, including prohibition on the CEO duality, should exist. This would help to remove the box-ticking and optimize governance processes in privately-owned companies.

However, for the exchange-listed companies, there should be stricter requirements regarding independence of the board. This could be achieved through the listing requirements and code of best practices.

4.2 What do state-owned companies need?

Unlike privately-owned companies, state-owned companies are bound to experience serious agency conflicts between the state, as a controlling shareholder, and managers. Therefore, there is an acute need for an effective control mechanism.

In response, legislation offers a board structure that is very weak in terms of control over the management, and seems not to be conducive to the resolution of agency problems in state-owned companies.

The author's opinion is that the most appropriate board structure for state-owned companies is a two-tier structure (without representative character and co-determination). The main advantage of a two-tier board is the clear separation of control and management that can guarantee independence of the supervisory board from the management of the corporation, so that the former can effectively carry out its role of supervision over the latter (Maassen, 2000, p. 6). In the light of a serious agency problem, this advantage is the key one. As for the one-tier board structure, its control potential, on the whole, is lower than that of the supervisory board of the two-tier board model, because there is no strict separation of control and management functions. While the independent directorship is a potentially effective tool of control within the one-tier board, it cannot fully replace the supervisory board in terms of control. An informal separation of functions does not provide the same guarantees as a formal separation. This seems to be especially true of the underdeveloped corporate culture of Kazakhstan. Kazakhstan companies, their shareholders and directors, as well as judges, have, as yet, no experience in the use of complex instruments of governance. Of all these mechanisms, the independent directorship is perhaps the most difficult to implement, even for the Anglo-American model of corporate governance. Therefore, the author considers a simpler and more orderly two-tier board structure to be more appropriate for the state-owned companies.

In addition, the establishment in state-owned companies of a board of directors, as an additional level of management, only exacerbates the agency problem, as the flash point of potential conflict of interest and abuse occurs not only at the management level, but also at the level of the board of directors. The supervisory board, which does not have management authority and is completely independent of the management, can reduce such a threat to a minimum.

Consequently, within the framework of Kazakhstan's system of corporate governance the agency problem in state-owned companies is more likely to be resolved by using a two-tier board.

4.3 Optional approach

It is clear that there is a need for both types of board structures in Kazakhstan: one-tiered and two-tiered. Such need can be satisfied by the use of an approach, developed within the framework of the European processes of harmonization of corporate law - an optional approach, which allows shareholders to choose between one-tier and two-tier board structures.

The concept of an optional approach is relatively new and is supposed to give shareholders the choice between one-tier and two-tier board structures. The establishment of an optional approach is a significant trend in the harmonisation of legislation on corporate governance in the European Union ("Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward" CON (2003) 284 final of 21 May 2003). The Regulation of the Council of Europe on the Statute for a European Company, adopted on 8 October 2001, gives shareholders of European companies the right to choose between the two board structures. At the moment, countries of the European Union such as France, Italy, Belgium, Hungary and others, have implemented the optional approach into their national legislation (Berghe. 2003, p. 71). At the regional level, in the framework of the CIS, the same trend is reflected in the Model Law on Joint Stock Companies, adopted by the resolution of the Interparliamentary Assembly of CIS Member States, on 28 October 2010, according to which a company can have a dualistic management system (a supervisory board and a management board) or a monistic management system (board of directors) (Chanturia, *et al.*, 2011, pp. 211-313). In the theory of corporate law of Kazakhstan, the feasibility of an optional approach within the framework of Kazakhstan's system of corporate governance was first substantiated by Professor Karagusov, who wrote that the Model Law on Joint Stock Companies proposes an unambiguous and much more appropriate regulation of issues of the board structure of a company, and that the right to establish a board structure of a company, as well as the right to change such a system, must remain with the shareholders (2011, pp. 224-225). N. Sarsenov also recommends the optional approach and uses the positive experience of France as example (Sarsenov, 2009).

The aforementioned duality within Kazakhstan's model of corporate governance, when state-owned companies and privately-owned companies

are in need of two different types of board structures, creates the basis for the adoption of the optional approach in Kazakhstan. The use of the hybrid board structure, for a relatively extended period of time, prepared companies for the acceptance of both one-tier and two-tier board structures. From a legal point of view, the author does not see any serious barriers to the introduction of an optional approach into the legislation of Kazakhstan.

Privately-owned companies will be entitled to use a flexible one-tier model board within which only creation of a board of directors will be mandatory, and the board of directors will have full authority to manage and control the company. Shareholders will also be able to vary the extent of independence of the board of directors: introduction of independent directors, establishment of committees and separation of the positions of chair of the board of directors and chief executive officer will not be mandatory. In addition, privately-owned companies will be entitled to create a two-tier governance model, if shareholders consider it more appropriate. This approach will allow the formation of a corporate governance structure that best suits the specific character of a particular privately-owned company. The general meeting of shareholders will have the authority to take decisions on changing the board model throughout the life of the company.

For state-owned companies, with a serious agency problem, the author considers that the formation of a two-tier governance, with clear separation of management and control, is more preferable.

5. CONCLUSION

Most companies in Kazakhstan have an excessively high concentration of ownership. On the one hand, this leads to minimization of the agency problem in privately-owned companies; and on the other hand, it creates a serious agency conflict in state-owned companies. A difference in the severity of the agency problem determines a difference in the need of the companies to have a board of directors as a supervisory mechanism. While privately-owned companies need a more flexible and dispositive board structure without legally prescribed control mechanisms, the state-owned companies are in need of an effective board, whose main function is the monitoring of the management. These two needs can be effectively satisfied through the establishment of the optional approach.

There are two principal functions of the corporate law: the first is to provide business enterprises with a functional and user-friendly legal form, which is able to facilitate the development of business, the second is to mitigate the agency problems (Kraakman, *et al.*, 2009, p. 2). The reform of the board structure proposed in this article satisfies both main functions of the corporate law. The differentiation of the

board structures, on the one hand, will enhance the appropriateness of the joint stock company legal form for those enterprises where the agency problem is insignificant and, on the other hand, will strengthen the much-needed control potential of the board structure of the state-owned companies.

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