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CORPORATE GOVERNANCE MECHANISMS EFFECTIVENESS: THE CASE OF TRANSITION COUNTRIES

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Abstract. *Ever since ownership and management were separated, corporate governance emerged as an essential institution of market economy. Based on this statement, several corporate governance mechanisms have been extensively researched. Developed and transition countries, according to the differences that determine the corporate governance model, which refer to the historical and cultural heritage of countries, socio-economic conditions, legal/institutional framework and ownership structure, apply various corporate control mechanisms. Since market institutions are missing in transition countries, and institutional framework is insufficiently developed, these countries must develop appropriate corporate governance model, as well as corporate governance mechanisms. Due to these mentioned features, the research topic is to analyze effectiveness of corporate governance mechanisms in selected transition countries with common socio-economic environment. Special attention is given to the problems of corporate governance mechanisms improvement and possibilities of overcoming them.*

Key words: *transition countries, privatization, corporate governance mechanisms, ownership concentration, board of directors*

INTRODUCTION

The main problem of corporate governance is how to ensure that managers run firms for the benefit of shareholders and therefore prevent the appearance of agency conflicts between owners (principal) and managers (agents). In above mentioned, corporations in developed, market countries are constantly devoted to improving corporate governance mechanisms. The role of corporate governance mechanisms is related to the process of harmonization of interests between owners and managers, as well as the process of effective strategic decision-making. Accordingly, development of appropriate corporate governance mechanisms is a relevant question, both for developed and transition countries, which are facing specific problems of corporate governance that occur as

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consequence of ownership and managerial transformation. Developed and transition countries, according to the differences that determine the corporate governance model, and those are referred to the historical and cultural heritage of countries, socio-economic conditions, legal/institutional framework and ownership structure implement various control mechanisms of managers. Transition countries are faced with numerous problems, disabling the application of corporate governance mechanisms of developed economies: undefined property rights, expropriation of the rights of minority shareholders, violation of contracts, underdeveloped stock markets, inconsistent and/or inefficient application of the legislation.

These problems arise from the process of transition towards market economy, especially as a result of the privatization and changes in ownership structure. However, it is not supported by an effective change in the formal institutional framework and the adoption of a set of laws concerning the following: governance of the companies, property rights, economic transactions, bankruptcy of the firms. Also, the development of the stock markets is related to the privatization and represents the means of property redistribution. Therefore, a common characteristic of transition countries is undeveloped market, with low level of liquidity, which results in inability of applying the external corporate governance mechanisms through market for corporate control. Since market institutions are missing in transition countries, and institutional framework is insufficiently developed, these countries must develop appropriate corporate governance model, as well as corporate governance mechanisms.

Due to these mentioned differences, the research topic is to analyze effectiveness of corporate governance mechanisms in transition countries, in accordance with the implemented corporate governance model. The research aim is to determine the similarities and differences between corporate governance mechanisms in transition countries of Central and Eastern Europe, as well as to point out the possible ways of improvement of their effectiveness. According to research topic, the hypothesis is as follows: ownership concentration is the key corporate governance mechanism in transition countries due to undeveloped institutional framework and undeveloped market for corporate control.

The qualitative research methodology is applied in this research and the comparative method of scientific analysis. The methods of analysis and synthesis are used to make conclusions by the process of generalization, i.e. to theoretically verify the research hypothesis. At the first section, the key characteristics and significance of corporate governance in transition countries are described. The second section analyses the corporate governance mechanisms that are applied in selected transition countries with common socio-economic environment: Czech Republic, Slovakia, Poland, Hungary, Slovenia, Croatia and Serbia. Special attention is given to the problems of corporate governance mechanisms improvement and possibilities of overcoming them at the third section.

1. ROLE OF CORPORATE GOVERNANCE IN TRANSITION COUNTRIES

Corporate governance could be defined as a set of relationships between a board of directors, shareholders and other stakeholders. It also provides "the structure through which the objectives of the company are set, and the means of attaining those objectives, and monitoring performance, are determined" [33]. On the other hand, it has also been interpreted as "the manner in which suppliers of corporate funds ensure appropriate returns to their investment"[38], but it has also been emphasized that a country's political/institutional as well as regulatory framework determines the quality of its corporate governance practices [36]. Based on the understanding of the concept of corporate governance and the view that corporate governance development in market and transition countries is characterized by a completely different context, analysis of corporate governance significance in post-communist countries should be adapted to the specifics of the process of transition to a market economy [34].

In fact, research in the area of corporate governance system of transition economies is based on identifying the common characteristics of post-communist countries. It is the consequence of the effort to promote the idea that the monetary model of reforms can be applied in all transition countries. Therefore, all countries can apply the same "recipes for healing", and inability of government to implement this policy caused the failure of the reforms [26]. However, experience of transition countries indicates that transition to the new market system is much more complicated. The process of building the market economy cannot be conducted according to corporate governance model of developed countries, since available time, resources and initial assumptions fundamentally differ. Also, modifications of the current system cannot be applied, since transition countries have specific economic system in which the residuals of old communist system and the beginnings of new market system exist in parallel. In addition, transition processes occur in the whole spectrum of economic, cultural and social diversity determining the potentials of changes in some countries.

Within the transition to market economy, privatization as the most important aspect of post-communist reforms resulted in the need for development of corporate governance system. At the beginning of the transition process, privatization of state-owned firms was regarded as the crucial element of reform at a microeconomic level [18]. In the transition countries, privatization involved selling the bulk of firms in the previously state-owned industrial sector. Privatization is considered to be a mechanism which may eradicate inefficiency of state property and influence the change in industrial structure in national and regional economy.

This viewpoint arises from the fact that privatization led to significant changes in ownership structure, as well as to the creation of the new corporate sector. The new corporate sector consists of “instant corporations” formed as the result of mass privatization, without the simultaneous development of legal and institutional structures necessary to operate in a competitive market economy [6]. Privatization has become a world-wide economic phenomenon where governments usually adopted the path in order to raise revenue, improve economic efficiency and develop their national stock market. Privatization has been viewed by most of economic actors as an inevitable step of the reforms required for economic development [31]. All transition countries have implemented the privatization as the process of transfer of control from the state to the private sector, using the specific models and methods. Privatization could be done in different ways: privatization by sale, voucher privatization and insider privatization [32]. Privatization by sale results in concentrated ownership, because it means sale of majority share block of the company to domestic or foreign investors (strategic partners). Voucher privatization means distribution of shares which leads to highly dispersed ownership. Insider privatization means that managers or employees are purchasing the shares.

However, privatization in the transition countries has posed a number of practical problems. Implemented privatization resulted in very different ownership structures and caused the development of different corporate governance mechanisms. It can be concluded that implemented privatization in transition countries resulted in separation of ownership and control, led to ownership concentration, as well as to very different ownership structures. The majority shareholder (i.e., controlling owner) is often associated with a business group [44]. Nevertheless, within the process of privatization in some transition countries, business groups have been created, instead of forming the autonomous companies. Transactions between privatized companies are carried out not by the market, but through direct business arrangements, the relations with the banks as well as the complex structure of mutual ownership and interdependence. This business group (i.e., business network) emerged as a natural consequence of socialism, and it is stimulated by the interests of the existing management structure. Also, undeveloped financial market favors the creation of business networks. In such circumstances, the role and the significance of corporate governance were marginalized. Hence, the problems of separated ownership and control are increasing, which negatively influences the performance of companies.

We can conclude that the above-mentioned corporate governance problem represents one of the most relevant components of corporate long term success, and caused the development of different corporate governance mechanisms. Since management is separated from those who provide capital, it is responsible for using the resources effectively in order to achieve strategic goals. Assurance that management will act in that way is important for successful achievement of economic performance of the organization as well as for its ability to attract long-term, stable and inexpensive source of funding. Fundamental task of corporate governance is to provide mechanisms which will ensure managerial responsibility towards shareholders for appropriate use of their resources. Shareholders have available governance mechanisms to help bring the interests of managers in line with their own.

These mechanisms can be classified as internal and external mechanisms: ownership concentration and board of directors are internal, and market for corporate control and legal protection are external mechanisms [5]. Consistent with that classification, in transition countries ownership concentration and board of directors should be the most important corporate governance mechanisms. Ownership concentration has the advantages due to better control of management actions, since major owners have the power and initiative to supervise managers. Owners with higher share of stocks are motivated to perform monitoring and dismiss unsuccessful managers, therefore reducing conflicts between owners as principals and managers as agents [32]. This attitude is based on the fact that corporate sector consists of corporations which were created as a consequence of mass privatization, which was not followed by simultaneous development of legal and institutional infrastructure necessary for market economy functioning.

Also, the board as internal mechanism of corporate governance represents the link between individuals that provide the capital (owners) and individuals exploiting that capital in order to create value (managers). The board has a role to monitor and control managers, in order to protect the owners' best interests. Composition, size and board roles are different depending on the board models. Generally, there are two board models: one-tier and two-tier boards. In contemporary studies, two-tier boards were generally recommended. This statement is based on separation of management and supervisory board. The central feature of internal corporate governance lies in the division of management and control by a two-tier structure. While the role of the management board is the running of the business, the role of the supervisory board is primarily the appointment, supervision, and removal of members of the management board [22]. The one-tier board model entrusts both management and control to the unitary board, who are vested with universal powers.

In addition to internal mechanisms of corporate governance, market for corporate control serves as an external mechanism that is typically activated when internal mechanisms for controlling managerial opportunism have failed [15]. In line with these arguments, studies of corporate governance mechanisms in transition countries require to identify some additional specified criteria, as well as some of common denominators in order to set universal assumptions and conclusions, as well as to conduct comparative research.

2. CORPORATE GOVERNANCE MECHANISMS: THE EVIDENCE OF TRANSITION COUNTRIES

Consistent with above classification of corporate governance mechanisms and specific characteristics of transition countries, the experiences of selected transition countries - Czech Republic, Slovakia, Poland, Hungary, Slovenia and Croatia (as members of EU), and Serbia (as candidate for membership), are analyzed. One of the key features of transition from former planned economies to market economies was the privatization process, which was influenced by integration with the European Union and pressured by international financial institutions. The privatization was conducted in different ways, which resulted in differences in corporate governance, ownership structures and other corporate governance mechanisms.

Czech Republic

In Czech Republic voucher privatization was carried out, where 40-80% of firm's equity was available for auction through vouchers, while remaining shares were distributed to employees (a small percentage) and state [1]. Privatization through vouchers resulted in the creation of Investment Privatization Funds, which led to ownership concentration, because IPFs obtained 70% of all available vouchers. In order to overcome legal obstacles, IPFs transformed themselves into holding companies, which finally led to ownership concentration. Institutional investors and industrial firms with foreign ownership are the most common owners, but the state still has a meaningful share with 12,7% shareholding [1]. Foreign investors have on average 58,6% of shares [1, 34]. The biggest owner has on average 60,6% of shares, while three biggest shareowners have around 76% of shares [1]. Although ownership concentration is a strong control mechanism of manager's opportunistic behavior, it has negative effect in sense of expropriation of minority owners' rights. That is confirmed with the rank of the Czech Republic, which was at 50th position by protection of minority shareowners' rights by the Global competitiveness report of the World Economic Forum in 2015 [42].

Regarding the board of directors as internal control mechanism, two-tier board is applied [27], which consists of managerial and supervisory board. Managerial board and supervisory board have at least three members, but employees have a representative at the supervisory board (one third of the members is elected by the employees). Candidates for employee representative are nominated by works council or trade unions, or in case of state-owned companies by electoral regulations established by employer in agreement with trade unions [14]. Czech Republic was at 34th position by board effectiveness in 2015 [42].

Market for corporate control as external mechanism is not fully developed and it is not often used as control mechanism. Still, Czech Republic was at 3rd place among the countries of Central and Southeastern Europe by the number of mergers and acquisitions in 2015 (185 completed transactions), where strategic investors participated in almost 83% in these transactions [17], which shows that there are efforts and tendencies towards more efficient development of market for corporate control. Comparing the number of transactions in 2011 to 2015, there is an increase in the number of transactions by 20,9% [39]. Even though the market for corporate control remains undeveloped, there is another limitation for improvement of corporate governance. The legal system is not efficient, which is confirmed with the results from the Global competitiveness report which show that Czech Republic is at 90th position by the efficiency of legal framework [42]. The efficiency of legal framework needs to be at much higher level in order to insure adequately protected property, minority rights and prevent managerial opportunism.

Slovakia

In Slovakia privatization was carried out through small-scale privatization, which was almost finished in late 1992, and large-scale privatization, which had two different stages. Firstly, there were two waves of voucher privatization, and then direct sales which was used in privatization of nearly 80% of companies [41], which resulted in ownership concentration. Dominant owners became individual investors, insiders and foreign investors [4]. The state holds on average 18% of shares [23]. The share of biggest shareowner is on average 39,4% [10]. Slovakia was at 92nd position by protection of minority shareowners rights by the Global competitiveness report of the World Economic Forum in 2015 [42], which is worse than Czech Republic and should be improved.

The two-tier board is dominant in Slovakia. The managerial board consists only of executive directors, while the supervisory board consists only of non-executive directors. The supervisory board consists of at least three members. If the company has more than 50 employees, one third of the supervisory board members is elected by the employees [30], whilst in state-owned companies, employee representatives have one half in the supervisory board [14]. The employee representatives are nominated by the trade unions and employees. Slovakia was at 73rd position by board effectiveness in 2015 [42].

The market for corporate control is undeveloped, and cannot be used as an effective control mechanism for managers. Slovakia is at 6th place among countries in Central and Southeastern Europe by the number of mergers and acquisitions. The number of mergers and acquisitions in 2015 was 65, where strategic partners participated with almost 86% in these transactions [17]. Comparing the number of transactions in 2011 to 2015, there is an increase in the number of transactions by 41,3% [39]. The increase in number of mergers and transaction shows the growing importance of this control mechanism. Slovakia was ranked as 138th by the efficiency of legal framework in 2015 [42]. Very low rank by the efficiency of legal framework suggests that implementation of legal framework is still a significant problem for improving corporate governance.

Poland

In Poland, mass privatization was carried out by transferring majority share blocks to National Investment Funds (NIF) (60% of shares), while the rest of shares was transferred to employees (15%) and treasury (25%) [28]. Vouchers, which represented one share of NIF each, were distributed to citizens, who became indirect companies' owners. With withdrawal of NIF, their shares were being sold to domestic and foreign investors. Privatization resulted in concentrated ownership [9]. The state has in average 4% of share ownership [1]. Meaningful stake in ownership have individual investors and industrial firms [1]. Foreign investors have on average 21,9% of shares [1, 34]. The majority shareowner has on average 43% of shares [2], while three biggest shareowners have 50% of shares [1]. Poland was at 63rd position by protection of minority shareowners rights by the Global competitiveness report of the World Economic Forum in 2015 [42]. The ownership concentration is very high, which implies that the minority owners' rights could be threatened, which is confirmed by low rank of protection of their rights.

The second internal mechanism of corporate control is managerial board. Management is conducted by two-tier board [9], which consists of managerial and supervisory board. The employees elect around one third of the of supervisory board members, depending on the size of supervisory board [21], two members on a board of six, three where the board has seven to 10 members, and four where the board has more than 10 members. In state-owned companies employees have 2/5 representatives in supervisory board, and employees have one representative in managerial board when the company have more than 500 employees [14]. Poland was at 66th position by board effectiveness in 2015 [42]. Still, Czech Republic has better position by board effectiveness.

The importance of the market for corporate control is reduced, even though the activity at this market is high in this part of Europe. The number of mergers and acquisitions in 2015 in Poland was 278, which was the second highest number in Central and Southeastern Europe. Strategic partners participated with almost 74% in these transactions [17]. Comparing the number of transactions in 2011 to 2015, there is a decline in the number of transactions by 46% [39]. Poland was ranked as 70th by the efficiency of legal framework in 2015 [42]. The position of Poland is better than previously analyzed countries, but still needs to be improved in order to improve corporate governance.

Hungary

In Hungary, privatization was conducted through direct sale to strategic partners or financial institutions [27]. Privatization resulted in very little employees' ownership, very little dispersed ownership and high concentrated ownership, where majority of shares were held by foreign investors [11]. One majority owner has on average 54,2% of shares, while three biggest shareholders have on average 71,5% of shares, where foreign investors participated in ownership with 70,6% [1, 34]. The state owns on average 2,4% shares [1]. Hungary was at 90th position by protection of minority shareowners rights by the Global competitiveness report of the World Economic Forum in 2015 [42]. Czech Republic and Poland have better protection of minority owners' rights, but the ownership concentration in Hungary is higher. Regulatory reforms have been introduced, but the enforcement is still lagging behind.

Regarding other internal mechanism of corporate control, by Company Act IV (2006), companies may apply one-tier or two-tier board. In case of one-tier board, the board has 5 to 11 members, whilst independent members have the majority. In case of two-tier board, there is managerial and supervisory board. Minority shareholders have the right to appoint one member of supervisory board. Employees choose one third of the members of supervisory board. The representatives are nominated by works council who has a duty to ask trade union for opinion [14]. Hungary was at 112th position by board effectiveness in 2015 [42]. Very low board effectiveness and low protection of minority rights are significant problems for improvement of corporate governance.

Market for corporate control is not significantly used as a mechanism for disciplining managers, as the activity on this market is reduced. Hungary takes 4th position in Central and Southeastern Europe by the number of mergers and acquisitions in 2015 (130 transactions), where strategic partners participated with almost 62% in these transactions [17]. Comparing the number of transactions in 2011 to 2015, there is a decline in the number of transactions by 5,2% [38]. Hungary was ranked as 96th by the efficiency of legal framework in 2015 [42]. Efficiency of legal framework needs to be improved in order to insure better protection of minority owners' rights and investors' property, as the foreign investors are the biggest shareowners and concentration of ownership is very high.

Slovenia

Slovenian privatization was conducted through transfer of 40% of shares to state funds' ownership, and the rest of shares were privatized through selling shares to insiders (employees and managers) and private investors [25]. Insider privatization was conducted in 90% of companies. State and investment funds were the primary share owners, who would sell the shares to private investors. Privatization resulted in relatively concentrated ownership. The biggest shareowner has 35% of shares, and the five biggest shareowners control on average 66,2 % of shares [24]. The most important shareowners are domestic companies, insiders (employees) and investment funds [25]. The state controls on average 12,4% of shares [24]. Slovenia was at 121st position by protection of minority shareowners rights by the Global competitiveness report of the World Economic Forum in 2015 [42]. Comparing to previously analyzed countries, Slovenia has the lowest rank by this indicator.

Companies have the choice to apply one-tier or two-tier board [16]. Public companies apply two-tier board of directors. In those companies employees appoint one third to one half of the members of supervisory board. If company has more than 500 employees, employees have the possibility to appoint one member of managerial board. The representatives are appointed by works council [14]. Slovenia was at 110th position by board effectiveness in 2015 [42].

The market for corporate control is not active, and the Slovenia was at 9th position in Central and Southeastern Europe in 2015 by the number of mergers and acquisitions. In 2015 in Slovenia 38 mergers and acquisition were conducted and the participation of strategic investors was 79% [17]. Comparing the number of transactions in 2011 to 2015, there is a decline in the number of transactions by 9,6% [39]. Slovenia was ranked as 115th by the efficiency of legal framework in 2015 [42]. Companies often follow the regulatory obligations and recommendations but implementation in practice is absent, so there is a very low result on efficiency of legal framework.

Croatia

Privatization in Croatia was conducted through two phases. Firstly, the goal was to terminate social ownership and to transfer it to private or state ownership, primarily through insider privatization. In the second phase, voucher privatization was conducted [40], which finally resulted in highly concentrated ownership. The majority owner has on average 51% of shares [37]. Three biggest owners have on average 80% of shares in listed companies [29]. Among owners with the largest share were nonfinancial companies, state and its institutions. The average ownership of the state among public listed companies is 10,8% [29]. Croatia was at 111th position by protection of minority shareowners rights by the Global competitiveness report of the World Economic Forum in 2015 [42]. Low protection of minority owners' rights is common problem when ownership is concentrated, like in case of Croatia.

Since 2007 two systems are being applied: one-tier and two-tier board. Two-tier board was applied by 98,9% listed companies in 2010 [37]. The average number of managerial board members is 2, but in 47% of companies there is only one member. The average number of supervisory board members is five. Employees have one representative in the board, and he/she is appointed by works council or by trade union [14]. Croatia was at 95th position by board effectiveness in 2015 [42].

Market for corporate control is not developed and is inefficient for corporate control. Croatia was at 11th position by the number of mergers and acquisitions in Central and Southeastern Europe in 2015 with 27 conducted transactions, which is much less than previous year, even though the strategic investors participated with 96% in these transactions [17]. Comparing the number of transactions in 2011 to 2015, there is a decline in the number of transactions by 59,7% [39]. Numerous changes have been conducted in the Company law and corporate governance in Croatia during two last decades, mostly as a result of the need of harmonization with the EU practice. Still, Croatia was ranked as 137th by the efficiency of legal framework in 2015 [42]. As Croatia has very low position by the efficiency of legal framework it is necessary to improve legal system and its efficiency, in order to improve corporate governance and its mechanisms.

Serbia

Privatization in Serbia was conducted through three models [7]. Firstly, insider privatization resulted in relatively dispersed ownership. Then, free distribution of shares in line with selling shares with discount was done, which resulted in ownership concentration. And finally, the privatization was conducted through sale to strategic partners, which led to ownership concentration in the hands of one or small group of shareowners [32]. Ownership is highly concentrated in Serbia, because one biggest shareowner owns on average 65,26% of shares. This conclusion is based on the analysis of the ownership structure of 2037 companies listed in database of the Central Securities Depository and Clearing House. The state and its institutions own on average 37,04% of shares. Other companies own on average 66,24% of shares, while individual investors own on average 44,31% of shares. High ownership concentration increases likelihood of the expropriation of minority shareowners, so the legal and regulatory reforms are essential. In line with this argument, Serbia was at 138th position by protection of minority shareowners rights in 2015 [42]. This result is the lowest of all analyzed countries.

According to Company Law from 2011, a company may apply one-tier or two-tier board. In practice, two-tier boards are more applied. At one-tier board, assembly and managerial board are the managing bodies. At two-tier board, assembly, the managing bodies are supervisory and managerial board. Managerial board has majority of independent members, while supervisory board has at least three members and they have to be independent. Employees usually do not have a representative in the boards. Serbia was at 111th position by board effectiveness in 2015 [42].

Market for corporate control is not developed. Serbia was at 8th place among Central and Southeastern Europe countries by the number of mergers and acquisitions in 2015, with 45 mergers and acquisition conducted, which is less than previous year. The participation of strategic investors was 93% [17]. Comparing the number of transactions in 2011 (67 transactions) to 2015 (45 transactions), there is a decline in the number of transactions by 32,8% [39]. Inactive market for corporate control cannot be used for disciplining managers. Therefore, Serbia was ranked as 125th by the efficiency of legal framework in 2015 [42]. Poor law enforcement is one of the main obstacles for protection of minority owners' rights, investors' property protection, for prevention of managerial opportunism and improvement of corporate governance. Numerous changes are conducted, mainly in accordance with the directions of EU and OECD recommendations, codes are defined, but implementation is lacking. Comparison of corporate governance mechanisms analyzed in transition countries is given in Table 1.

Table 1 Comparison of corporate governance mechanisms in transition countries

Indicators	Czech Republic	Slovakia	Poland	Hungary	Slovenia	Croatia	Serbia
Ownership structure as corporate governance mechanism							
Ownership dispersion vs. concentration	OC[2]	OC	OC	OC	OC	OC	OC
Dominant owner's identity	Institutional investors and industrial firms	Individual investors, insiders and foreign investors	Individual investors and industrial firms	Foreign investors	Domestic companies, insiders and investment funds	Nonfinanc. companies, state and its institutions	Domestic and foreign companies and state
Share of the biggest owner	60,6%	39,4%	43%	54,2%	35%	51%	65,26%
Share of state ownership	12,7%	18%	4%	2,4%	12,4%	10,8%	37,04%
Board as corporate governance mechanism							
Board model	Two-tier	Two-tier	Two-tier	One-tier and two-tier	One-tier and two-tier	One-tier and two-tier	One-tier and two-tier
Proportion/ number of employee representatives in the board	1/3 of board members	1/3 – 1/2 of board members	1/3 – 2/5 of board members	1/3 of board members	1/3 - 1/2 of board members	1 board member	/
Board effectiveness[3]	34	73	66	112	110	95	111
Market for corporate control as corporate governance mechanism							
Ranking by the number of M&A in CSE in 2015	3	6	2	4	9	11	8
Number of M&A in 2015 comparing to 2011	153 - 185 Higher by 20,9%	46 - 65 Higher by 41,3%	516 - 278 Lower by 46%	137 - 130 Lower by 5,2%	42 - 38 Lower by 9,6%	67 - 27 Lower by 59,7%	67 - 45 Lower by 32,8%
Legal framework as corporate governance mechanism							
Ranking by protection of minority shareowners rights[4]	50	92	63	90	121	111	138
Ranking of efficiency of legal framework[5]	90	138	70	96	115	137	125

Source: Authors

[2] OC – ownership concentration
[3] Ranking by Global Competitiveness Index
[4] Ranking by Global Competitiveness Index
[5] Ranking by Global Competitiveness Index

3. Improvement of the Corporate Governance Mechanisms Effectiveness in Transition Countries

Starting with the corporate governance mechanisms analysis in transition countries, it can be concluded that the processes of property and managerial transformation created a specific environment for development of corporate governance mechanisms. There are four key features. The first feature is slow process of property and managerial transformation and absence of market of corporate control. Therefore, the process of privatization and restructuring, and developing a suitable system of corporate governance model for transition countries are the key elements to replace the missing market institutions. Achieving the ownership transformation and strengthening the role of the owners are essential conditions for improving corporate governance. Possibility for policy intervention is related to control and ownership disclosure and transparency.

The second feature refers to the problem of insufficient effectiveness of boards of directors as an important internal control mechanism of managers. Boards of directors have been used as an instrument of political control over the CEO's work. Hence, the different modalities of CEO's domination over board appeared in practice. The use of power varied depending on the political forces, managerial and leadership skills of directors, but still the boards of directors had a role of executive political power. Thus, boards of directors are not effective because the owner controls the board and can fire or hire its members. The possibility for boards of directors as corporate governance mechanisms enforcement is: voting transparency; introduce cumulative voting as well as train the board of directors [12].

The third feature is related to ownership concentration as the primary corporate control mechanism. Concentrated ownership is dominant in transition countries for two reasons [44]. Firstly, ownership dispersion means that the majority owner has to share relevant information with external investors, and they may have risk aversion, because they want to protect strategic information from the outsiders, especially when it relates to company's competencies. Sharing information requires trust between different parties, which is rare in transition countries because of the inadequate institutional framework. Secondly, concentrated ownership exists because that is the only possible way to prevent managerial opportunistic behavior in the conditions of undeveloped market institutions. This stand is based on the hypothesis of preference of control and on the results of numerous empirical studies which confirm that higher ownership concentration enables better monitoring and restricts opportunistic managerial behavior [32]. Active monitoring by majority owners can increase the quality of managerial decisions, prevent exaggerated diversification, as well as prevent exceeding compensations. Therefore, when ownership is concentrated in the hands of the majority owners, the control of managerial behavior is increased and principal-agent conflict is mitigated. Ownership concentration improves corporate performance, lowering the agency costs of dispersed ownership.

However, ownership concentration may lead to principal-principal conflict between majority and minority owners [20], which occurs when majority owners gain private benefits at the expense of minority owners [13]. Principal-principal conflict represents the fourth, most important feature. The dominant shareholder may tend to abuse minority investors particularly under conditions of poor institutional order [35]. In transition countries there is no adequate legal protection of minority shareowners' rights, because this problem has additional weight. Possibility for policy intervention is related to reinforcing laws that protect minority shareholders whilst maintaining the incentive to hold controlling blocks [8].

Accordingly, codes of best corporate governance practice developed in many countries play an important role in the process of setting standards for corporate behavior and boosting activism of minority investors. Despite different national legal regimes, the set of guidelines proposed in the codes of best practice remains similar. Principles of corporate governance usually refer to the equal treatment of shareholders with emphasis on the protection of minority shareholders, corporate transparency, board functioning, procedures of voting, and electing shareholders representatives. As a result, codes and the formulated rules of corporate governance build public pressure on dominant shareholders as well as provide rating of companies according to their compliance with corporate governance [3].

Starting from listed futures, the required assumption of improvement of corporate governance mechanisms effectiveness is finalization of the process of ownership transformation, development of institutional framework and creating market economy institutions necessary for economic growth. Implementation of appropriate institutional rules and establishment of market institutions increase the responsibility of managers for company performance. In order to effectively allocate resources, investors must have the ability to control those who use these resources. Effectiveness of corporate governance mechanisms is increased when the owners have clearly defined power which will allow them to control and when they have good access to information which prevents information asymmetry. In addition, minority owners should be protected from expropriation of majority owners through effective legal system.

CONCLUSIONS

Privatization and restructuring, as the two main aspects of post-communist reforms, led to growing interest for corporate governance research in transition countries. These processes present the key factors for transition success as well. Privatization is crucial, since it creates effective owners, enables more effective use of resources, and confirms dominance of market mechanisms. In addition, privatization was designed to eliminate the constraints on the independent managerial decision-making process imposed by state ownership. Nevertheless, real privatization effects were not in accordance with expectations. This was caused by unbalanced development of macroeconomic and microeconomic instruments in the first stages of transition process. In fact, in transition countries the focus was on achievement of macroeconomic stability in order to create an appropriate environment for privatization process. Then, it is necessary to implement microeconomic changes that correspond to macroeconomic policy of transition countries. Accordingly, corporate governance is a powerful instrument of microeconomic policy and effective way of transition to market economy.

Corporate governance system has the key role in the process of economic regeneration in transition countries. Therefore, it improves the performance of enterprises by aligning conflicts of interest, and by reducing opportunistic behavior. The above-mentioned is achieved by improving effectiveness of corporate governance mechanisms, because all transition countries faced specific problems that result from the process of the ownership and management transformation. Primarily, the inefficiency of corporate governance mechanisms in the selected countries might be due to: weak minority investor protection, along with entrenched positions of managers, who remain in control despite that privatization had transferred ownership to outsiders, undeveloped capital markets as well as ineffective boards of directors. The inefficient corporate governance in the selected countries can also be explained with the weaker legal systems. Consistent with above arguments, the key corporate governance mechanism is ownership concentration, which confirmed initial research hypothesis. Our analysis showed that selected countries are characterized by similar majority owner's identity and weak protection of minority shareholders' rights, too.

Therefore the enforcement of corporate governance mechanisms is needed. All transition countries have made significant progress in developing corporate governance mechanisms and are moving towards adopting the OECD Principles on voluntary or statutory basis. Also, the necessary assumption of improving the effectiveness of corporate governance mechanisms is development of institutional framework suitable for market economies. We emphasize the necessity of higher legal protection of minority owners' interests in order to prevent expropriation of their interests. In contrast, ownership concentration results in negative effects that can jeopardize the corporate control benefits. Therefore, large shareholders have both the incentives and the means to restrain the strategic independence of managers. In the transition environment, managerial strategic independence, or their ability to make good decisions without restrictions imposed by new owners of privatized firms, may become particularly important.

In addition, board of directors is another governance instrument that can affect the decision-making process, shaping the extent of managers' strategic independence. Strategy research particularly emphasizes the importance of the strategic board role when the firm faces a highly uncertain environment of economic transition. Board members associated with foreign investors also improve monitoring role of the board, and mitigate moral hazard costs related to managerial decision-making autonomy [19]. Accordingly, the enhancement of board effectiveness is one of the main conditions to improve corporate governance in transition countries. On the way to joining the European Union, these conclusions are especially significant for Serbia, which needs to establish a strong institutional and legal framework, enabling the effective implementation of corporate governance mechanisms.

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EFEKTIVNOST MEHANIZAMA KORPORATIVNOG UPRAVLJANJA – ANALIZA ZEMALJA U TRANZICIJI

U uslovima razdvojenosti vlasništva i upravljanja, korporativno upravljanje predstavlja važnu instituciju tržišne ekonomije. Shodno navedenom, istraživanja u oblasti mehanizama korporativnog upravljanja su sve intenzivnija. U skladu sa razlikama koje se odnose na istorijsko i kulturno nasleđe zemalja, socio-ekonomske uslove, pravni/institucionalni okvir i vlasničku strukturu, razvijene i tranzicione zemlje primenjuju različite mehanizme korporativne kontrole. Pošto u tranzicionim zemljama nedostaju tržišne institucije, a institucionalni okvir je nedovoljno razvijen, potrebno je razviti odgovarajući model, kao i mehanizme korporativnog upravljanja. U skladu sa navedenim karakteristikama, predmet istraživanja je analiza efektivnosti mehanizama korporativnog upravljanja u tranzicionim zemljama koje odlikuju slični socio-ekonomski uslovi. Posebna pažnja je posvećena problemima unapređenja efektivnosti mehanizama korporativnog upravljanja i mogućnostima za njihovo prevazilaženje.

Ključne reči: *tranzicione zemlje, privatizacija, mehanizmi korporativnog upravljanja, koncentracija vlasništva, upravni odbor*