

Cost Management Strategy as a Determining Factor of the Corporate Business Quality in the COVID-19 Pandemic Context

Dong Zhao¹; Sergey A. Orekhov²; Vladimir V. Velikorossov³; Roman V. Glazov^{4*};
Anzor U. Soltakhanov⁵

¹Institute of Standardization, Qingdao University, Qingdao, Shangdong, China.
¹dongzhao666@qq.com, ORCID: 0000-0003-0488-2787

²Plekhanov Russian University of Economics, Moscow, Russian Federation.
²sorehov@mail.ru; ORCID: 0000-0002-7386-8244

³Plekhanov Russian University of Economics, Moscow, Russian Federation.
³Velikorossov.VV@rea.ru; ORCID: 0000-0001-5845-4820

^{4*}VTB Bank, Moscow, Russian Federation.
^{4*}rglazov@mail.ru; ORCID: 0000-0001-6098-6244

⁵Plekhanov Russian University of Economics, Moscow, Russian Federation.
⁵Soltakhanov.AU@rea.ru; ORCID ID: 0000-0002-8683-8423

Abstract

This article examines the importance of managing the costs of modern corporate structures at a strategic level, in the context of the specific crisis caused by the COVID-19 coronavirus pandemic. The strategic cost management system is considered as a complex tool for improving the efficiency of the corporate structure. We made the analysis of this system from three positions: the concept of the value chain, the concept of strategic positioning, the concept of factor analysis. We introduced a new notion of “business quality” which is applicable to modern corporate structures at the strategic level. The notion is characterized by two main approaches: from the point of view of internal mechanisms of corporate governance (an objective approach based on obtaining comprehensive information) and from the point of view of external mechanisms (a subjective approach based on the attitude of external stakeholders to the value of corporate securities).

Key-words: Corporation, Corporate Governance, Strategic Cost Management System, Business Quality, Economic Crisis, COVID-19 Pandemic.

The Summary Statement of Contribution

The scientific value of the article is in the expansion of the conceptual and categorical apparatus of the theory of corporate governance with the new concept of “corporate business quality”, the

development of management theory by identifying and concretizing the relationship between the system of strategic cost management and the corporate business quality. The practical significance of this article lies in the developed recommendations for the formalization of the strategic cost management system within the framework of corporate governance mechanisms, the formation of the key performance system indicators and monitoring the achievement of these indicators at different levels of corporate governance. This should be done in advance and should apply the lessons learned from managing costs in the context of the COVID-19 pandemic.

1. Introduction

The Russian economy was in an extremely difficult condition in March-April 2020, and, apparently, it will be in this condition for a year and a half. The penetration of the coronavirus COVID-19 into the country forced the Russian authorities to take tough measures to prevent the spread of the pandemic. The business of the majority of industries and sub-sectors was suspended or transferred to a distant mode, citizens were subjected to forced self-isolation, the activities of state structures were minimized. The mid-term forecast of the Bank of Russia, published on April 24, 2020, predicts a possible drop in the Russia's GDP by 6%, curtailment of spending for private consumption by 2.6% (by 3.6% for households), gross fixed capital formation may fall by 9.6 % (Lukoil, 2020). An additional negative factor is the fall in oil prices and the lack of progress in cooperation with Western countries, maintaining the sanctions politics. These problems had a significant impact on Russian corporations, forcing corporate management to focus on finding reserves for increasing business stability in the context of the actual economic and social crisis.

The economic crisis caused by the COVID-19 pandemic is characterized by a drop in corporate revenues, an increase in debit debts, and a crisis of non-payments. One of the most obvious ways for adapting the business to this crisis is to reduce costs. However, the current realities differ significantly from the previous crises and require from Russian corporations a deeper understanding of the cost management mechanisms, since the search for the most effective cost-quality combination comes to the fore. This, in turn, requires the development of a separate cost management system, which, of course, is of a strategic nature and must be implemented into the corporate governance system.

It should be noted that corporate governance encompasses the entire complex of relationships between the management of a corporation, its board of directors, shareholders, creditors, government authorities, society and other interested parties. The modern theory of corporate governance says that the mechanisms of corporate governance actively influence society, involve it in the problems of the

corporate business. Having a well-functioning corporate governance system in a corporation is the basis for effective cost management and improving business quality. Accordingly, we can consider the corporate costs management system at the strategic level as one of the subsystems of the corporate governance system, which quality directly affects the quality of the corporate business and its continuity of operations during the pandemic.

2. Materials and Methods

We used such research methods, as analysis, synthesis, deduction, induction, classification, systematization, methods of vertical and horizontal analysis, coefficients analysis, statistical assessment of the strength of relationship, method of the expert assessments.

3. Results

We substantiated the introduction of the concept “business quality” into the scientific context, which means the level of how the corporation meets the expectations of stakeholders within the framework of the corporate governance mechanisms.

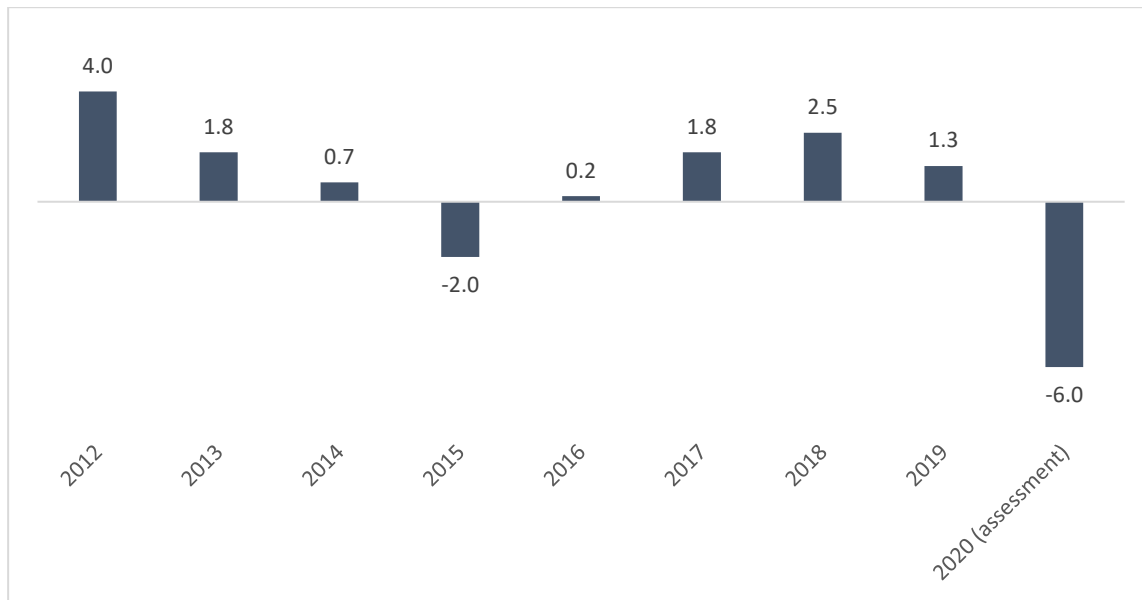
The systematization of approaches within the system of strategic cost management was carried out, presenting the concepts of the value chain, the strategic positioning, and factor analysis.

The article reveals the impact of the strategic cost management system on the quality of business in terms of internal standards and the key performance indicators of management. We proved that the strategic cost management system does not affect the quality of the business in relation to the external stakeholders.

4. Discussion

The impact of the extremely unfavorable external and internal economic and social environment caused by the COVID-19 pandemic is causing serious damage to the Russian economy. The Russian GDP is falling, the disposable income of the population is falling, and unemployment is growing. General sentiments and expectations of both consumers and representatives of all business segments are in the negative zone. Economic actors assess the prospect of overcoming the crisis as very distant.

Figure 1 - Indexes of the Physical Volume of the RF GDP



In percent (%) to the previous year (The World Bank Data, 2020)

In these conditions, corporations should pay special attention to finding the most effective corporate governance tools, for example, the strategic cost management system. Strategic cost management has an impact on all economic indicators of the corporate structure, showing the management capabilities in terms of maintaining the sustainability of the business during the pandemic. Taking into account the involvement of corporate governance entities in the strategic cost management system, we can definitely assume that building an effective cost management system is necessary to increase the stability of corporations in conditions of limited business opportunities or a multiple drop in revenue.

So, the analytical approach to cost management is based on the data that the corporate management structure receives from the management accounting system. Scientists note that a prerequisite for the high-quality functioning of the corporate accounting system is its high adaptability, achieved through the development and implementation of corporate data warehouses, the use of OLAP technology and display pieces, distribution of computing power and building a chain of back-up servers to ensure data safety (Sharma, 2020). It should be noted that corporate accounting systems must ensure cost accounting without errors, effective management of business processes, adjustments to operational and administrative expenses, operational assessment of the financial results of the corporation, especially in the context of the transfer of employees to remote work, the transfer of most of the business to online form, the need to control the restrictions established by the authorities and the complication of corporate relations.

Building a strategic cost management subsystem in the corporate governance system implies not only reliance on the above-mentioned high-tech solutions, but also a change in the approach to costs. Costs are beginning to be considered not only in the context of management accounting, but also as a tool to ensure the tactical survival of the corporation and increase its strategic stability.

When the corporation's management switches to a strategic cost management system, it recognizes that the cost of production and the value of the business is the result of the interaction of many factors that determine the fluctuations of costs (Blocher et al., 2015; He et al., 2020; Mallin, 2016). Consideration of strategic cost management as a subsystem of corporate governance in the scientific literature follows from three main concepts:

- The concept of the value chain;
- The concept of strategic positioning;
- The concept of factor analysis.

First formulated by M. Porter, the concept of "value chain" is a congruent set of business areas that form integral value for a corporation, from sources of resources to finished products and their after-sales services (Porter, 1998; Robben & Probert, 2015). In the context of the value chain concept, strategic cost management does not focus on internal processes, but goes beyond the individual business. Corporation manages costs in order to achieve corporate goals, taking into account the processes outside the corporation. Thus, here we can talk about the actual merger of corporate governance mechanisms and strategic cost management mechanisms, since they involve all stakeholders.

Considering strategic cost management, taking into account the choice of a competitive strategy, we move on to the next concept - strategic positioning. Based on the provisions of M. Porter's theory, a corporation can compete either through leadership in terms of costs, or by offering products of higher quality than the competitors do (differentiation) (Porter, 1998; Robben & Probert, 2015). These strategic competitive approaches imply different approaches to cost management:

- If a corporation strives to be a leader in terms of costs, then its management will focus on careful accounting of all costs and the development of effective tools for their optimization.
- If a corporation competes through product differentiation, then the cost management will focus on marketing, development of new product characteristics, etc.

The concept of factor analysis postulates that value is the result of the interaction of many factors (Gorsuch, 2014; Pantano et al., 2020). Therefore, the strategic cost management system should be aimed at determining the main factors in each specific situation, assessing their impact on costs and

making appropriate management decisions. Within the framework of this concept, all factors can be divided into two large groups:

- Structural factors (the amount of investments required for the production of goods; the level and reliability of the corporation's vertical integration; accumulated experience in terms of business processes and procedures; the efficiency of the used technologies; the completeness of the product line).
- Functional factors (involvement of personnel in continuous improvement processes, implementation of kaizen, etc.; application of the TQM concept; combination of production capacities; organization of the cost chain).

Management must take into account the following aspects to conduct a qualitative analysis of the factors that determine the costs of the enterprise:

- The costs variation of a corporation is often not determined by the size of production;
- One of the most important areas of the strategic costs analysis in the corporate structure is to determine their relationship with competitive advantages;
- The strategic position of the company in the market is situational, therefore, the study of costs should be based on a situational approach;
- Strategic cost management involves the use of various scientific tools, which helps to make more balanced and objective management decisions.

So, strategic cost management is directly related to corporate governance and the quality of the corporation's business processes. Involving all stakeholders in strategic cost management in the context of the coronavirus pandemic requires expanding the traditional relationship between costs and quality of products or provided services. In our opinion, in relation to a corporation, it is necessary to introduce into scientific studies the category of "business quality", which will indicate the degree of the company's compliance with the demands of society, state, investors and other interested parties. And if the products produced by the corporate structure through the category "quality" give an idea of the compliance of the consumers' expectations with the production standards, then the category "business quality" is an integral characteristic of the entire corporate governance system. In the context of the economic crisis, the use of integral characteristics of corporate governance systems is one of the most relevant approaches to ensure adequate analysis and assessment of the corporation's stability.

The corporation's market capitalization is an integral quantitative characteristic of business quality. This is because of the fact that only the market price of a share includes the impact of many factors, including the basis factor of the coronavirus COVID-19, and is an objective indicator of the attitude towards the corporation on the part of all stakeholders. Market capitalization is calculated as

the product of the market value of one share in a corporation by their number. At a theoretical level, the relationship between business quality and strategic cost management is obvious. The more efficiently the corporation's management administers costs, the more sympathetic the stakeholders are to the company and the higher the corporation's capitalization is.

$$V_{corp} = P_e \times Q_e \quad (1)$$

where V_{corp} – the corporation's market capitalization;

P_e – market price per share;

Q_e – number of the corporation's shares in circulation.

Maintaining or insignificant decrease in relation to the leading market capitalization indices means for corporation a positive assessment by stakeholders of the sustainability of the corporate governance system during pandemic. The corporation receives a "credit of trust" in the form of the investors' funds in its securities in anticipation of the situation being rectified and receiving future income from a competitive business. The difference between product quality and business quality is manifested in a number of important strategic points presented in Table 1.

Table 1 - Differences between Product Quality and Business Quality

No	Parameter	Product quality	Business quality
1	Essence of the definition (corresponds to what)	Standards, the consumers' expectations	The interested parties' expectations
2	Main subjects of assessment	The structure of the corporation's quality control, consumers, regulatory authorities	All interested parties
3	Valuation horizon	Operative	Strategic
4	Assessment character	Utility maximization from consumer	Utility maximization from investments
5	Key costs indicator	Sales volume	Capitalization
6	Key driver of the influence	Market uptake	Share (investment) price
7	Linkage to productive processes	High	Low

However, the hypothesis should be justified in practice and there are several questions to answer. How strategic cost management determines the quality of the business? Is the business quality the detached from reality desire of the corporation during the pandemic, that would help to survive the drop in revenue and the crisis in payments? To the questions, it is necessary to collect statistics on the integral indicators characterizing both scientific categories, and compare the variation of these indicators.

The CTI: Cost-to-Income indicator will be an exhaustive characteristic of the corporate strategic cost management system effectiveness. We calculate this indicator as the ratio of gross operating expenses to operating income (revenue) (Orekhov, 2019):

$$CTI = \frac{OPEX}{R} \quad (2)$$

where OPEX – the corporation’s operating expenses;

R – the corporation’s revenue.

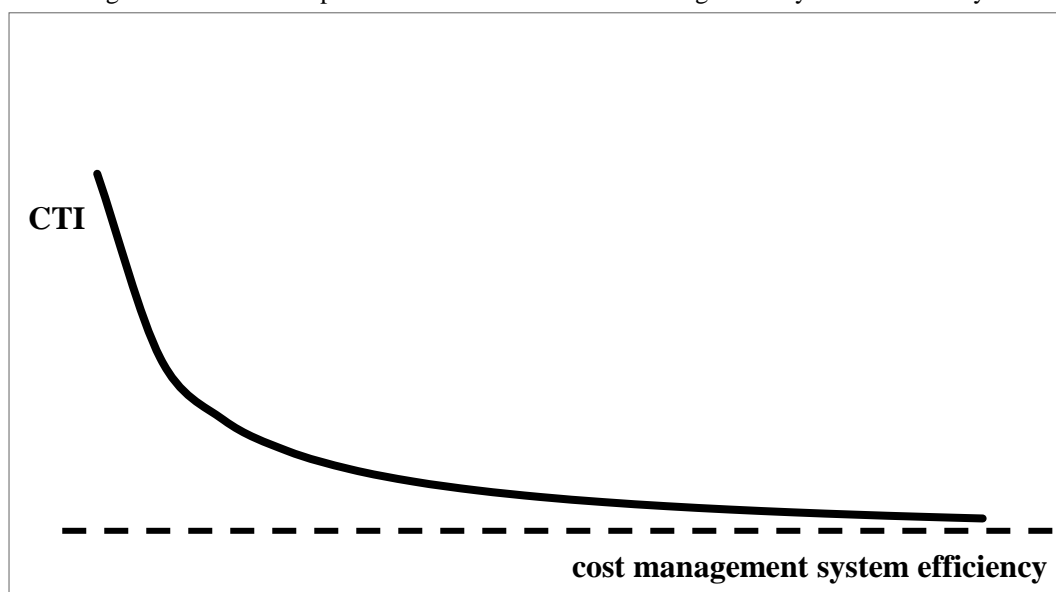
The CTI indicator characterizes the share of costs in one ruble of revenue. It is an additional opposite indicator of the profitability for operating activities, they compose 1 in the sum. The calculation of CTI in terms of operating profitability is shown in formula (3).

$$CTI = 1 - \frac{Pr}{R} \quad (3)$$

where Pr – operating profit.

The natural tendency of corporate management is to adjust corporate governance mechanisms so that the CTI indicator constantly decreases, which will increase business resilience during pandemic. However, a decrease in CTI is only possible to a certain level, below which it cannot fall. This is the level of self-reproduction of the corporate governance system and a certain output of the corporation’s products with the optimal operation of all business processes. This level is an unattainable ideal.

Figure 2 - Form of Dependence of CTI on the Cost Management Systems Efficiency¹



¹Offered by the authors

Let us put forward a hypothesis about the presence of an inverse relationship between the CTI indicator, which characterizes the integral effectiveness of the strategic cost management system, and capitalization, which characterizes the business quality. To test our hypothesis, let us observe the two largest corporations in our country, the state-owned PJSC Gazprom and the private PJSC LUKOIL. These corporations show maximum openness to investors, their securities are traded on stock exchanges, and corporate governance mechanisms are transparent.

The annual reports of selected corporations highlight the specifics of strategic cost and investment management. The Boards of Directors from PJSC Gazprom and PJSC LUKOIL have independent directors who ensure control over cost management through a system of powers and committees (Table 2).

Table 2 - System of Strategic Cost Management in PJSC Gazprom and PJSC LUKOIL

Characteristics of the strategic cost management system	PJSC Gazprom (Rothaermel, 2016)	PJSC LUKOIL (Stiglbauer et al., 2012)
Independent directors, people	3	4
Share of independent directors in the board of directors, %	27%	36%
Overall cost management	Audit Commission at the General Meeting of Shareholders,	Audit Committee under the Board of Directors
	Audit Committee under the Board of Directors	
Private cost management	Internal Audit Department,	Human Resources and Remuneration Committee
	Appointment and Remuneration Commission	

Table 3 - Selected Indicators of the PJSC Gazprom Financial Statements

Year	PJSC Gazprom			
	Revenue,	OPEX,	Capitalization,	CTI
	mln. RUB	mln. RUB	mln. RUB	
2010	3 661 699	2 341 685	4 581 000	63.95%
2011	4 735 822	2 907 021	4 079 000	61.38%
2012	5 002 902	3 428 321	3 390 000	68.53%
2013	5 247 300	3 603 425	3 295 000	68.67%
2014	5 589 811	3 943 669	3 062 000	70.55%
2015	6 073 318	4 635 502	3 222 000	76.33%
2016	6 111 051	5 244 983	3 659 000	85.83%
2017	6 546 143	5 714 090	3 089 000	87.29%
2018	8 224 177	6 181 191	3 634 000	75.16%
2019	7 659 623	6 387 071	6 070 000	83.39%

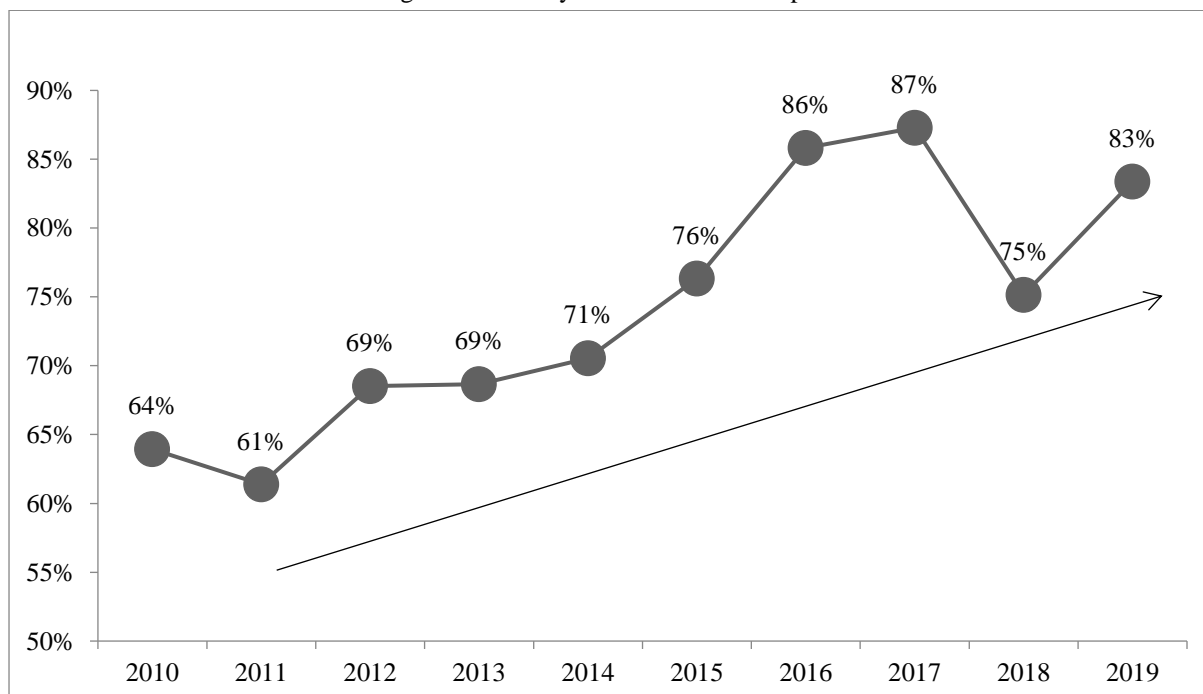
(Orekhov & Novoselov, 2012)

It should be noted that the structure of the corporate governance system in PJSC Gazprom provides tighter control over costs than in PJSC LUKOIL. On the other hand, the share of independent directors in the PJSC LUKOIL board of directors is greater than in PJSC Gazprom, which gives the first-mentioned corporate structure greater independence for assessments by the corporate management.

The data on PJSC Gazprom, collected from the official financial statements, are presented in Table 3. The depth of the data represents the last 10 years, which allows us to draw generally relevant conclusions about the presence or absence of the relationship between the CTI indicator and the capitalization of the corporate structures. The CTI is calculated using formula (2).

As follows from Table 3, PJSC Gazprom almost constantly increased the share of expenses in revenue, reducing its operating profit in the period 2010-2019. In 2018, there was a decrease in the indicator, but in 2019 it again showed significant growth. The average absolute increase in the CTI indicator, calculated for the studied period, amounted to 2.2 points over the year, the downward trend in the effectiveness of the strategic cost management system is almost linear (Figure 3).

Figure 3 - CTI Dynamics of PJSC Gazprom



Let's calculate the Pearson correlation coefficient, which shows the closeness degree of the relationship between the two indicators, in our case, between CTI and the capitalization of PJSC Gazprom. Pearson's correlation coefficient is 6%, which indicates that there is no relationship between

these indicators. Thus, our hypothesis that the effectiveness of the strategic cost management system and the quality of the business, expressed in capitalization, are inversely related, was not confirmed in this case.

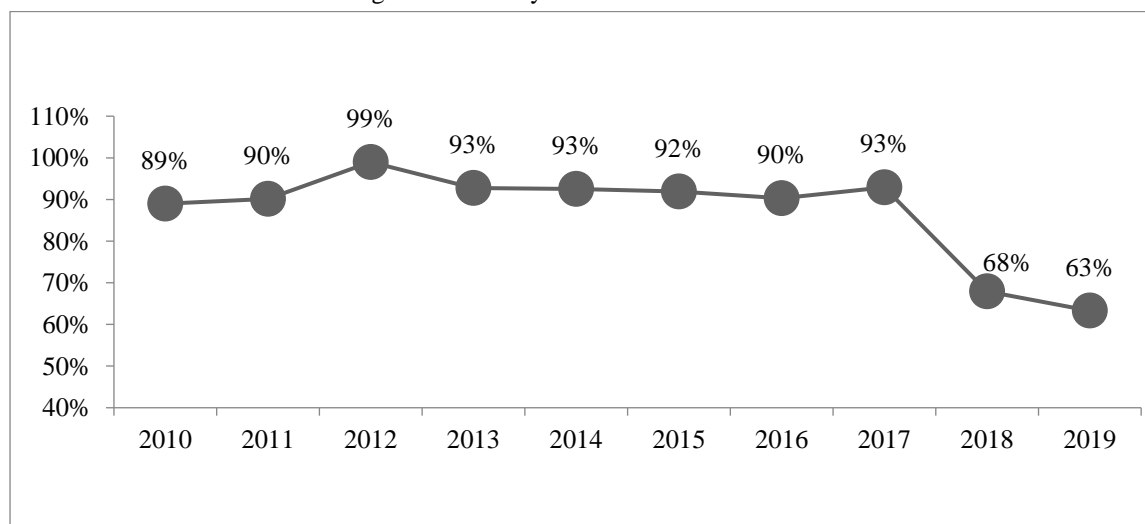
Let us further check our hypothesis using the example of PJSC LUKOIL. The data required for the calculation are summarized in Table 4.

Table 4 - Selected Indicators of the PJSC LUKOIL Financial Statements (Gazprom, 2017)

Year	PJSC LUKOIL			
	Revenue, mln. RUB	OPEX, mln. RUB	Capitalization, mln. RUB	CTI
2010	3 335 502	2 968 983	1 487 000	89.01%
2011	3 927 974	3 541 348	1 455 000	90.16%
2012	4 324 043	4 280 327	1 695 000	98.99%
2013	4 512 319	4 185 440	1 740 000	92.76%
2014	5 504 856	5 092 522	1 893 000	92.51%
2015	5 749 050	5 283 321	1 995 000	91.90%
2016	5 227 045	4 720 529	2 934 000	90.31%
2017	5 936 705	5 517 562	2 836 000	92.94%
2018	8 035 889	5 461 297	4 250 000	67.96%
2019	7 841 246	4 962 955	5 247 000	63.29%

As we can see, there is no linear growth in the CTI indicator of PJSC LUKOIL, as we saw in PJSC Gazprom. The sharp decline in cost management efficiency that occurred in 2012 gave way to an improvement trend until 2016. Then the share of expenses in revenue increased again and in 2017 amounted to 93%.

Figure 4 - CTI Dynamics of PJSC LUKOIL



The Pearson's correlation coefficient, which characterizes the relationship between CTI and capitalization, calculated from the data in Table 4, was 89%. This indicates a high relationship between CTI and the capitalization of PJSC LUKOIL. The effectiveness of the strategic cost management system significantly affects the market value of the corporate structure.

Thus, testing the hypothesis for the presence of a feedback between the CTI indicator and the corporation's capitalization at two corporate structures showed mixed results. The cost management system does not affect capitalization in PJSC Gazprom, while in PJSC LUKOIL this effect is obvious. Based on the results obtained in two examples, we cannot assume that the effectiveness of the strategic cost management system does not affect the quality of the business. This is due to the fact that the concept of "business quality" is very capacious and largely subjective. Stakeholders can currently positively assess the decline in the effectiveness of strategic cost management, expecting that the corporation will recover from the effects of the pandemic and will generate high revenues in the future. Moreover, we carried out the assessment on data up to 2020, and the approach to consideration of cost management this year by investors and lenders, taking into account the crisis, may be significantly changed.

On the other hand, an external assessment of the strategic cost management system in the current crisis cannot be sufficiently objective. Stakeholders that are external to the corporate structure pay attention to the dividend policy in a pandemic, speculative aspects of securities and the level of state support for the corporation, etc. An internal assessment of the strategic cost management system, on the contrary, is more objective, so that positive operational result is laid down in the KPI of top management, therefore, both control and cost management in this focus are tied to the business quality in terms of internal corporate indicators of management reporting.

The above conclusion is confirmed in a survey made by ten experts, top managers of Russian corporations. It was carried out by us in March 2020 (Table 5). According to the data obtained from experts, the strategic cost management system is formalized by the internal regulations of the corporation in the form of certain business processes and procedures in 90% of cases. Also, in 90% of cases, if the strategic cost management system is formalized, there is an internal assessment system in the form of key performance indicators of divisions and/or specific corporation managers. In the overwhelming majority of cases, there is no external assessment of the strategic cost management system effectiveness.

Table 5 - Results of the Expert Survey²

Expert No.	Availability of a formalized system for strategic cost management	Internal assessment of system performance	External assessment of system performance	Scoring assessment for the impact of the system on the business quality	
				Quality as an internal category (achievement of corporate KPI)	Quality as an external category (share value)
E1	Yes	management KPI	Absent	4	2
E2	Yes	management KPI	Absent	4	1
E3	Yes	management KPI	Absent	3	2
E4	No	Absent	Capitalization gain	4	2
E5	Yes	management KPI	Absent	3	3
E6	Yes	management KPI	Absent	4	3
E7	Yes	management KPI	Absent	4	2
E8	Yes	management KPI	Absent	3	3
E9	Yes	Absent	Absent	3	2
E10	Yes	management KPI	Absent	4	3

Further, the experts were interviewed to assess the degree of the corporate cost management system impact on the quality of business in the context of the coronavirus pandemic. Number 1 meant no influence within the assessment and 5 - maximum influence. Let's calculate the average score for each grade column:

- On average, according to experts, the system of strategic cost management affects quite strongly the quality as an internal category (3.6 points).
- On average, based on expert assessments, the strategic cost management system has little effect on quality as an external category (2.3 points).

Our results show that, first of all, the system of strategic cost management in the context of the crisis caused by the COVID-19 pandemic is aimed at the business quality in terms of internal corporate communications.

5. Conclusions

Summing up the results of the study, we can state that in the context of the COVID-19 pandemic, corporate structures are obliged to improve the business quality, which is an integral indicator of the corporation's work stability at the background of falling revenues, increasing uncertainty, and a crisis of non-payments. Unlike product quality, business quality does not reveal

²The survey was conducted and systematized by the author in March 2020.

product potential (demand, sales, customer satisfaction), but the potential of the corporate governance system in a specific crisis environment.

The business quality has two components that make it possible to give a comprehensive description based on the criterion of attitude to the mechanisms of corporate governance. First is that internal mechanisms of corporate governance form an objective approach to the business quality, expressed in the corporation's management KPI. Second is that external mechanisms of corporate governance form a subjective approach to the business quality, manifested in the volatility of securities and the capitalization dynamics of the corporate structure.

The strategic cost management system is an integral part of the corporate governance mechanisms of every modern corporate structure, which requires constant attention from management, especially in the current context of the COVID-19 pandemic. The strategic cost management system affects the business quality, but this impact is manifested mainly in the framework of internal assessments and criteria. External mechanisms of corporate governance are subjective and do not react in a relevant way to the effectiveness of the corporate strategic cost management system.

In order to improve the corporation's business quality, develop strategic cost management system, it is imperative to develop internal regulatory documents that establish KPIs for managers and departments, to form and maintain internal corporate mechanisms of cost control at the level of the owners, the board of directors and operational management. Moreover, as the practice during the current coronavirus crisis shows, it is necessary to carry out the above-mentioned actions in advance and preview several scenarios of the crisis development.

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Declaration of Interest

Authors declare no conflict of interests.

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