

Corporate governance in European transition economies: Emerging models

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Abstract. The purpose of this paper is to contribute to the debate on corporate governance models in European transition economies. The paper consists of four parts. After a historic overview of the evolution of corporate governance, the introduction presents various understandings of the corporate governance function and describes current issues in corporate governance. Part two deals with governance systems in the (mainly domestically) privatized former state-owned companies in Central European transition countries, with the main types of company ownership structures, relationships between governing and management functions, and deficiencies in existing governance systems. Part three is dedicated to the analysis of factors that determine the efficiency of the relationship between the corporate governance and management functions in Central European transition economies. It deals with the issue of *why the German (continental European) governance model is usually the preferred choice and why the chosen models underperform*. In the conclusion the author offers his suggestions on how the Central European transition countries should improve their corporate governance in the future.

Key words: Corporate governance, role of executive managers in companies, governance models, Central European transition economies.

1. Introduction

The issue of corporate governance has been gaining importance in the developed market economies as well as in the transition economies. The basic reasons for this trend are the same, but the socioeconomic environments vary and therefore the analytical issues seem to have quite different weights in different groups of countries.

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These issues have attracted much research interest in recent years, more in developed countries than in transition countries. This paper contributes to these research efforts. Its purpose is to identify the main characteristics of the corporate governance models and practices in European transition countries as well as to analyze them on a comparative basis and to suggest directions for their further development. This paper consists of four main parts. The first deals with the historic development and essence of the corporate governance function. The second analyzes governance systems in the (mainly domestically) privatized former state-owned companies in Central European transition countries. The third part deals with the factors that determine the efficiency of the relationship between the corporate governance and management functions in the transition environment. The author's main suggestions on how to further develop corporate governance in Central European countries are given in the conclusion.

Enterprises appeared in the history of mankind as small economic units governed by individual owners. Their effectiveness and efficiency depended on efficient behavior – that is, economic decision-making and implementation of decisions. Economic efficiency forced enterprises to grow and to attain such sizes that individual owners were no longer able to govern individual enterprises by themselves. The decision-making process became too complex for them. Owners were forced to employ professional executives called managers to assist in managing their enterprises (Rozman, 2000). The previous unified governance function was divided into two organizational functions: governance, mostly making decisions to protect owners' interests, and management, coordinating business activities in the most efficient way in order to attain the objectives and goals set by governance. The professionals that took over the management function became agents of the enterprise's owner. This development opened the possibility that managers might not act in the best interest of an owner – a well-known agent problem, as we interpret it nowadays. The issue of how much autonomy managers should have was born.

Further development required that an enterprise employ more capital than an individual owner was able to invest, which produced a pooling of capital owned by multiple owners. The governance function was no longer carried out by a sole individual, but by multiple owners. Enterprises became partnerships in this way, and later corporations with dispersed ownership. This development contributed to the evolution of a corporate governance function that ceased to be a simple relationship between an enterprise's owner and his managers. It became a complex set of relationships between owners on the one hand and a set of relationships of owners towards corporate managers. The stated relationships can be established in many ways; therefore many corporate governing models are, at least theoretically, possible.

Historically, two main types of relationships have been developed within the corporate governing function and between the governing function and the management function. These are known as the Anglo-American and German (continental European) models. Both of these (conceptual) models somewhat differently solve the problem of socioeconomic power allocation, the problem of the efficiency of decision-making, and finally the problem of governance and management function conceptualization.

Corporations became progressively larger and more complex. Both small and large share-

holders – such as insurance companies, pension funds, and other funds – delegated progressively more authority to executive managers. Such developments enabled managers to concentrate decision-making power in their hands, and even to disregard corporate owners' interests to a significant extent.

The theory of corporate governance is not well developed. There is a multiplicity of interpretations of the relevant phenomena (Turnbull, 1997). Shleifer and Vishny define governance as the ways in which suppliers of finance to corporations assure themselves of receiving a return on their investment (Shleifer & Vishny, 1996). This definition is not broad enough to include many corporations' shareholders in transition economies. Corporate governance as the system by which companies are directed and controlled (Collin & Cesljas, 2002) is a very general and insufficiently precise description of the phenomenon. It does not emphasize the essential issues linked to solving the conflict of interest between two groups of actors – that is, owners and managers – and the importance of the solution for the efficiency of the company.

Historically, the corporate governance function has evolved as an organizational function (which is determined by the individual socioeconomic system) that is the source of all authority in the corporation, which develops dynamically in the process of determining objectives, goals, and policy, and making other important decisions, and which has to preserve and to develop the interests of the owners (Lipovec, 1987).

The governance function has not carried out its appropriate role in the developed corporate world in the last 30 years (MacAvoy & Millstein, 2003). An increasing number of individual owners, an increasing share of institutional owners, the decreasing power of individual investors, and the growing role of multinational corporations, strategic alliances, networks, virtual organizations, and enterprise clusters have contributed to this development. The stories of Enron, World Com, Vivendi, Parmalat and many others vividly illustrate this problem.

Privatized corporations in European transition countries are also confronted with the weaknesses of their governance systems. State and state-administered institutions, private investment funds, and internal owners dominate in many companies, and external investors do not have enough voting power to control companies (Gregoric, Prašnikar & Ribnikar, 2000). The underdeveloped capital markets do not provide the needed inflow of fresh capital into corporations, nor does their low liquidity level offer indirect owner control over the behavior of management boards.

Historically, throughout its development the corporation has had one basic objective: to carry out business activities with a view toward enhancing corporate profit and shareholders' gain (MacAvoy & Millstein, 2003). A recent development is the view that other stakeholders should also participate in governance and that they should make major strategic decisions together with owners as well as supervise managerial decisions and participate in decisions on profit sharing. The continental European environment at least partly accepted such a position sooner than the Anglo-American part of the world. The "stakeholder concept" of the corporate governance function is gaining support because of various reasons and contemporary developments.

2. Governance systems in the privatized former state-owned companies in Central European transition countries

The Central European transition countries have privatized most of their former state-owned companies. The wide range of privatization methods applied produced different types of company ownership structures. In addition to ownership structures, political, cultural, and other determinants contribute to establishing distinct corporate governing systems and relationships between the governance and management function in corporations. The relevant solutions are not without weaknesses. All three sets of issues deserve analysis.

2.1. Main types of corporation ownership structures in Central European transition economies

Governments have created very different approaches to privatization. Sales methods with preferential treatment of privileged buyers were the dominant approach in Croatia (Benic, 2000). The Czech Republic used voucher privatization as the most important approach. East German privatization was based mostly on the sales method (Brezinski, 2001; Balaton, 2001). Hungary sold over 70 percent of privatized property to foreigners (Bornstein, 1997), but domestic small investors were able to buy shares of smaller state-owned companies using the MEBO approach. The Polish privatization approach consisted of two main privatization methods: capital privatization (the sale of companies' shares to private investors) and "liquidation" privatization (MEBOs in reality; Bornstein, 1997). Slovakia used voucher privatization at first and a direct sales method mostly later (Djankov & Pohl, 1998). Slovenia applied a gradualist privatization approach based predominantly on mass-privatization approaches.

With the exception of Croatia, Germany, and Hungary, the privatization approaches above produced very dispersed ownership structures in Central European transition countries. Many small private owners appeared that received ownership without paying the real market price for their shares. In the majority of cases they did not even feel like real owners. It is therefore expected that the process of ownership concentration would appear in those environments – and this is what actually happened.

In the second half of the 1990s ownership concentration increased for all types of owners except banks in the Czech Republic (Kocenda, 2002). A relatively small group of well-informed insiders was very well aware of the loopholes in the legislation. They used these loopholes at the expense of those that were not participating in their unethical behavior (Pavlik, 2001). In a short period of time they concentrated a huge amount of capital in their hands.

There was also an ongoing ownership transfer to outsiders and a steady decline in employee shareholding in Poland in the second half of the 1990s (Kozarzewski, 2001). The concentration process was rather slow at first because most privatized companies inherited a kind of inertia in internal relationships supported by the top managers that had enough power without having a relevant share in the company's property. Later managers became aware of the links between authority and ownership, and they started to concentrate ownership in their hands. In this way the elites be-

came established in companies and at the same time two trends are continuing: a decrease in the number of shares of non-managerial employees and an increase in those of outside investors.

At the end of the formal privatization process, 76.7 percent of companies had a majority of internal owners and less than a quarter of privatized companies with predominantly external owners held 56.3 percent of privatized former social (state) capital in Slovenia (Pucko & Edwards, 1999). Later, Slovenia also experienced a rather intense ownership concentration process from the mid 1990s onwards.¹ The most important owners in Slovenia have become state-administered funds (the pension and restitution funds) and private investment companies that are now undergoing transformation in their financial holdings. Top managers control companies that have a majority of internal owners. Many thousands of small shareholders in commercial companies and in private investment companies are powerless.

In spite of the growth of ownership concentration in Central European transition economies, ownership dispersion is still large as far as large business is concerned. This situation enables the top managers to hold excess power in their hands. They are not forced to pay proper attention to their companies' shareholders. The absence of a strong legal mechanism that would effectively protect the rights of minority shareholders increases the top managers' power. On the other hand, such companies' ownership structure does not assure the inflow of fresh capital into companies.

2.2. Main types of relationships between governing and management functions in companies in Central European transition economies

Two extreme views prevail today regarding the corporate governance system (Kuznetsov & Kuznetsov, 2003). The new neoclassical school considers shareholders to be the only group that governs a company. The corporate social responsibility school requires looking beyond the classical concept of shareholders' wealth by suggesting the stakeholder approach. Many authors prefer to deal with what are known as "outsider" (US, UK) and "insider" (Germany, Japan, other parts of continental Europe) systems of corporate governance (Gregoric, Prašnikar & Ribnikar, 2000). Dispersed ownership and liquid capital markets as well as strong legal protection for investors are an important assumption of the outsider corporate governance system. The strong legal protection of creditors, highly concentrated ownership, and relatively illiquid capital markets, as well as an approach favoring stakeholders, seems to be the basic assumption of the insider system.

Legal regulations can allow or forbid the concentration of voting rights in various countries. It is not permitted everywhere for shareholders to concentrate their voting rights without concentrating ownership. For example, Germany and the Netherlands allow this. Banks and other finan-

¹ An analysis by Gregoric, Prašnikar and Ribnikar (2000), of voting rights of largest shareholders in 136 selected Slovenian companies listed on the Ljubljana Stock Exchange shows that in half of all companies the largest shareholder held an average voting stake of 27.4 percent and that only 5 percent of companies had a shareholder holding 75 percent of the voting rights in 2000 (p. 199). The conclusion of the analysis was that in 95 percent of companies no shareholder could exercise any substantial influence at the Shareholders' Assembly.

cial companies are not allowed to be shareholders in a number of countries. The Anglo-American system does not allow the legal institutionalization of employees' right to share ownership or profit in companies (the right to economic democracy; Zalar, 1998). One can find an autonomous corporation surrounded by markets in the Anglo-American environment on the one hand, and business groups as a typical constellation of corporations, mostly with the financial corporation in the center in continental and northern Europe, on the other hand (Collin & Ceslajs, 2002).

Taking into account all the stated differences, one can better understand the logic and distinctive features of the outsider and insider corporate governance systems that we frequently deal with as the Anglo-American and German governance models (Rozman, 2000). These two models can also be characterized as a one-tier and a two-tier model.

The Anglo-American corporate governing system is based on:

- The organization of a large independent corporation;
- A board of directors that is quite independent regarding its shareholders and stakeholders;
- Corporations situated in environments characterized by strong financial markets and little government intervention;
- A competitive culture;
- A legal system that discourages ownership by banks and other financial organizations.

The model consists of two governing bodies: the shareholders' assembly and the board of directors. Members of the board of directors are insiders and outsiders. The board has two main tasks: 1) supervising business results and 2) supervising strategic decisions.

The German (continental European) model is based on (Collin & Ceslajs, 2002):

- Business group systems that dominate in the economy;
- Weak financial markets;
- Strong government intervention;
- A rather cooperative or authoritarian culture;
- Close connections between corporations and financial organizations.

The model incorporates three governing bodies: 1) the shareholders' assembly, 2) the supervisory board, and 3) the management board. Representatives of employees are also members of the supervisory board. Members of the management board cannot be outsiders. The main tasks of the supervisory board are to hire and fire the management board and to supervise the company's business performance. The law mainly determines the role of the corporate governance function.

European transition countries were able to choose between these two governance models. Central European countries mainly chose a variant of the German model. Russian reformers opted for the Anglo-American model of corporate governance (Kuznetsov & Kuznetsov, 2003). For example, Macedonia's Law on Trade Companies introduced a solution that allows both the one-tier and two-tier model (Drakulevski, 2002). The Commercial Code determined the corporate governing model in Poland. Its main characteristics are derived from the German model. The shareholders' assembly, the supervisory board, and the executive board are characteristic of the two-tier system. Slovenia and Croatia introduced similar systems.

The German model was applied and the still existing wide dispersion of ownership in Central European transition countries has enabled top managers to behave rather independently and to hold major power in their hands. In his research on corporate governance in Poland, Kozarzewski found that the executive board has the greatest influence on decision-making processes, not only in tactical decision-making but in strategic decision-making as well (Kozarzewski, 2001). While ranking the perceived influence of different governing and managerial bodies and groups in Polish companies, he found the executive board president and the executive board as a whole to occupy the first two places (close to one another), followed by the biggest shareholder (with significantly less influence), and then the general assembly and, finally, the supervisory board. The trade unions were the least influential. Very little importance was attached to the role of owners in general as well.

As a rule, owner control over the executive board remains rather weak in companies in transition economies if the company's ownership is dispersed. Lack of experience and inherited relationships from the former state-owned enterprises contribute to the limited efficiency of owners' control. Supervising bodies tend to be weak, overly passive, not knowledgeable and not capable enough. The corporate supervisory board exercises control over the executive bodies of the company according to legal regulations mainly by making decisions regarding the appointment and dismissal of the executive board, by determining the remuneration of the executive board members, and by supervising the company's business performance in general.

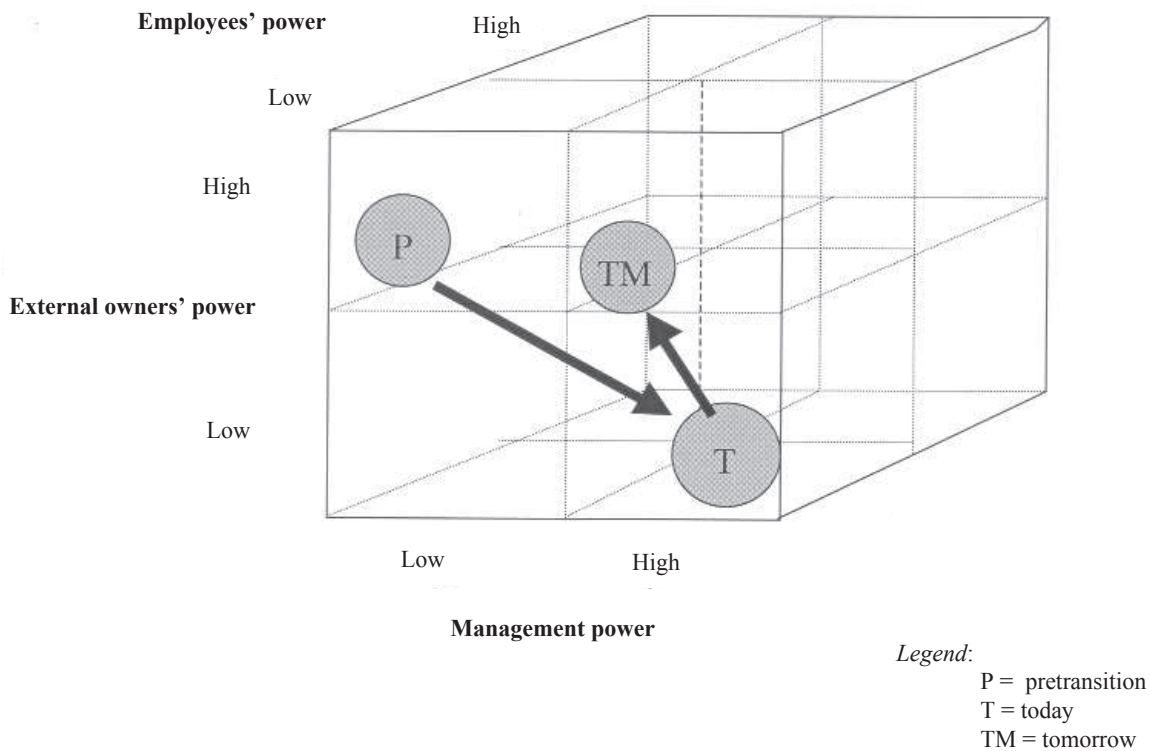
A special trait of the personnel composition of supervisory boards in privatized companies is the very high participation of insiders (49 percent in the Polish case, for example; Kozarzewski, 2001). Among outsiders, managers from other businesses frequently comprised the largest category. The representatives of labor unions are mainly members of the supervisory boards in larger companies, but they do not exercise strong influence over the board's behavior.

The governance power distribution described here is quite typical for large domestically privatized companies nowadays.

In the pre-transition period, governance power was held by external owners (mostly governments). The privatization of large state-owned companies mainly resulted in dispersed ownership of large domestically privatized enterprises, and governance power was transferred to executive managers (slightly more so in companies with a dominant share of internal owners than in those with a dominant share of external owners; see Figure 1). The current tendencies show that the ownership consolidation process now underway will increase the power of external owners in corporate governance. On the other hand, the power of employees in companies will be increased on the long run primarily because of the importance of their knowledge and skills.

Kozarzewski has found certain empirical evidence for the existence of such a trend. His findings relate to the dynamics of the composition of supervisory boards, which shows a trend of increasing the representation of stakeholders in these bodies (Kozarzewski, 2001). This may support this paper's thesis and, more generally, even prove that the German model will become even more fully implemented.

Figure 1. Changing patterns of the governance power distribution in domestically privatized large companies in Central European transition economies



2.3. Deficiencies of the existing governance systems in the Central European transition economies

Regardless of the corporate governance model applied in the country, the responsibilities carried out by the board depend mainly on 1) deficient legal regulations (Kozarzewski, 2001), 2) the dispersion of ownership, 3) directors' attitudes, 4) directors' willingness to take on responsibilities, 5) directors' attention to their duties, 6) directors' ability to assess the corporation's environment, organization, personnel, and political affairs, as well as resulting financial accounting practices (MacAvoy & Millstein, 2003), and 7) directors' remunerations. The lower than expected efficiency of the governance function is due to deficiencies in some or all of these factors.

Loopholes in the legal system enable supervisory boards to avoid exercising their legal obligations and responsibilities to the shareholders. Executive boards tend to exploit situations and primarily look to fulfill their own interests. Dispersed ownership contributes further to this deficiency. In companies with concentrated ownership, the agency problem takes on a new dimension in the sense of

the expropriation of the rights of minority shareholders by large ones (Gregoric, Prašnikar & Ribnikar, 2000). Legal systems have not adequately protected minority shareholders (Pavlik, 2001) and have contributed to a situation in which the legal regulations are much more “liberal” than is usual in developed countries. The Czech manner of capital concentration was extremely unfair in this regard. It has also aroused feelings of injustice, unfairness, and disgust in the Czech population (Pavlik, 2001). The corporate governing systems will have to wait a long time before the great distrust in them is diminished².

Deficiencies in corporate governing structures in the Central European transition economies include:

- Combination of the ownership function with the management function. Very often managers are simultaneously major shareholders in the company;
- Concentration of voting rights in the hands of corporate top managers by using different proxy mechanisms;
- Combination of the hired employee function with the control governing function (an employee being a supervisory board member), which creates a complicated system of subordination in the company;
- Avoidance of using experts for representing ownership interests in the governing bodies.

The Russian experience with the application of the Anglo-American governing model at the beginning (Kuznetsov & Kuznetsov, 2003) should be a serious warning that the corporate governance system chosen has to be in accordance with the environmental circumstances. The Anglo-American model belongs to liberal ideology. It is far less than perfectly suitable for the circumstances that characterize Central European transition economies. There, the key assumptions for the proper functioning of the model are absent. Capital markets are not efficient. The right of free exit for shareholders cannot be easily implemented. The shareholder (especially a minority one) is not really legally protected. For the most part, the maximization of shareholders’ wealth is not a dominant managerial criterion of decision-making. A competitive culture does not prevail, but instead an authoritarian and paternalistic one that promotes looking for solutions along the lines of the stakeholder paradigm. Banks and financial organizations are not excluded from ownership of corporations. Government intervention in the governing function is rather strong.

The relationships between a company’s supervisory board and executive board frequently depend on the old inherited authoritarian and paternalistic approaches (Sysko-Romanczuk & Lozano, 2002). The large share of insiders, especially the managerial staff, holds ownership shares and frequently represents shareholders on the supervisory boards. It is more or less a common legal requirement that a member of the executive board is not allowed to simultaneously be a member of the

² The changes made in the Czech Commercial Code, the Securities Act, and the Auditing Act in 2001, as well as the revised Corporate Governance Code adopted by the Prague Stock Exchange (Mallin, 2004), could contribute to a turnaround in this regard.

supervisory board. In spite of this barrier in the governance bodies, reproduction of elites of former state-owned enterprises still prevails (Kozarzewski, 2001). Therefore, the old technocratic and bureaucratic management behavior cannot be quickly replaced with completely different behavioral manners. The inclination towards rather slow managerial decision-making, a short-term orientation, a relatively high level of inflexibility, strong relationships with local communities, a low degree of managerial mobility, and strong interpersonal ties are firmly rooted in the behavior patterns.

Ideally, the supervisory board's chairman should be an independent director, coming from outside the company. Chairmen should ensure that focused information on key issues reaches the board. They have to create meaningful agendas for board meetings and call for management presentations around strategic issues, not just around current problems and short-term corporate performance. They should be dedicated to their tasks as chairmen, which also demands that they be well remunerated for the job they perform. All these dimensions of the chairman's job are far from being fully implemented. There is therefore much room for improvement in the corporate governance function in the transition environment.

It is also unclear which corporate governing models that determine the efficiency of relationships between the corporate governance and management functions are the most suitable for individual European transition economies. The dilemmas are numerous, but it seems that any solution must be built around realistic basic assumptions, which might or might not exist in a particular country.

3. Factors determining the efficiency of the relationship between the corporate governance and management functions in Central European transition economies

3.1. Why the German governance model is the preferred choice

The Anglo-American governance model evolved from the classical economic postulate: governance is conducted by owners or by their representatives. The governance function has all the power in a company. The purpose of the business is to create a profit. Owners are the sole risk-takers. A profit earned by a company belongs to the company's owners and nobody else (after a tax on profit has been paid). Other company stakeholders do not carry the risk of loss and therefore they are paid according to their productive contributions. Their services are paid in accordance with a contract. The other stakeholders beyond the owners are not eligible to participate in profit sharing. The owners are the only group of residual claimants.

The outsider governance model has been modified during the 20th century. In the last few decades it has been transformed in corporations with dispersed ownership into a model in which the governing and management functions were nearly integrated. Management boards have taken over an inappropriate share of decision-making power and they have ceased to be accountable to companies' owners. This transformation resulted in deformations that are described as a corporate go-

vernance crisis. The new neoclassical school seeks a remedy by stating that it is necessary to return to corporate fundamentals and to make management boards responsible to shareholders' interests again (MacAvoy & Millstein, 2003). The insider governance model is quite impractical as a theoretical model because stakeholders are not a homogenous group and have unclear objectives. Therefore it is impossible to define a distinct criterion for business decision-making on such a basis. The insider model cannot be a substitute for the outsider model.

The continental European (insider) model tends to be built on the assumption that its interest groups should govern a company – that is, its stakeholders. They can assert the appropriate social responsibility for the company. The owners are no longer the only risk-takers and investors in the company. Because of dispersed ownership, they do not take more risk than other stakeholders. Employees invest in the circumstances of the evolving knowledge society by greatly developing certain specific knowledge or skills, which demands that they assume a significant risk – authorizing them to participate in governing their enterprises. The present tendency to increase the variable component of employees' remuneration, which is apparent, requires risk sharing between owners and employees. Companies are becoming the main actors responsible for the destruction of the environment. This fact requires that local communities have a say in a company's governance. Governments play a prominent economic role nowadays. They have a strong responsibility for the well-being of their citizens (more so in some parts of the world). Government intervention in governing systems through installments of rather detailed legal regulations make possible the argument that governments are becoming one of the important corporate stakeholders.

Governments intervene radically not just in companies' behavior regarding environmental protection but in profit sharing practice as well. Its legal regulations define the share of the company's profit that belongs to owners. Profit distribution to owners is regulated and constrained in detail by requirements regarding creating the company's reserves (legally demanded, statutory, and others). The government's intervention in profit distribution is argued by a need to protect debtors and other interest groups (including employees; Slapnicar, 2003).

The adoption of the continental European governance model as the target one was the dominant practice in the Central European transition countries. Its attractiveness is based on its characteristics. It assures a strict separation of governance and management functions in companies (more in theory than in practice). It assures, at least formally, that owners (and, in the case of larger companies, also other stakeholders) control the management board's strategic behavior. It is a more suitable governing system in environments where "external control" in the form of commodity and capital markets is still not sufficiently efficient (Kozarzewski, 2001). It better enables a broader influence of all main stakeholders on company strategic decision-making by having the representatives of not only owners on the supervisory board. Many companies have faced a crisis situation in the Central European transition countries. Maintaining jobs has been a critical social issue. The stakeholder approach to governing somehow seems to produce more socially responsible decisions about the company's future.

Codes that legally regulate the corporate governance systems in individual transition countries prescribe the main relationships between a company's executive board, supervisory board,

and general assembly (or partners' meeting in smaller companies). The executive board is usually defined as the supreme executive authority in joint stock and limited liability companies. It represents the company in all judicial and non-judicial matters. It is the main decision-making body in a company and is constrained only by the authority of other statutory bodies and their competences. The supervisory board has the competency to examine the company's balance sheet, profit and loss statement, and reports from the executive board and the company's auditor, to examine the executive board's proposals regarding the distribution of profit and coverage of losses, to report the results of these examinations to the general assembly, to suspend or fire individual members of the executive board or entire board, to submit proposals to the general assembly on approving financial statements and the executive board's annual report, the company's charter changes, and the sale of the company, to issue bonds or new shares, and to make other similar strategic decisions (Kozarzewski, 2001). The legal system usually allows a supervisory board to broaden the range of the supervisory board's responsibilities through an appropriate provision in the company's statute.

3.2. Why do the selected corporate governance models underperform in the Central European transition countries?

In the beginning of the transition period, there was a typical tendency for a significant number of company executives to be replaced. In Hungary and the former East Germany the majority of these were replaced (Dobak, 2003). At the same time an irreversible generation change had begun, which meant the appearance of younger executives and supervisors. A well-defined class of domestic owners was not established during the first part of the 1990s in the part of Central Europe in transition. New young business leaders have gathered a new range of knowledge and new skills. The entire system of market institutions has been built up. Privatization has taken time. Historical, cultural, and political factors have led to the introduction of worker participation in management in corporate governance systems in some countries (in Slovenia, for example³), which has even produced more complex new demands. All these developments have contributed to the development that new corporate governance models, mainly introduced in these environments by laws, have not produced the optimal results.

The rather dispersed ownership of companies and high shares of insiders as owners in some of these countries (e.g., the Czech Republic, Poland, and Slovenia) created power struggles between external owners, management executives, and employees at companies. The investors or external owners, frequently being private investment companies, acted with the aim of protecting their investments rather than maximizing the value of their companies. Employees as internal owners behaved first of all with the aim of earning salaries that were as high as possible. Management executives attempt-

³ According to the Worker Participation in Management Act (1993) at least one-third, and in companies with over 1,000 employees at least one-half, of Supervisory Board members must be workers' representatives.

ted to protect their managerial positions and to collect as much wealth as possible. Under such circumstances, the corporate governance function was not focused on the long-term effectiveness of companies.

The ownership consolidation process of companies started immediately after the end of the official privatization procedure. In general, it seeks higher company financial efficiency. This is its common characteristic. In other respects, two main stakeholder groups support it: External investors try to consolidate their governing power in a smaller number of companies, and corporate executives try to protect and concentrate their managerial decision-making power either by increasing their ownership stake in companies or by further dispersing the company's ownership, primarily using acquisition strategies. Employees as internal owners are losing their ownership and power in governing their companies.

The corporate governance function will underperform as long as:

- A highly dispersed corporate ownership enables corporate executives to neglect owners' and other stakeholders' interests;
- Internal owners are the dominant owners' group not interested in the long-term future of the company;
- Corporate executives maintain most decision-making power in companies by developing their informal power networks;
- Existing possibilities for exploiting insider information are not radically diminished;
- Insiders are allowed to be members of the supervisory boards;
- Governments and state-administered funds are not withdrawn from the corporate governing structures;
- The weak legal protection of creditors and minority shareholders is not done away with;
- The liquidity of capital markets is not improved.

An improvement in the efficiency of the corporate governing function might also be expected through further development of corporate executives and supervisory board members. The supervisory board members will have to:

- Develop a more responsible attitude to their role;
- Take their supervisory responsibilities very seriously, paying proper attention to their duties;
- Develop abilities to cope with corporate executives in all important regards, including knowledge of accounting skills;
- Provide an efficient remuneration system for themselves that will stimulate them to intensively dedicate themselves to the governance function.

The role of employees in the governance function will be improved if its importance and power is linked primarily to the level of employees' knowledge and skills and not so much their size in a company.

Other stakeholders might have an interest in participating in corporate governance, but it is better to take their interest into account through laws, government regulations, and other legal limitations to avoid making companies a battlefield of diverse political interests.

4. Conclusion

The corporate governance function is contributing to reconsideration everywhere today. A uniform corporate governance model is not appropriate for all countries, not even for all transition countries. Historical, cultural, economic, and political realities strongly influence its suitability. In spite of this, different models certainly have many common characteristics and they deserve to be identified.

The modest accumulated experience with governing practices in the Central European transition countries and their analysis can identify the main directions for the future development of corporate governing models in this part of Europe.

Analysis shows that it is necessary to further develop the stakeholder governance model, which will not deny the central role of owners' interest in corporate governance. On the other hand, owners' interests should not be the only ones that are incorporated into the corporate governing process.

The corporate governance function must begin looking beyond the mere creation of wealth for shareholders. Knowledge-based industries demand highly knowledgeable employees that invest and risk much in providing their expert knowledge. Their remuneration is high enough that they are able to accept variable pay systems linked to corporate financial performance. They are, therefore, the most important group of stakeholders, beyond owners, and are entitled to participate in corporate governance. This does not mean that a workers' self-management system of corporate governance has to be developed on this basis. The dominant power within the corporate governance has to be balanced according to the level of risk that individual stakeholders assume. The investors in companies will still be those that carry the greatest risk for an extended period of time in transition countries because capital is still a very scarce resource in these environments. Moreover, structures of economies still will not be dominated by high-tech industries and thus a large number of highly skilled employees.

Other stakeholder groups do not have the same characteristics. Therefore their interests should direct companies indirectly through government regulations or at least corporate governance codes. The government has a prominent economic role, but it does not mean that it should be represented directly in corporate governance. On the contrary, it should abandon its presence in companies as soon as possible.

Managers are responsible for balancing stakeholders' interests. They will maintain the most powerful role in companies, but in promoting their own interests they must be constrained by the demands for satisfactory benefits created for all other stakeholders. Because they will be primarily responsible to owners and employees, they will be not allowed to disregard their interests.

Different supervisory boards are needed. They should occupy themselves with corporate strategy objectives and strategies, and structure their meetings around these issues. They should require that management inform them about its strategic proposals. They should listen to managers, but question the premises and evidence, approving sound proposals, but also suggesting alternatives when they become convinced that it is needed. Supervisory boards should take their share of responsibility for the company's strategy and its implementation. The supervisory board must therefore evaluate the performance of management. It should employ efficient measures over time to follow and

evaluate corporate strategy implementation. The balanced scorecard is merely one possibility for performing this task. It is not suggested that the supervisory board should not monitor periodic financial statements and management performance reports – however, doing so is not enough. Supervisory boards should establish whether it is necessary to improve the quality of their various decision-making committees, including the strategic planning committee, audit committee, corporate conflicts committee, personnel and remuneration committee, risk management committee, and ethics committee.

Fixing reward schemes for the members of management board is an important task of the supervisory board. Rewards should not be based primarily on fixed salaries, but must be related to extraordinary company performance and not on variables that are not under the management board's control. Supervisory boards must be responsible for hiring and firing the company's management board. Everybody expects the board to carry this out responsibly, while observing high ethical standards.

For developing the corporate governance function along these lines in transition countries, an independent position of the chairman of the corporate supervisory board primarily accountable to (two) stakeholder groups is indispensable. To develop such an independent position it will be necessary to consider the option for chairmen in larger companies (especially if corporate ownership structure is dispersed) to become professionals fully paid by the companies for the demanding jobs that they are expected to do.

Future improvements in the corporate governance function in companies in the Central European transition countries will also be implemented by making all the changes that have already been enumerated in section 3.2, which need not be repeated here.

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Resumo. O objectivo deste artigo é o de contribuir para o debate sobre os modelos de governança corporativa nas economias de transição europeias. O texto compõe-se de quatro partes. Após uma revisão histórica da evolução do tema, a introdução apresenta várias perspectivas sobre a função da governança corporativa, e descreve as matérias em discussão actual sobre o assunto. A segunda parte aborda os sistemas de governança nas companhias privatizadas dos países em transição da Europa Central, nomeadamente as estruturas organizacionais, as relações entre a governação e as funções da gestão, e as deficiências nos sistemas de governança existentes. A terceira parte analisa os factores que determinam a eficiência da relação entre governança corporativa e as funções da gestão nas economias em transição da Europa Central. Trata da questão de saber *porque razão o modelo alemão (Europa Continental) é a escolha preferida e porque é que os modelos escolhidos funcionam abaixo do esperado*. Na conclusão, o autor fornece algumas sugestões sobre como é que as economias em transição na Europa Central podem melhorar a sua governança corporativa no futuro.

Palavras-chave: Governança empresarial, papel dos executivos, modelos de governança, economias de transição na Europa Central.