The Entrepreneurial Board: Empowerment of Boards in Founder-Managed Companies in Emerging Markets

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The paper investigates the role of boards in founder-managed firms with concentrated ownership in emerging markets. The existing literature suggests that this type of companies, even if they decide to recruit high-profile individuals as directors, rarely empower the boards in the corporate governance structure. The paper conducts a revelatory case study of AFK Sistema – a large Russian investment company with key assets in high-tech industry, which is controlled and managed by the founder. We observe that, contrary to the expectations, in this company the founder decided to empower the board of directors, at the same time focusing on recruiting independent directors (in particular foreigners) to the board, even in spite of costs associated with this governance structure in the Russian context. Based on this puzzle, we develop a theory of an entrepreneurial board, where directors are expected to take initiative in relations to both internal and external actors and where empowerment of boards is necessary to provide them with proper motivation. We also propose testable implications of this theory.

Keywords: board of directors, founder-managed firms, entrepreneurial function, emerging markets

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1. Introduction

The role of boards in companies with concentrated executive ownership remains a disputed topic. The agency theory, which is the dominant paradigm for studies of boards in the literature, suggests that in case the company is controlled by its management, the role of the independent directors should be limited, since the principal-agent problem between managers and owners is absent (e.g. Gabrielsson 2007; Desender et al. 2013). This could be particularly true for the founder-managed companies, where the business success is determined by the vision and the energy of the entrepreneur. The resource dependence theory suggests that even in this case boards can matter for the company, linking organization to external actors and thus reducing the uncertainty, as well as providing legitimacy and critical resources (Hillman and Dalziel 2003); thus, the boards exercise an important service function.

However, while the resource dependence theory explains why companies attempt to recruit independent directors on their boards, it does not necessarily argue that in order to obtain resources through independent directors one needs to empower the board as a decision-making actor. Independent directors may accept positions on powerless boards in exchange for remuneration or in order to enhance their future career by gaining from company's reputation; in exchange, they would provide access to resources and information to the company management, with the board remaining a strictly advisory institution. This is indeed what is frequently observed in companies, where politicians or bureaucrats occupy board positions without active intervention in the company operations or strategy decisions. Furthermore, board empowerment comes at a cost: it may make the decision-making slower and less flexible and makes the use of ties and connections of the owner (if they are, for example, based on purely informal relations and imply the use of informal business practices) more difficult.

The aim of this paper is to develop a theory explaining why founder-managed companies with concentrated ownership may recruit independent directors and create strong boards,[1] even if the owner continues to manage the company. We suggest that it happens in case the founder is particularly interested in establishing a board, where independent directors actively take initiative on behalf of the company, for example, acquiring new business projects and securing new partners, which are then offered to the management. This board may be important for the founder as a tool to ensure long-term growth and survival of the company. In a sense, board members act as co-entrepreneurs for the company, and thus we refer to this activity as the 'entrepreneurial function' of the boards. Certainly, we do not equate the activity of the board members in this case to the entrepreneurship (particularly, because the risks and decision-making ability are hardly comparable), yet we argue that entrepreneurial function can be exercised only by intrinsically motivated board members and cannot be achieved if board members are motivated merely by remuneration. Intrinsic motivation, in turn, requires the empowerment of the boards.

We construct the theory inductively, based on a case study of a Russian company *AFK Sistema*, which provides an example of the development of such an entrepreneurial board. Looking at an emerging market company (like a Russian one) in the context of this study seems to be particularly promising. Emerging markets are generally characterized by very high concentration of ownership (Claessens and Yurtoglu 2013). Furthermore, for emerging

[1] We define the 'strength' of the board as the degree of involvement in the corporate decision making and the ability to act as a veto player (Almazan and Suarez 2003). The 'strength' is not a binary characteristic, but rather a matter of degree. In the extreme case of a 'weak' board, the board automatically approves any decisions submitted by management without further discussion or has very limited responsibilities; this board could exist merely to satisfy the requirements of the law. If the strength of the board increases, a larger portion of company decisions are subject to board approval and, more importantly, directors can change and shape company decisions.

markets it is typical that owners (both founders and family business owners) are actively engaged in company management. The empirical literature on Asian markets shows that under these conditions monitoring function of boards is weaker than service function (Young et al. 2001; Tian and Lau 2001; Peng et al. 2008; van Essen 2012). In the case of *Sistema*, as we will show, the owner goes beyond that, actively promoting a strong and independent board. However, for emerging markets costs of empowering boards, which we have mentioned, are particularly high due to the high uncertainty of the market, political and social situation (frequently requiring very fast response from the management) and the crucial role of informal business practices. Based on our observations, we develop a more general theory of entrepreneurial boards and propose a number of conjectures for further research.

The paper is organized as follows. The next section presents a brief literature review relevant for this study. The third section presents the context of the study and the methodology. Main observations from the case study are reported in section four. The fifths section develops the theory of entrepreneurial boards. Finally, the last section concludes.

2. Literature review

The role of boards in companies with concentrated ownership is primarily discussed within three branches of literature. The first one concentrates on monitoring function of boards, consistent with the agency approach, and emphasizes how it can be transformed in case the company is controlled by a few dominant owners. In case concentrated ownership is not associated with direct involvement in management of the company, there is still space for opportunistic behavior of managers, and thus, the board's monitoring function can be required. The extent to which boards play a role in this context depends on the type of ownership: Sur et al. (2013), for example, distinguishes between institutional, corporate and family ownership, suggesting that the monitoring function is relevant for the first. In case key shareholder is directly involved in company management, boards can play a role in resolving 'principal-principal' problems - the possible opportunistic behavior of the dominant shareholder jeopardizing interests of minority shareholders (Anderson and Reeb 2003; Young et al. 2002; 2008).[2] In this case, however, strong boards may appear only either as a 'concession' of the dominant shareholder, or as an attempt to improve company's attractiveness on capital markets. In our paper, we intend to investigate a case where 'principal-principal' conflicts are unlikely to explain the formation of strong boards in companies with executive ownership.

If the dominant shareholder is directly involved in company management (as it is the case for founder-managed firms) and the pressure from minority shareholders is limited, the role of boards can be explained by their service function. This is what Sur et al. (2013) expect to affect board formation for companies with family and corporate ownership (in the latter boards should play an important role in improving connections between different parts of corporate structure). Thus, the role of boards should be explained by the resource dependence perspective (Desender 2009; Bettinelli 2011; Daily et al. 2013). As mentioned, this approach looks at boards as structures, which make it possible for the company to optimally manage external dependencies and uncertainties. Board members can provide advice to the company management, enrich the company by giving access to information and other resources, and, finally, serve as a source of legitimacy and reputation (Pfeffer and Salanick 1978).

The extent to which the board can exercise these functions depends on several characteristics: board size (which has been in the focus of the early literature, see Pfeffer 1972); the background and the composition of board members (Westphal and Fredircsson 2001; Kroll et al. 2008, McDonald et a. 2008; Kor and Sundaramurthy 2009; Faleye et al.

[2] The ability of boards to resolve the 'principal-principal' conflicts is subject to controversy in a large recent body of empirical literature (Kaymak and Bektas 2008; Hu et al. 2010; Jiang and Peng 2011).

2012; Johnson et al. 2013); and the way board members interact with each other and with management (Huse et al. 2011; Tian et al. 2011). Composition of board members, in turn, is investigated from two perspectives: on the one hand, the literature looks at particular types of directors and their contributions to the company (Hillman et al. 2000; Faleye et al. 2011; Krause et al. 2013); on the other hand, the contribution of the board may depend on how its members 'fit together' – from what Hillman et al. (2010) characterizes as 'board capital'. There exit a vast empirical literature confirming that the resource dependence perspective indeed reflects an important aspect of the board's role (for a survey see Hillman et al. 2009). Yet, as mentioned, resource dependence perspective does not explain the reasons for empowering boards, which is at the core of our study.

The explanatory power of resource dependence theory for individual firms clearly depends on their characteristics and evolution (Daily and Dalton 1993; Kroll et al. 2007; Courtemanche et al. 2013).[3] The dynamic perspective is precisely at the core of the third group of studies relevant for us – the literature on founder-managed firms, where the effects of board characteristics can be different from other firms with executive ownership (Garcia-Ramos and Garcia-Olalla 2011). There are two problems founder-managed firms face in turn of their development. First, the 'threshold firm' argument (Daily and Dalton 1992; Gedajlovic et al. 2004) suggests that after certain period of growth further successful development is

[3] Most notably, Lynall et al. (2003) suggest that different approaches to board formation depend on the stage of the company development and the relative power of the CEO vs. the external financiers. In our analysis, we look at a case where at all three stage the CEO is dominant vis-à-vis external financiers; in this case Lynall et al. predict that at early stages of company development boards should be dominated by the CEO's personal network (and provide to the CEO support in ensuring her power); at the subsequent stages resource dependence logic becomes dominant. Our analysis attempts that even in case of the dominance of the CEO pure resource dependence explanation may be insufficient to describe the actual power attributed to the board; hence, further theoretical arguments may be needed.

feasible only if founders transfer control over the firm to the professional management. Second, if the founder remains active in firm management, the company will sooner or later face the problem of succession (e.g. to the next generation of founder's family), which is known to be a critical point many firms do not survive (e.g. Miller et al. 2003). Audretsch and Lehmann (2006) generally argue that boards with appropriate composition can enhance entrepreneurial access of knowledge spillovers. Zahra et al. (2009) indicates that strong boards of directors may improve their ability to cross the threshold, since the directors will assist the management in accumulating knowledge and concentrating on key strengths of possible development.

We acknowledge the importance of this argument; in the case of *Sistema,* it is also possible to trace the 'crossing of the threshold' in terms of professionalization of management for this company as well (although, as mentioned, the owner remained actively involved in company decision-making). However, we also observe the presence of another challenge (which could, somewhat simplified, be referred to as 'second threshold'[4]), where development of independent and strong boards becomes necessary. In this case, the main challenge for the firm is associated with trust and legitimacy. Legitimacy provision is one of the key elements of board formation in the resource dependence theory (Certo 2003; Hillman et al. 2007); however, in particular for emerging markets (but also in other contexts) there may be a deeper problem of trust company has to deal with. Emerging markets are typically characterized by very low trust levels, affecting the way business is conducted with domestic partners and making personal connections a crucial component of the business operations (Oleinik 2005). Dealing with foreign partners, companies from emerging countries often face substantial

[4] Note that we do not argue that this threshold should always occur after the 'first', i.e. when challenges of decision-making require professionalization of management. Although the timing seems to be like this in our case, it may be a coincidence.

mistrust as well, for example, due to general mistrust to their country of origin resulting from intransparency, unclear origin and intransparent business practices (e.g. Filippov 2010). As we will argue, founder may be able to overcome this mistrust, using her own personal reputation;[5] however, over time, this resource may become insufficient. This is precisely the 'second threshold' we describe, which, as we will try to argue, could be associated with emergence of the entrepreneurial boards, and which constitutes our contribution to the literature.

3. Case selection and methodology

3.1. Russian context

Russia is, as many other emerging markets, characterized by a very high level of ownership concentration. The empirical research repeatedly has shown that most Russian companies are controlled by a single owner or a coalition of shareholders, although to actually trace the ownership structure is very hard due to its intransparent nature (Chernykh 2008). These ownership structures rarely represent the case of a 'family firm', as it is known in the standard management literature. Since the origins of business in Russia are linked to privatization of originally state-owned assets of Soviet companies, Russian founder-managed companies often emerge as relatively big groups, where the initial owner (or coalition of owners) managed to succeed in the privatization struggles of the 1990s and subsequent property redistribution. It typically required strong political and business connections of initial owners, which were then used to establish business contacts and to protect the property in the lawless environment of the early stage of Russian economic reforms. At the same time, Russian companies created in the 1990s are currently facing the problem of intergenerational

[5] Throughout the paper, we use the concepts of 'trust' and 'reputation' interchangeably.

succession or of crossing the threshold from founder-managed to professionally managed firms (Dolgopyatova et al. 2009).

Russia is a continental law country, with two main legal forms of corporations: limited liability company (OOO) and joint stock company (AO).[6] For our purpose, the last type is relevant, since this is the form used by large public Russian companies (and, in particular, by *Sistema*). For this legal form, the Russian law envisions a strict separation between the board of directors (or the supervisory boards, which have to be established in all companies with more than 50 shareholders) and the management of the company (which may be exercised either by a single CEO or president or by a collective managing body); thus, in the Russian system the function of the boards rather resembles that of supervisory boards in two-board corporate governance systems (e.g., in Germany). The positions of the board chairman and the CEO are separate, and the share of members of the collective managing body may not exceed 25% of the number of directors (lower-level managers may be included in the board without any limits).

The board of directors is, specifically, assigned the following authorities according to the law: it determines the main directions of company development and strategy; approves selected main transactions, including acquisitions and reorganizations of the company; assembles and prepares the shareholder meetings and determines their agenda; approves the internal regulations of the company and approves the emission of new stocks; and provides recommendations for regarding the dividend payment. Furthermore, it may be assigned the responsibility to select the management of the company (Chapter 8 of the Russian Joint Stock Companies Act). However, in addition to these issues, companies may grant additional

[6] For more detailed description of legal forms of Russian companies and in particular on sub-forms of the AO see Iwasaki (2007). In 2014, the system experienced a major reform, which, however, happened after the conclusion of our investigation.

authorities to the board; thus, the responsibilities of boards in Russian companies can vary substantially.

At the same time, the extant research shows that operations of Russian business are dominated by informal governance practices (Estrin and Prevezer 2011). Regardless of the authorities of the board in the company by-laws or in the legislation, in some companies boards actually exercise a certain influence on the decision-making, while in others they turn into mere approval mechanisms for the suggestions of the dominant shareholder, which have been established merely to satisfy the requirements of the law (on the similar international experience see Cohen et al. 2012). Internationalization has improved the quality of corporate governance in Russian firms (Heinrich 2003) and, in particular, supported the empowerment of the boards; but even in this case many companies apply a purely formalistic approach to merely satisfy the formal requirements needed to obtain foreign financing; at the same time, the dominant informal governance structure still mostly excludes the boards. From this point of view, the same formal by-laws and regulations can be associated with both ‘working’ and ‘sleeping’ boards (Dulyak 2013), giving company owners de-facto large opportunities for designing various governance structures.

The existing empirical evidence on Russian boards generally suggests that the boards are typically relatively weak in terms of their ability to influence the company strategy. In most Russian companies, boards are under control of management and key shareholders, with outside directors forming a minority of the board members (Lazareva et al. 2007). Iwasaki (2008) suggests that the Russian companies are characterized by extremely heterogeneous board structures: while in some of them boards are dominated exclusively by insiders, others have boards with very large share of outsiders; he also shows that the composition of board directors is driven primarily by bargaining between shareholders (‘principal-principal’ conflicts). Having large share of outside directors, however, does not improve the performance of Russian boards (Peng et al. 2003). Furthermore, governmental representatives play an important role in boards of many Russian companies (Frye and Iwasaki 2011). Melkumov (2009) argues that resource provision may be as well an important task for Russian boards, although conjectures that this task should be particularly assigned to boards of companies, created already in the Soviet period (as a legacy of pervasive role of networks in the Soviet economy). In this paper we investigate a case of a Russian company, which, contrary to these observations, has a strong functioning board of directors.

3.2. Case selection

The choice of a single case study approach in this paper follows the argument of Yin (1984), who suggests using a *revelatory* case to observe phenomena previously unexplored in scholarly debate, which could serve as a starting point for further theory building (cf. Eisenhardt 1989). The case we use therefore had to satisfy two criteria. First, it should be a single-owner founder-managed firm. Second, it should be a firm where, contrary to the expectations of the theory, there is a large share of independent directors in the board, and the board is endowed with substantial authorities in the corporate governance structure; this would allow us to reveal the functions of board previously not discussed in the literature and to develop the theory we are interested in.

Sistema was established in 1993 and already in the late 1990s was acknowledged as one of the largest Russian business groups (Pappe 2000), consistently ranked among the top 10 Russian companies in terms of revenues; in 2013 it ranked 308 in the Fortune 500 Global ranking. Key financial indicators of *Sistema* are summarized in Table 1. The company emerged as a conglomerate, including a large number of service and high-tech companies. Over time it transformed into an investment company with a diversified portfolio. As of early 2014, two main assets of the company are *MTS* (one of three largest mobile service providers in Russia) and *Bashneft* (one of ten largest oil companies in Russia); both companies are also listed, as is *Sistema*. Until the acquisition of *Bashneft* in 2009, *Sistema* was one of the very few large high-tech companies in Russia; even currently it is strikingly different from other Russian companies (mostly focused on energy and metals). *Sistema* has a highly concentrated ownership structure. As of 2013, the company's founder, Vladimir Evtushenkov, holds 64.19% of the company's stocks and continues to be personally engaged in the governance and management of the company. In the 1990s, *Sistema* used a cross-holding structure, as many other Russian businesses; the information about key owners was published since early 2000s, with Evtushenkov remaining the dominant shareholder (see Figure 1). There is also no evidence of gradual decline of the share of the founder over time.

Table 1 about here

Figure 1 about here

Most assets of *Sistema* are located in Russia and other post-Soviet countries (although recently the company also invested in an Indian telecommunications company) and it does not have major foreign shareholders (*Deutsche Bank* is a nominal shareholder representing the owners of the GDR, which as of the end of 2013 accounted for 19% of the shareholder capital); however, many subsidiaries of *Sistema* (particularly *MTS*) have large investments abroad. Many of the holdings of *Sistema* developed as joint ventures with European multinationals (including, for example, *Allianz* or *Deutsche Telekom*); *Sistema* also has experience of cooperation with other large Western companies (e.g. *Siemens*). *Sistema's* stocks are listed both in Russia and in the UK (through GDRs at the London Stock Exchange). Thus, for *Sistema* the task of broadly defined internationalization (including searching for partners abroad and acquiring capital) can be considered highly relevant. After the Crimean crisis in 2014 started and the Russian deputy prime minister Igor Shuvalov recommended Russian companies to consider delisting from Western stock markets quoting increasing risks, Evtushenkov in an interview argued against this measure for his company, literally claiming that "there are no risks only in the cemetery".[7]

In autumn 2014 (i.e., about six months after the conclusion of our investigation), unexpectedly to the observers of the Russian economy and business community, *Sistema* became subject to one of the most infamous governmental attacks against private business in Russia in the 2000s. The Russian prosecution initiated an investigation concerning the legality of the privatization of *Bashneft* and the subsequent purchase of this company by *Sistema*. Evtushenkov was put under house arrest, and the office of the Prosecutor General filed a law suit requesting deprivatization of the company; in October 2014 the trial court decided in favor of the prosecution. The situation, one the hand, is unlikely to have influenced the results of our investigation (due to its entirely unpredictable nature), but, on the other hand, illuminates a number of important observations we made during the case study, as it will be outlined in what follows.

3.3. Methodology of the study

The data collection for the empirical case study was based on archival research and semi-structured interviews. Archival research was used for preliminary information gathering and analysis of formal rules concerning the role of the board in *Sistema*. We mostly looked at company information (website, reports and financial statements, company by-laws and other regulations), as well as information in the public media on the members of the board. We also looked at the agendas of the board meetings, as well as other available information on the board activity published by the company (e.g. attendance of board meetings etc.).

[7]http://www.finansy.ru/t/page_fin_0.html, accessed 28 August 2014.

Furthermore, we collected the statements of company managers made in their public media appearances (in particular, those by the company's founder and CEO). In particular, we used the information of large interviews with Evtushenkov, published almost annually by leading Russian business magazines or newspapers (*Forbes Russia, Vedomosti*); the detail and the amount of information in these interviews again confirms the high level of openness of the company.

In the next step, we conducted a set of semi-structured interviews with key decision-makers, able to provide us with the information relevant for this study. Overall, we interviewed four groups of actors. The first set of interviews was conducted with the directors. We selected the set of respondents to receive a broad coverage of various groups represented in the board, and thus interviewed three Russian and two foreign members of the board (the distinction may be particularly important for the emerging market context). In the management team, we interviewed the senior vice president responsible for corporate governance (and thus potentially able to reflect on the management view on the role of the board) and two first vice presidents responsible for particular investment areas of *Sistema*. We also interviewed the corporate secretary, i.e. the person responsible for the implementation of the corporate governance system and organizing the communication and cooperation between the board and the management team. Finally, we conducted an interview with the founder of the company, who is responsible for key decisions and thus crucial for our study. Overall, we conducted ten interviews. *Appendix* lists the main interviews we conducted.

All interviews were conducted in fall 2013 – winter 2014 in Moscow. The interviews typically lasted for 60-90 minutes and were conducted in Russian (by Russian native speakers) with Russian counterparts and in English with foreigners. All interviews took place within the facilities of *Sistema*. Each interview started with verifying general information concerning the respondents (e.g. their relation to *Sistema*, industry experience etc.). The remaining part of the interview typically consisted of three parts. The first focused on understanding the respondent's perception on the role of board of directors in *Sistema,* its interaction with the management team and the procedures used for the board operations. The second discussed potential contributions of the members of the board to the functioning of the company. The third discussed the recruitment of the board members and possible changes over time. For directors, managers and the corporate secretary the plans of the interviews were designed separately (although to some extent overlapped). While we based each interview on a set of questions prepared in advance and sent to the respondent, there were multiple deviations from the original plan following the particular path interview has taken.

In the final step, we discussed our conclusions with the corporate secretary of *Sistema*, who reviewed the short summary of this paper. Thus, we were able to check whether our observations indeed fit the self-perception of the company managers and members of the board of how they see the role of the board in the company. This step is necessary, since otherwise the theoretical priors and the lack of information about particular details of company operations could bias our results. Furthermore, in spring-summer 2014 (after conclusion of the interviews) we collected additional information on *Sistema* from newly available open sources to validate our conclusions and look at further company evolution.

4. Main findings

4.1. Evolution of the corporate governance in *Sistema*

As most Russian companies, *Sistema* emerged as a business with rather transparent property structure (Pappe 2000) and with weak corporate governance. Interestingly, though, the interviews we conducted indicate that, at least according to the current recollection of events, Evtushenkov has attempted to implement some form of formal corporate governance in *Sistema* beyond the formal requirements of the law already at a relatively early stage of the company's development:

> "I have spent 15 years in *Sistema* and have seen the entire way from a small company to a dynamically run company following all Western procedures. I have to acknowledge that there were many pessimists, when it was promoted, many thought that it is excessive, excessive paperwork. But Mr. Evtushenkov – we have been working together for 15 years - consistently followed this line" (interview, director).[8]

According to Pappe (2000), in the 1990s the company's business assets were primarily concentrated in the City of Moscow – and *Sistema* had very strong ties to the Moscow city government of the mayor Yuriy Luzhkov at that moment of time, which probably have substantially contributed to the company's business activity. In 1998, the company entered a period of expansion, associated with acquiring assets throughout the country. Furthermore, since 1997 *MTS* moved on to developing from a Moscow-focused mobile phone provider to a company present throughout the Russian Federation (furthermore, the late 1990s – early 2000s were the period of massive expansion of cellular phone access in Russia). In 2005, the IPO of *Sistema* at the LSE followed. Thus, one could hypothesize that this massive growth could shift the company towards the threshold, where instituting corporate governance mechanisms and professionalizing management became important. This is, in fact, what one could observe in 2002-2007.

[8] All quotations translated by the authors. Quotes are referenced without naming particular interview partners, specifying merely the position of the subject (director, member of the management team, or founder).

Let us provide an incomplete list of changes *Sistema* underwent during the period in question. In 2002, *Sistema* published the list of beneficiaries (Russian companies in the 1990s rarely provided any information on the property structure at all); in 2004 it has adopted a number of internal directives regarding the functioning of its governance institutions, as well as the Corporate Behavior Code, which specified the corporate governance procedures and included additional norms on transparency. The company adopted a risk management directive and a dividend policy directive; first independent directors joined the board of *Sistema* in 2004 (in 2005 the first foreign director was appointed). In 2007 the company created an internal scoring system for corporate governance of subsidiaries; over the period in question, the company decentralized the management of subsidiaries and reorganized it, dividing subsidiaries into industrial groups.

In 2007, the first corporate social responsibility report was published. In 2006, *Sistema* shifted from a single CEO system envisioned in the Russian law to a collective management body (*pravlenie*) system, which can be seen as an element of professionalization of management. Throughout 2006-2009, the management body experienced substantial personnel changes (the ratio of newcomers and resignations to the number of board members at the end of the year varied between 40% and 70%), reflecting the changes in the company. [9] Overall, the changes seem to be consistent from moving to a more professional, transparent and formalized management necessary for the founder-managed companies at a certain point of their evolution.

[9] The managing body of the company continued changing at a high speed after 2010. In the interviews, company officials explain the fast turnaround of management team by changing portfolio of assets company holds. Interestingly, the board membership shows much more persistence than the composition of the managing bodies: while the key managers of the company are frequently replaced, directors typically keep their position for a number of years. Between 2006 and 2013, on average, the company replaced 1.6 board members per year.

The transformation also affected the functions of the board. Before 2006, board primarily assisted the CEO in exercising the managerial tasks. During this period, according to the interviews, the board meetings were very frequent and typically devoted to tactical issues; board was primarily composed of company executives. The establishment of *pravlenie* in 2006 allowed the board to concentrate on the issues of strategy. At the same time, as Table 2 shows, the share of independent directors in the *Sistema* board initially was rather low, as was the share of foreign directors. Thus, professionalization of management, establishment of corporate governance bodies and increasing transparency did not immediately result in creation of a strong and independent board. However, over time the situation seemed to change.

By the end of the first decade of the 2000s, *Sistema* still faced the major challenges of internationalization beyond the original market niche and intensifying contacts with foreign partners, on the hand, as well as ensuring long-term successful development and stability of the company given the ageing of the founder, on the other. In particular, a possible trigger for concerns regarding future organization of *Sistema* became the global economic crisis of 2008-2009, which also had a substantial effect on Russian business. Although, as Table 1 shows, the fundamentals of the company remained robust during the crisis, it did change the perception of the company leadership. Responding to the question about possible 'milestones', when changes in the operations and organization of *Sistema* became particularly pronounced, the interviews clearly revealed that it happened after the crisis. "Crisis did shake us up quite strongly, everybody started to move. Before crisis everything was good, we had a lot of money, we were growing, capitalization was growing. Euphoria was there. After the crisis everybody started to move" (interview, director).

Hypothetically, there were several opportunities the company could have taken to respond to the challenges. It could, for example, substantially reduce the level of transparency, return to the practice of personalized decision-making and take a very conservative stance on future strategy, possibly extracting revenue from the most stable ‘cash cows’ in the company portfolio. One option associated with this development would imply a transformation into a family-owned firm. The son of the founder, Felix Evtushenkov, became vice-president of *Sistema* in 2008. However, in an interview of Vladimir Evtushenkov to *Vedomosti* (published on 23 December 2013), he clearly stated that “*Sistema* is not a family business, and will never be one”. Instead, the company pursued a strategy of strengthening the corporate governance mechanisms in 2011-2013. Furthermore, the company’s strategy was redefined: *Sistema* positioned itself as an investment company rather than a conglomerate. For us, the most relevant fact is that the new changes had substantial implications for the composition of the board. As the Table 2 shows, the number of independent directors reached two thirds of the board members; the share of foreign citizens also increased substantially.

Already in 2003, *Sistema* created an International Consulting Council, headed by Ron Sommer (former CEO of *Deutsche Telekom*) and including high-ranked (current and former) foreign managers and board members of *RWE*, *Coca-Cola*, as well as Russian influentials (like Zhores Alferov, the only Russian Nobel Prize winner in physics alive and State Duma member; or Arkadiy Volskiy, president of the Russian Union of Industrialists and Entrepreneurs, the association representing Russian big business). The Council was set up in preparation of the international IPO of *Sistema*, had no decision-making authorities and represented an advisory body for discussion of company strategy. Thus, this council would fit the picture of a pure ‘service body’ to a much greater extent, as well as an attempt to get access to networks and reputation of high-profile members. However, in 2011-2013, instead of pursuing the Council approach, and *Sistema* focused on acquiring high-profile individuals as members of the board (at the same time endowing it with real authorities); the Council is not mentioned in company reports and other documents after 2005. While it is hard to explain this shift in terms of the pure resource dependence perspective, we will attempt to provide an explanation based on the entrepreneurial functions of the board.

In what follows, we will investigate the results of the transformation of board composition and operations, as they were observed by early 2014. We stress that from the interviews and discussions we have no reasons to expect that the changes in the corporate governance structure, as of early 2014, reached certain equilibrium. For example, in 2014 a new deputy chairman of the board from the ranks of independent directors was appointed (at request of the independent directors).

Table 2 about here

It remains to note that *Sistema* has systematically outperformed the existing Russian corporate governance standards in terms of transparency. The share of independent directors in *Sistema* exceeds substantially the recommendations of the Russian Corporate Governance Code (most recent version, as adopted in 2014), which requested that at least one third of the board members are independent directors. It also outperforms several international standards in this respect. The UK Corporate Governance Code (2013) recommends that at least one half of the board members are independent; in *Sistema*, the share of independents substantially exceeds this number.

4.2. Composition of the board

As a first step, let us have a closer look at the composition of the *Sistema* board over time. Based on the biographical data, we attempted to classify the independent directors into several groups: industrial specialists (e.g., deep knowledge of markets, where *Sistema* subsidiaries operate); functional specialists (e.g., having expertise in accounting, marketing etc.); former CEOs of large Russian and international companies; investment experts (i.e., having experience in operating investment companies similar to *Sistema*) and political and social influential figures (see Table 3). One can see that while there is a small group of industrial experts on board (1-2 directors), company rarely appoints them at the *Sistema* board level (one can more frequently encounter them in the boards of subsidiaries). Functional experts are somewhat more frequent. There seems to be an increase of the number of investment experts, probably consistent with the new self-identification of *Sistema* as an investment company since 2009-2010. Two groups, which account for the largest shares of independent directors and also exhibit most substantial growth over time, are CEOs of large companies and politicians and bureaucrats. This may be consistent with the importance of legitimacy, reputation and connections as the main contribution *Sistema* board members could provide.

Table 3 about here

Table 4 provides more detailed information on individual board members as of 2013; it shows that a director of *Sistema* frequently has multiple areas of expertise. The contributions of Roger Munnings can be described as a combination of functional expertise (in the audit committee of the board he chairs, due to his year-long experience with the KPMG), knowledge of international markets (especially in the Western Europe) and of industrial expertise (oil and gas, healthcare etc.). David Iakobachvili, in addition to be well-connected in the Russian business community, also has experience of managing *Wimm-Bill-Dann* – a Russian food producer, which was among the first to be listed internationally. Marc Holzmann has experience in business, academia and governmental structures. The table, however, clearly confirms that the board of *Sistema* includes high-profile individuals with strong reputational resources and connections.

Table 4 about here

Thus, the composition of the board of *Sistema* indicates that the company indeed attempts to use the resources of the board members, rather than to keep the board for purely formal reasons. A director, in his interview, describes the shift in the composition of the board as an outcome of initiative of Evtushenkov, willing to keep people with different experience and competences in the board. The interviews provide mixed information about how selection of board members is done. Some directors explicitly say that they were invited by Evtushenkov personally to join the board; in other cases the suggestions are done by company managers and directors, but the ultimate decision rests with Evtushenkov. Thus, the changes in the board composition do not appear as a result of external pressure – on the contrary, they are driven by the founder himself. Furthermore, at least for foreign members of the board it is unlikely that by becoming directors they were able to improve their personal reputation (*Sistema*, while successful, is not a company with global recognition), what they could potentially use e.g. to acquire new board positions. Thus, we need to have a closer look at the motivation of the board members, as we will do in what follows.

4.3. Functioning of the board

We investigated the procedures of board functioning based on official information and interviews. Overall, *Sistema* board appears not merely a collection of high-profile individuals, but a body with substantial influence in corporate governance of the company – what one could refer to as *functioning board.* While almost all respondents explicitly acknowledge it in the interviews (they frequently referred to what they call “extended responsibility” of the board as part of the philosophy of the *Sistema* corporate governance), there are two indicators supporting this claim: the attention the company pays to organizing the work of the board and the ability of the board to revise the decisions prepared by the management.

After 2006, when the board of *Sistema* assumed its current functions, it regularly meets 8 to 10 times a year. In terms of topics, since 2006 two issue areas appear to be particularly important: general strategy issues, considering, for example, new business activities, general directions of the company development (i.e. concerning multiple business segments) etc., and the approval of acquisitions and divestments (which is obviously very important for an investment company). Overall, about 50% of all issues on the board agenda belong to these two areas. In terms of time devoted to different issues, strategy takes about 50% of the time of the board meetings, according to the interviews. In the area of strategy, “no important decision is made without the board” (interview, director). More tactical issues are rarely discussed at the board (see Table 5).

Table 5 about here

The meetings of the board are typically preceded by the meetings of committees, although the frequency of committee meeting differs, depending on the structure of the agenda. Since 2011, the board includes five committees: strategy; appointments, remuneration an corporate governance; audit, finance an risk; ethics and control; and investor relations and dividend policy. Throughout the last decade, the number of committees was steadily growing (from originally three). Within the structure of the committees, the strategy committee has been indicated by the respondents as a particularly important one, also receiving a lot of attention of Evtushenkov. Until 2011, most committees included both board members and company managers; however, as of 2011, only directors may participate in committees.

The directorate shows significant commitment to participation in the board activities. On average, a board member attended more than 90% of the meetings of the board during his tenure; only few board members attended 80% of the meetings. The attendance of the committee meetings exceeds 80%, with the exception of strategy committee, which has the largest membership (it is close to 70%). This is important, since, as we will show in what follows, board meetings of *Sistema* are time consuming. The interviews also reveal that Evtushenkov himself devotes a lot of attention to the activity of the board, actively participating in the discussions of the directors. Unlike other Russian companies, where the board meetings typically merely have to accept the already prepared set of decisions, in *Sistema* board carefully reviews the suggested decisions, and it is not uncommon for the board to request the decision to be improved or revised. The respondents were not unanimous with respect to how often the board actually turns down the proposals of the management, but all agree that it is not an exceptionally rare case.

It is also the case that the management adjusts the proposal for final discussion at the board based on the previous informal communication with the directors (according to some respondents, it happens in roughly 20% of the cases). The board rarely makes an immediate decision on the items on the agenda in case of issues of crucial importance for the company and strategy decisions; typically the members engage in detailed discussion of the topic. Fast-track decisions happen merely in case of purely technical items, or of the items are poorly prepared (in this case there are consequences for those responsible). Occasionally the members of the board suggest new topics for discussion (typically as an extension of the currently debated topics), but it happens infrequently during the meetings of the board themselves (typically the proposals have to pass through the committees of the board). There exists a monitoring system for the decisions of the board. After each meeting, a special list of directives, including responsible managers, is prepared; at the beginning of the next meeting, the board checks as to whether these directives were implemented or not.

Most *Sistema* directors acknowledged that exercising their function on board is a time consuming procedure (directors residing abroad, for example, referred to a ‘board week’ preceding the actual board session, when they have to come to Moscow and participate in numerous meetings). As of 2014, the company decided to move from a one-day meeting of the board to a two-days meeting; with smaller issues decided on Friday within a short (2-3 hours) meeting and major issues discussed on Saturday in a longer (4-5 hours) meeting; this was done following a suggestion of the independent directors.

The company invests substantial effort in ensuring that board members actively cooperate with each other during the board meetings. For example, the board meetings (typically taking place on Saturday) are always preceded by an informal dinner on Friday, which serves as a communication channel between directors and the management (the importance of this informal institution cannot be emphasized enough – literally every interview we conducted contained references to these informal meetings and perceived them as a highly positive feature of *Sistema*’s board of directors organization). The function of this dinner is, as in case of the board committee meetings, to prepare the final decision of the board – however, unlike committees, which have to follow a certain more formalized routine, the dinner serves as a platform for free exchange of thoughts and ideas.

Furthermore, the board members socialize informally on numerous other occasions with each other and with the members of the management team (e.g. common ski tours in winter). The company encourages contacts between directors and the management team: directors have the opportunity to discuss issues of their concern with the managers, and the managers are also allowed to directly contact the board members. The attention devoted by the company to the work of the board is perceived as extraordinary even by the directors themselves: “I have never seen a company where the board meeting honestly lasts for several days” (interview, director); “It is known that many Russian companies do it [implement the corporate governance norms] only formally, to satisfy some rating criteria. We intend to go away from it – while ratings are important for us, we search for efficient mechanisms of work” (interview, member of the management team).

The respondents, interestingly, see the strength of the *Sistema* board of directors as unusual even for the standards of their Western partners with concentrated ownership:

> Recently I was engaged in negotiations with a very large European … company, which is controlled by one family. After we finished negotiations, where we did not find a common ground, we suggested as part of creating stronger ties between companies … to conduct joint sessions of the boards of directors and to exchange their members, so that two our members join their board and two of their members join ours…. But in the end we understood that for them the board is purely nominal: the owner makes the decisions.” (interview, director).

As in case of board composition, the system of board functioning we observe in *Sistema* did not emerge by coincidence or as an outcome of external pressure (e.g. conflict among shareholders). All respondents in the interviews we conducted unambiguously confirm that the strengthening of the board is explicitly promoted by the founder. This was also confirmed by the founder himself in his interview. The interviews explicitly point out that by introducing the relatively more powerful board the dominant shareholder actually limits his decision power: “He [Evtushenkov] as a shareholder could have had absolute power. He, based on his convictions, consciously decided to balance it out” (interview, member of the management team). Furthermore, Evtushenkov did not merely envision or support the creating of the corporate governance structure we described, but is actively engaged in the routine work of the board, e.g. encouraging board members to express their opinion regarding the issues on the agenda (interview, director). For us, the active position of the founder (who is, as mentioned, the dominant shareholder) is especially important, as it is incompatible with the principal-principal explanation, which suggests that strong boards emerge as a result of power struggles between shareholders.

At the same time, the management of the company clearly recognizes that a functioning board comes at a cost within the Russian context. It applies generally to having a developed corporate governance structure. A director, in his interview, points out that his personal feeling is that in Russia for the owner it may be better not to have a publicly open company and not to disclose any information. There are segments of Russian business, where having access to semi-legal instruments (e.g., grey salaries), which a transparent company cannot afford. Also, technically, preparing a board meeting (with a large share of foreigners) is not an easy task: a director in his interview describes the already mentioned shift to a two-day sessions model of the board as a “hard” decision. Still, in spite of these costs, the company opts for a strong board and explicitly supports it- thus, it is likely to be valuable for the founder.

4.4. Entrepreneurial function and motivation

The interviews revealed multiple functions and contributions board could provide for *Sistema.* For example, advice and expertise play an important role (as it was indicated by the founder himself in his interview, where he explains the development of corporate governance structures in the company by its size and complexity and the need to have independent information on every company decisions). Similarly, many interviews confirm the importance of political connections of the members of the board, what is not unusual for emerging markets. However – and this is the most important finding for us – respondents repeatedly referred to the importance of what we have described as ‘entrepreneurial function’.

As discussed, we define entrepreneurial function as taking initiative in relations to internal and external actors. Previously reported evidence, in line with the interviews confirms that in relations to managers board members often proactively seek contacts and discussion. As for external actors, there are two ways in which *Sistema* board could be seen as exercising the entrepreneurial function. First, direct evidence of these activities is, as mentioned, the involvement of board members in the project acquisition for the company. It is acknowledged by both directors and management. On the board side, a director in the interview describes the work of the board in the following way: “we are generating projects, the board members are very active in this respect. I have brought several myself”. Occasionally, the members of the board refer to their industry specific expertise in acquiring projects (interview, director). On the management side, according to an interview

> “The board includes a large number of independent directors with broad interests, who are actively expressing their interest into deals made by company and suggest to consider various investment opportunities – for instance, to me as the portfolio manager – which are associated with their activity, geography and membership in other boards.” (interview, member of the management team)

As the interviews reveal, from the point of view of the management independence of directors is particularly relevant because they have larger network of contacts different from that of the company management itself.

Second, interviews with management and directors show that the members of *Sistema* board are expected to actively represent the company and promote it in the networks of connections they have access to (especially while exploring new markets and business opportunities). In this case *Sistema* board members do not produce new projects directly, but still act independently and use their reputation on behalf of the company. A member of the management team describes the board as a "ministry of foreign affairs" or the "UN" of *Sistema*. A foreign director suggests that the reason for his appointment was, among others, "to bring my international contacts, my international experience to this board" (interview, director). The importance of reputation as the key resource board members can provide is explicitly acknowledged in the interviews.

> "It starts with a name. A foreign investor does not know *AFK Sistema*, but he knows that a certain Mr. X, a reputable person, was once the *Coca-Cola* president and joined *Sistema*. He is a reputable person and would not join a company engaged in dubious activities. He accepted responsibility, including the legal one…. But the member of the board would not join any company, there are currently serious risks – reputational ones, but also that of criminal prosecution." (interview, director).

Furthermore, the importance of proactive participation and contact-building for *Sistema* seems to be increasing over time as opposed to pure advisory functions:

> "A member of the board came, looked at the file, suggested an interesting question, asked it, looked at it, and went away. Now everything has changed. Consider a meeting with foreign investors. … We go to a Singapore, where

> nobody knows us, but there is a person, who is known, who can say – I am responsible, I know them. This person is trusted. This is an entirely different situation.” (interview, director).

At the same time, as the founder points out in his interview, the activity and the connections of the board members should be perceived merely as complements to his own contribution due to specific features of Russian business. In Russia, the owner cannot distance himself from the activities of the company, and has to spend substantial amount of time to “protect the business” (the experience of the attack against *Sistema* in autumn 2014 confirms the importance of these risks; in this case, however, neither political connections and very cautious behavior of Evtushenkov nor the reputation of the board managed to protect the company). Thus, the strong board with an entrepreneurial function seems to be a solution to a dilemma the owner arguably faces: on the one hand, there is a need to actively promote the company internationally (what requires connections and reputation valid there), but on the other hand, the owner has to remain active in managing business due to the importance of his connections as a shield against risks within the home country.[10]

The company explicitly acknowledges the link between the entrepreneurial function of the board and the need to motivate the members of the board accordingly. To start with, the management is clearly aware of the need to improve the motivation of the board members given the function board has to exercise in the company corporate governance structure. Furthermore, remuneration is considered to be insufficient to provide appropriate motivation.

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[10] The importance of the entrepreneurial function is also pointed out in the 2013 annual report of *Sistema:* “Moreover, in 2013, the corporation increased its focus on using the potential of its Board members in its core business activities – in particular, using their vast business contacts to expand its international contact network and look for new investment ideas.” (AFK Sistema 2014: 67).

> “We motivate them [board members], pay a lot of money. But to create the true motivation of an independent director to work for the company and not merely appear at board meetings for formal reasons, turned out a difficult, in fact a very difficult task” (interview, member of the management team).

Unlike the management staff, which can be (and is) motivated by clear performance indicators, a formal approach is inapplicable to the board members due to their position in the company. Company by-laws specify three components of the remuneration of board members: (1) a fixed remuneration for participation in board meetings and other tasks (the founder explicitly argues in his interview that this remuneration is independent of their actions, and sees it as a strength of the remuneration system, keeping board members independent); (2) additional profit-bases remuneration paid by the end of the year in form of stocks (50%) and money (50%); (3) additional remuneration based on the capitalization growth of the company. Stock holdings in the company capital can be seen as the first tool incentivizing directors to invest effort in the entrepreneurial function. Indeed, most independent directors own small portfolios of the company stocks.

The second and, probably, more important motivation factor in terms of this paper is the intrinsic motivation. The crucial role of intrinsic motivation is acknowledged by the management; according to the corporate secretary:

> “People, who work in the *AFK Sistema* board, do not work merely for money. Money, for sure, has to be present, … it is adequate to what is paid to the board members of large companies. [What is important is] activity, participation in what is happening, contacts, ability to develop each other and people surrounding you. A person, who just came for money, is insufficient, we need creative motivation.

> It is a specific issue, one cannot gain it for money" (interview, corporate secretary).

The founder makes a similar comment (also confirming the importance of entrepreneurial function for the board members):

> "Each of them [board members] is to a large extent already involved in the things we do, and – I will honestly say that – not formally, not just that they come, spend some time and go. Many of them feel concerned, many come outside the official board meetings, many organize various connections to funds, to people, in the West, wherever they are integrated, etc."

In the interviews of independent directors they explicitly mention intrinsic motivation as driving their behavior. One of the directors, while describing his work in other boards of directors (outside *Sistema* group), explicitly refers to another company, where he decided not to continue his engagement in the board because the business model of the company was less interesting and more simple than that of *Sistema*. He also explicitly says that he is personally interested in many areas of *Sistema* activity, as well as points out the importance of the feeling of involvement into *Sistema* activity (created by the attention of Evtushenkov) as a crucial feature. Another director also repeatedly refers to the fact that contributing to the company is "interesting" for him, for example, because of the company's multi-sector profile (one can argue that the breadth of the *Sistema* activities provides larger opportunities for self-actualization for the board members). The interviews also show that this intrinsic motivation could interplay with extrinsic one: directors, who express strong personal interest in the development of the company, may also decide to purchase additional stocks of *Sistema*, and thus develop stronger extrinsic motivation.

Finally, we have to stress that the composition of the board seems to increase its attractiveness for individual board members as well. To some extent, it may refer to networking among directors. From this point of view, the already described effort of *Sistema* to increase cohesion within the board and the ability of its members to work together plays an important role.

5. A theory of an entrepreneurial board

5.1. Origins and functions

The case of *Sistema* illuminates the possibility of what we refer to as 'entrepreneurial boards' – boards, where external directors are taking initiative on behalf of the company (particularly, focusing on its long-term development goals) in relations to external and internal partners, and especially are engaged in acquiring projects for the company. Based on these observations, we propose the following causal mechanism explaining the formation of entrepreneurial boards. This mechanism relies on three plausible assumptions, which are outlined in what follows.

First, we assume that company's ability to operate in certain markets crucially depends on trust to the company from the possible counterparts, which in turn is derived personal reputation of particular manager or director of the company of the company or individuals associated with it (assumption A1). It seems to be particularly plausible for companies from emerging markets, if they operate both domestically (because of weak rule of law, which makes impersonalized transactions risky, see North 1993) and internationally (where poor reputation of or lack of information about the country of origin may frighten business partners). However, the role of personal connections is, obviously, non-negligible in developed countries as well (it may matter, for example, if the legal disputes are considered particularly threatening due to delays in implementation of projects or costs of litigation).

Second, while we acknowledge that each individual's reputation is a dynamic characteristic and can be acquired over time, we also assume that the speed of reputation acquisition is slow, and in some cases particular individuals may find it extremely hard to acquire reputation relevant for certain groups of business partners (assumption A2). For example, if company enters new markets or substantially expands the scope of operations, it may be very hard for its managers to acquire reputation relevant for the new potential partners. For founder-managed firms, reputation of the founder obviously depends on the success of the company; but we assume that in some cases even the founders of extremely successful businesses will find it hard to establish connections outside their 'original' markets. The problem may be particularly pronounced for emerging market companies pursuing a broadly internationalization strategy, i.e. attempting to acquire foreign partners. The international business literature acknowledges the existence of these problems and discusses various tools to overcome them (Hitt et al. 2000; Luo and Tung 2007).

Third, we assume that mere association with the company by a particular individual is insufficient for the company to use this individual's reputation in business affairs. Stated otherwise, merely hiring a particular individual or including her in the set of directors does not automatically allow the company to access the resource of this individual's reputation. Reputation can only be used in case of individual's active personal participation – for example, if she promotes company's activity within the network it has access to (assumption A3). It may be the case, because this personal participation implies greater commitment of the individual to the company and is associated with greater personal costs (of time and effort) for the individual; and thus creates a costly, and therefore credible, signal in favor of the company (cf. Farrell and Rabin 1996).

Based on these three assumptions, the mechanism looks as follows. At the early stage of their development, founder-managed companies typically crucially rely on the ability of their founders, including their reputation (as it follows from A1). As mentioned, reputation matters in particular in emerging countries with their lack of impersonalized exchange; here (political) connections of the founder also serve as a tool protecting company from possible expropriation and give access to governmental support, which is often a crucial advantage in competition. Over time, if successful, the company faces the challenge of limits to founders' ability to sustain their growth. From A2 it follows that the limits may also emerge due to the inability of the founder to provide the reputational advantages needed to operate in new markets (especially in case of internationalization) or because the founder considers the long-term development of the company, where her personal reputation may not be available.

We have to stress that the orientation of the founder also varies from firm to firm: founders may be more concerned about value maximization or pursue a conservative harvest strategy (Le Breton-Miller and Miller 2008; Miller and Le Breton-Miller 2011; Miller et al. 2011). The founder may also have some sort of 'Schumpeterian' motivation:[11] she may be intrinsically motivated to preserve the company in the long run, looking at it as her 'creation' and not merely a tool of revenue. The problems we describe, however, would be faced by different types of founders. 'Value-maximizers' will encounter that subsequent growth of the company is impossible (furthermore, since the company relies on founder's reputation, simply 'selling it and going away' is also impossible). Those interested in conservative harvest strategy or pursuing Schumpeterian motivation would face the problem of intergenerational change (which may endanger the protection of reputation) or simply believe that in a long run large company cannot survive, focusing on conservative harvest opportunities only.

[11] Schumpeter (1937) emphasizes that the will to create and to establish a new entity is driving the entrepreneurial behavior.

The founder requites (a) to establish a set of individuals with broad reputational resources allowing the company access to new markets or ensuring its continuous survival in the future and (b) make sure that (as A3 requires) these individuals actively engage in promoting the reputation of the company. Selecting the external directors for the board and designing board's activities can be instrumental in achieving this task. While professional management (which has been emphasized in the previous literature on threshold founder-managed firms) could also hypothetically complement the connections of the founder by using its own informal ties, boards have a much broader membership, and thus are likely to give larger opportunities for finding new connections and improving reputation of the company. Furthermore, connections are not necessarily the main characteristic selection of managers should be based upon, due to their need to oversee the day-to-day business operations. In many cases it may be easier to convince an individual possessing crucial reputation to become a director of the company than to join its management staff. Finally, the the set of incentives for management often makes it particularly focused on short-term implications of business decisions, while, as mentioned, the main goal is to ensure the long-term survival and growth of the company. External directors, indeed, frequently are able to give company access to various networks of their personal contacts (this is, as mentioned, the standard argument of the resource dependence theory) and are less dependent on short-term concerns than managers.

More specifically, the company attempts to build up the *reputation of the board*, which in turn affects the *reputation of the company*. This 'collective' reputation of the board is determined by the reputation of its members, but also the extent to which they are willing to invest their time and effort in the company's work. There are clear spillovers between actions of individual board members in terms of this board reputation (and, respectively, company reputation), which make increasing the cohesion of the board particularly important.

The board becomes 'entrepreneurial' if its members are taking initiative on behalf of the company and focusing on its long-term interests. In case of *Sistema,* which is redefining itself as an investment company, entrepreneurial function may be in particular associated with acquiring projects. By incentivizing this activity, the company, at the same time, gains from reputation benefits of these members (in line with A1 and A3) and from their knowledge benefits; indeed, it is likely that the members are better able to judge the potential of their networks and the opportunities the company can obtain there. Even if management (or hired experts) are well informed about business opportunities, they are no substitute for active external directors – because the reputation of external directors makes the actual acquisition of these opportunities more likely. Besides, in many cases directors use the tacit knowledge they possess, which is difficult to obtain otherwise.

However, incentivizing directors for active participation in the project acquisition is a non-trivial task. We argue that empowering the board the company provides the necessary incentives for the active participation of its members. The literature has acknowledged the link between the board power and the willingness of its members to engage in strategic management (Golden and Zajac 2001). The main argument, nevertheless, comes from the literature on entrepreneurship. Starting from Schumpeter (1937), it emphasizes the role of non-material factors in the entrepreneurial motivation; entrepreneurs are often driven by their aspiration to self-actualization and development (Benz 2009; Carsrud and Brännback 2009). Empowering directors and making them active participants of the company decision-making, the company encourages them to act on similar motivation. In case of appropriate selection of directors (that is, the board members are chosen from those willing to act in an 'entrepreneurial fashion', if there is an opportunity for it, from the start), the company can achieve active participation of its directors in the project acquisition and thus create the entrepreneurial board. Besides, empowerment allows the board directors to manage the risks associated with abuse of their reputation, which should make them more eager to put it at stake while acquiring projects for the company.

Thus, the board can be described as ‘entrepreneurial’ from two angles: first, because of the motivation of their members (derived from the opportunities to self-actualization) and second, because of the use of tacit knowledge (the literature, starting from Hayek (1945) has emphasized the importance of knowledge acquisition and tacit knowledge in entrepreneurial action, see Shane 2000; Shane and Venkataraman 2000; Eckhardt and Shane 2003; Davidsson and Honig 2003) in acquiring projects. In terms of the language of the dynamic capabilities (Teece 2007), involvement of directors should therefore allow the company to sense (through knowledge advantage of directors) and to seize (through the reputation mechanism, in line with A1) new business opportunities, as well as to maintain them (through the interaction between the management and the board).

The empowerment as an additional factor strengthening motivation of board members does not preclude the importance of other, intrinsic and extrinsic motivation elements. From the intrinsic motivation point of view, board members may be more inclined to assume the entrepreneurial function if other board members are also active in this respect – particularly because there are spillovers from actions of board members to other board members, relevant for their reputation. Also, extrinsic motivation (shareholdings and payment) play a role; in case of shareholdings, intrinsic and extrinsic motivation can mutually reinforce each other. We merely want to emphasize that in case entrepreneurial function is crucial, empowerment becomes more important than in case the company expects the board to exercise the pure service function.

5.2. Implications for further research

The described mechanism is unlikely to be equally strong in all founder-managed companies. Thus, based on the observations from *Sistema* and the theoretical argument we developed, we suggest a number of propositions, suggesting avenues of further research of entrepreneurial boards.

Generally, we expect that empowerment of boards is more likely if the entrepreneurial function (acquisition of projects) is particularly important, as opposed to the service function. If at the current stage of company's development board members serve purely as advisors to the company management (in line with resource dependence theory), while the companies may acquire external directors (through generous remuneration), they will not empower the board. Thus, in order to predict the likelihood of emergence of entrepreneurial boards, we need to identify the set of companies for which entrepreneurial function is particularly important.

Entrepreneurial function is particularly important for diversified companies relying on permanent stream of project acquisition. Obviously, investment companies like *Sistema* should therefore exhibit particular interest in entrepreneurial boards; due to the need to permanently enter new sectors and industries, the companies may face particular strong challenges in terms of the ability to rely solely on the reputation of the founder (assumption A2). However, similar issues could be faced by other types of conglomerates and diversified companies operating indifferent sectors, or by companies attempting to shift their industrial focus. Furthermore, geographic diversification may also make entrepreneurial board especially important – thus, global companies are more likely to exhibit it than companies operating within one country.

Entrepreneurial function is particularly important for companies, operating in dynamic fragmented sectors. In this case, on the one hand, limiting oneself to a particular sector or set of partners may be particularly costly for the company, since the competitive advantages crucially depend on its dynamic capabilities. From this point of view, traditional industries may be less inclined to nurture entrepreneurial boards than industries with high speed of innovations. On the other hand, fragmented nature of the sector makes limits of the founder's reputation particularly important (in oligopolistic sectors, on the contrary, the small group of players makes it easier for a single individual to possess the necessary reputation).

Entrepreneurial function is particularly important for threshold companies, where the project acquisition relied on the reputation of the founder. This conjecture is obvious; small companies, until certain level of their development, do not need entrepreneurial boards due to the limited scope of their operation, even if they work in dynamic fragmented industries; if the project acquisition was independent of the reputation of the founder (e.g., due to strong support of outside partners), again, the need to use entrepreneurial boards may be more limited.

Entrepreneurial function is particularly important for emerging markets. On the one hand, as described above, in emerging markets personal reputations are especially important in doing business, since the resources are often allocated through closed networks (Boisot and Child 1996; Puffer and McCarthy 2011), and if emerging market companies attempt to enter global markets, they frequently are perceived with mistrust by their potential partners. On the other hand, again, in emerging markets it is crucial for the company to maintain active participation of the founder in its operations, since in many cases connections of the founder shield the company from possible expropriation by predatory bureaucrats and extra-legal pressure by competitors (if the founder does not have the necessary connections, companies rarely manage to succeed). It means that this type of companies is particularly dependent on finding *complementary* sources to founder's reputation (rather than simply transforming the company into professionally managed firm), and entrepreneurial boards may be particularly useful in this respect. Finally, emerging market environment can be conducive to very fast expansion at the early stage of the company's development (for example, because of lack of competition), but at the same time the companies reach the limit of growth based on the connections of the founder relatively early, again making entrepreneurial board an attractive solution.

These propositions may provide ground for further investigation into the possible entrepreneurial function of the board, going beyond the particular case studied in this paper.

6. Conclusion

It remains to summarize the main arguments of the paper. We attempted to investigate the reasons for empowerment of boards in founder-managed companies. Since the founder is actively engaged in company management, principal-agent problems cannot explain the creation of strong boards. Furthermore, while in this case the boards can play the crucial role in providing resources and expertise to the company, it cannot explain the empowerment of boards as such. In a revelatory case study of *Sistema* we demonstrated a case where a founder-managed company in the absence of principal-principal problems opted for a strong board, which was explicitly promoted by the founder in spite of certain costs.

To explain this puzzle, we suggested that boards can exercise what we referred to as 'entrepreneurial function' – the board members take initiative on behalf of the company and pursuing its long-term goals in relations to external and internal actors (for example, acquiring projects for the company). The entrepreneurial board emerges as a tool to augment founder's connections and reputation, which provided initial push for the growth of the company, at the same time allowing the continuous use of the founder's reputation and connections (often still essential for the company functioning). However, to ensure that board member exercise this function, it is essential to ensure their intrinsic motivation in company functioning; this, in turn, requires empowering he board. This is precisely the mechanism we observe in case of

Sistema. While the company first tried to create a strictly advisory International Consulting Council with influential members (especially foreign business leaders) capable of strengthening *Sistema's* reputation, after a while it abandoned this approach – instead, it focused on attracting independent directors to the board, where they actually had real authority to influence company decisions.

We expect entrepreneurial boards to be particularly important in case of emerging markets – first, because of crucial role of reputation, and second, because of the need for the founder to remain engaged in company functioning. In particular, entrepreneurial board can be instrumental in overcoming reputational obstacles to internationalization companies from emerging markets often face. However, we do not consider entrepreneurial boards a specific function of emerging markets – in fact, the need to realize the entrepreneurial function of the boards may be highly relevant for any business, where steady acquisition of new projects is crucial and which operates in a field or industry with crucial role of personal connections and reputation.

As mentioned, this paper is based on a single case study. This approach was useful to identify the entrepreneurial function of the board and the preconditions for its development. However, we acknowledge the need of further investigations; thus, we concluded the paper with a number of propositions, which could provide helpful hypotheses for further studies.

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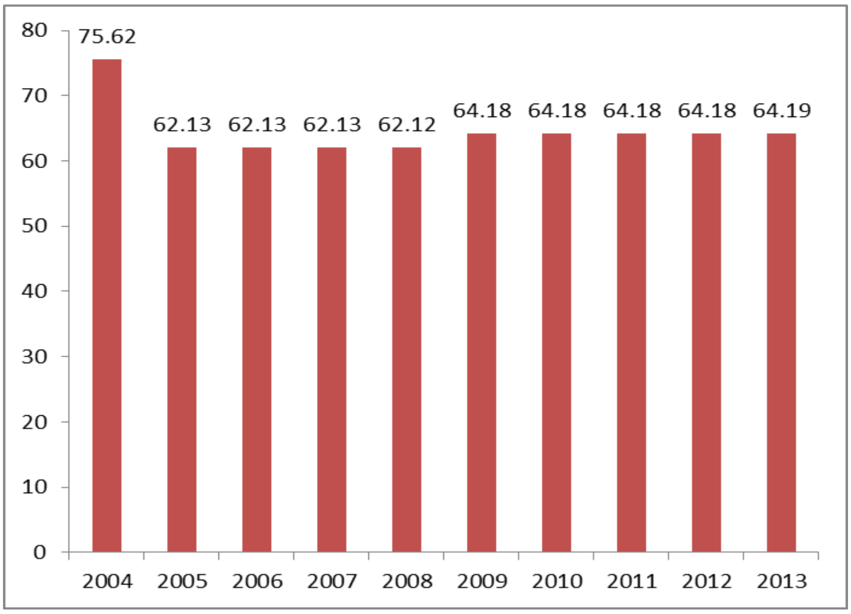

Figure 1: Share of stocks held by the founder, %

Table 1: Key financial indicators of Sistema, 2006-2013, millions of USD

	2006	2007	2008	2009	2010	2011	2012	2013
Turnover	10266.59	13410.65	16071.13	18749.82	28099.00	32981.00	34241.00	35942.07
Net profit	813.00	1571.90	61.98	1643.44	918.00	218.00	1794.00	2257.53
Total assets	20191.24	28396.66	29177.12	42011.04	44109.00	43902.00	44726.00	43249.00
Shareholder equity	4520.71	6658.76	9327.82	14010.00	14209.00	13706.00	13315.00	14495.70

Source: official reporting of Sistema; total assets and shareholder equity as of the end of the reporting year (31 December); other indicators are reported for the respective reporting year

Table 2: Evolution of membership in the board of Sistema, 2005-2013

	2005	2006	2007	2008	2009	2010	2011	2012	2013
Number of directors (end of the year)	11	11	10	10	13	11	12	13	13
Independent directors	3	4	3	4	4	3	5	8	8
Non-executive directors	6	5	5	4	7	6	6	4	4
Executive directors	2	2	2	2	2	2	1	1	1
Russian citizens	10	9	8	7	8	7	8	7	6
Foreigners	1	2	2	3	5	4	4	6	7

Source: compiled by authors based on company information

Table 3: Professional background of Sistema independent directors, 2005-2013

Year	2005	2006	2007	2008	2009	2010	2011	2012	2013
Industrial experience	2	2	1	1	0	1	2	2	1
Functional experience	0	1	1	1	1	1	1	2	2
Experience in investment company business	0	1	1	1	1	0	0	2	2
CEOs and entrepreneurs	1	2	2	2	1	1	3	4	4
Politicians, former bureaucrats, community influentials and scientists	2	2	1	2	3	1	1	2	3

Note: a director may have multiple forms expertise, and thus counted several time.

Table 4: Independent directors of Sistema with no prior work experience for the company, 2013

Name	Russian / Foreign	Year of birth	Brief description
Robert Kocharyan	Foreign	1954	Former president(1998-2008) and prime minister (1997-1998) of Armenia
Roger Munnings	Foreign	1950	Managing partner of KPMG in Russia (1996-2008); chairman of world energy and natural resource committee of KPMG (1993-2008)
Brian Dickie	Foreign	1955	President of Booze, Allen and Hamilton (1993-1998) and TXU Energy (1999-2003); managing director of European private equity business of Investcorp (Bahrain based alternative investment company, 2003-2010)
David Iakobachvili	Russian	1957	Founder of Wimm-Bill-Dann (1992); extremely well-known in the Russian business community
Serge Tchuruk	Foreign	1937	CEO of Orkem (1986-1990); Total (1990-1995) and Alcatel (since 1995)
Jeannot Krecke	Foreign	1950	Minister of Sports (2004) and of Economy and External Trade (2004-2011) of Luxembourg
Marc Holtzmann	Foreign	1960	Chairman of Meridian Capital HK; Colorado Secretary of Technology (until 2003); president of the University of Denver (2003-2005)
Peter Mandelson	Foreign	1953	UK Secretary of State for Trade and Industry (1998); Secretary of State for Northern Ireland (1999-2001); EU Trade Commissioner (2004-2008); Secretary of State for Business, Innovations and Skills (2008-2010)

Note: ‘foreign’ or ‘Russian’ is based on the center of activities of the particular board member, and not on nationality.

Table 5: Agenda of the board meetings of Sistema, %

Types of issues	2009	2010	2011	2012	2013
Business strategy, new investments and activities	22	25	19	22	30
Functional strategy			9	7	7
Appointments and personnel	7	4	3	10	11
Participation in subsidiaries	6	12	9	16	10
Approval of deals	34	37	33	17	19
Approval of internal documentation	2		1	2	2
Financial reporting and audit	14	12	8	12	8
Corporate governance and issuance of securities	15	10	18	14	13

Source: compiled by authors based on company information.
Note: approval of deals, according to the Russian law, refers to (1) acquisitions (large-scale transactions, which, however, happen infrequently) and (2) transactions with affiliated parties (e.g. transfer of shares from the parent company and subsidiaries and vice versa), which are of more technical nature and are much more frequent.

Appendix: List of interviews

Respondent	Position	Additional information	Employed in the company // holds current position	Date of the interview
1- Igor Petrov	Corporate secretary	Member of two boards of directors of Russian partly government-owned companies	2006 // 2006	8 Oct 2013
1- David Iakobachvili	Independent director	Chair of IR and dividend policy committee; member of audit and finance committee	NA // 2011	17 Oct 2013
2- Roger Munnings	Independent director	Chairman of audit and finance committee; member of appointment, remuneration and corporate governance committee, IR and dividend policy committee, and ethics and control committee	NA // 2010	22 Oct 2013
3 – Dmitry Zubov	Director	Member of appointment, remuneration and corporate governance committee	1998 (with a subsidiary) // 1999 (memberoftheboard; 2000-2012 – deputy chairman)	19 Nov 2013
4 – Jeannot Krecke	Independent director	Member of appointment, remuneration and corporate governance committee and IR and dividend policy committee	NA // 2012	12 Dec 2013
5- Alexander Goncharuk	Deputy chair of the board	Chair of ethics and control committee; member of strategy committee and appointment, remuneration and corporate governance committee	1993 (withasubsidiary) // 1996 (member of the board, 2008 – deputy chairman)	23 Jan 2014
1 – Vladimir Evtushenkov	Chair of the board, founder and owner of the company	Chair of strategy committee	Founder // 1994 (member of the board, 2006- chair of the board)	20 Feb 2014
1 – Sergei Drozdov	Senior vice-president, member of the collective managing body	Head of Corporate Governance Complex since 2011 (before that, head of Property Complex since 2002)	1995 // 2006 (was member of the board in 2002-2006)	26 Nov 2013
2 – Anton Abugov	First vice-president, member of the collective managing body	Head of Investment Complex Telecom and Media since 2012 (before that, head of Strategy and Development Complex since 2006)	2006 // 2006	27 Nov 2013
3- Alexei Buyanov	First vice-president, member of the collective managing body	Head of Investment Complex Financial Assets since 2013 (before that, head of Finance and Investment Complex since 2002)	1994 // 2006	27 Nov 2013