DOI: 10.20472/IAC.2018.044.033

SAXHIDE MUSTAFA
Riinvest Institute, Kosovo

CORPORATE GOVERNANCE, INSTITUTIONAL REFORMS AND BUSINESS ENVIRONMENT (A SHORT COMPARATIVE ANALYSES FOR SOME WB COUNTRIES)

Abstract:

Through providing tools and mechanisms for balanced representation of stakeholders' interests (first of all, to owners, management and employees) corporate governance according to OECD principles should ensure the increase of the value of the assets of companies, their competitiveness capacities and attractiveness to investors. As in general in transition economies building these mechanisms and implementing these principles at the companies proved to be problematic more in their implementation than in developing legal framework. Institutional environment, maturity of democratic institution, and especially business environment seems to be very relevant the quality of corporate governance in transition economies. This paper after presenting some of theoretical discussions on specific corporate governance issues in transition economies presents also short comparative overview regarding achievements in key areas of corporate governance in Kosovo, Albania, Croatia and Bulgaria. This comparative analyses demonstrate that corporate governance and its implementation very much depend on the level of institutional maturity, especially perceptions on the level of corruption and also to business environment which provides conditions for free and fair competition.

Keywords:

Corporate governance, institutions, business environment, boards, transition.

JEL Classification: G30, G38

1 Theoretical Discussions

Newly created enterprises and enterprises created through privatization in transition economies amongst others face serious problems to develop sound corporate governance systems. Many scholars considered this as a serious obstacle for their incorporation and their competitiveness capacities. It has also a negative impact on their investment attractively and access to capital and thus in trends of their growth and sustainability.

Literature evidence shows that Central European countries have made significant achievements in implementing the OECD principles for corporate governance, but this is not case with companies at Eastern and Southeast Europe countries. Privatization process in many of these countries was implemented in the conditions of week rule of low and leaded to concentrated ownership structures. These structures were under heavy influence of new owners (oligarchs) which were not motivated to develop structures and mechanisms for sound corporate governance. Their links and interrelation with political elites in power was reflected in the way corporations are governed. In these circumstances creation of competent and independent governing structures – company Boards, the transparency and accountability, role of stakeholders, and respect to ethical codes and principles were heavily neglected.

Majority of Central European countries have approved the Continental model of corporate governance (Two Tire Model with Supervisory Board and Managerial Board), while Eastern and Southeast European countries have implemented both models with the Anglo-Saxon model(One tire model with nonexecutive Board of Directors) dominating (Mustafa, 2018).

Price liberalization was almost implemented at the beginning of reforms in a path from planned and centralized economy apparatus towards market economy. But this was accompanied with economic downturn, rising unemployment, and also with policy respond to create conditions for development of private sector and the establishment of macroeconomic and fiscal stability. Under this institutional and business environment was initiated and developed process of reorganization of enterprises. They had fide a way to survive in a situation where subsidies offered by the state were canceled. Depending on the conditions and the given institutional and reform context in some countries, this stage has been shorter (Central Europe and the Baltic countries), whereas in the case of the Soviet Union and some of the East and Southeastern Europe countries it has been accompanied by chaotic state, disorientation and total passivation of the former state enterprise sector. Next phase of structural reforms and institutional arrangements included privatization and deep restructuring of enterprises. This included the creation of new governance and management structures in enterprises to take on the responsibility to operate above breakeven point and to ensure efficient growth and a profitable firm (Carlin, 2003). The form of ownership that derives from privatization had an impact on governance structures and as well on company performance. This included usually from external privatization or from internal privatization with MBO (Purchasing state companies from their management) and EBO (buying state companies from employees) has been seen more important for relations in the governing structure of corporation (Hashi, 2002). Carlin (2003) argues that external privatization (sale of companies to outside investors) has been more effective in controlling managers. The absence of capital markets in most of transition economies has favored concentrated ownership. On the other side has been proven true that foreign owners (foreign investors) have demonstrated more sense and commitment towards profitability.

Also when it comes to internal privatization companies that resulted from privatization through MBO has been proven more profitable than those where dominated ownership of workers. Also there are findings that prove that companies which after privatization have resulted in more concentrated ownership have been the most prone to quick restructuring (Marcincin & Wijnbergen, 1997).

Although it is clear that corporate governance structures of privatized companies and those established as private companies were for long time aside of theoretical or empirical research, evidence shows that environment of institutional reforms and methods of privatization had an impact on forms of ownership change and ownership structure which has been proven relevant on the behavior of post privatized companies. This is related with creation of effective governance structures and institutional frameworks that ensure transparency and sound financial reporting, bankruptcy proceedings, also a legal framework that protects investors and owners, provides balance of interests among stakeholders, and addresses the issue of ‘disciplining of managers (Riinvest, 2006). It is considered that success in building an effective corporate governance framework in countries transition is important not only for the performance of companies but also for their competitive capacities, their attitude and achievements towards internationalization and their relationship with governments and ruling authorities (Estrin, 2002).

Conditions under which was implemented transition including especially methods and privatization policies, level of economic development, character of economic politics have had their impact in dynamics and quality of achievements in modernization of corporate governance process. Two groups of countries can be identified in this context. The first one is related to the situation in Central European countries, in Baltic countries and some of the states coming out of former Yugoslav (primarily Slovenia and Croatia) were managed at early stages to have free elections, and governments resulted from these elections were credible and able to implement structural reforms and build sound democratic governance and Rule of Low. But this was not the case, for instance with Russia, other countries emerging from the former Soviet Union and most Southeast European countries (Esterin, 2002). Albania experienced long and painful transition and also Kosovo has similar experiences, for well-known reasons, with its delayed transition. Both economies share more features with this second group. The first group countries also enjoyed advantages of earlier access to EU integration processes. Legal on other reforms and in general building capacities to comply with EU standards resulted with has better success in enterprise restructuring, their performance and the more successful implementation of corporate governance. In this area the fragile democratic institutions that lack the capacity or willingness of party elites in those governments to enforce the law. (Crotty & Jobomem, 2004) has been proven factor of key importance.

Inability and lack of willingness to enforce low, contracts and to build effective judicial system was reflected with turbulent business environments in those countries. Under these conditions one of the main problems is the protection of investors. There is absence of friendly Investment environment, which does not have enough incentives to implement corporate governance standards (Mustafa S 2018). Some countries that used shock therapies in a hope that fast track in change of ownership will induce a fast transfer ta market economy institutions, including the development of corporate governance. This included also attempts to induce “Principal” and “Agency” system in governing companies. But this did not prove successful in most Southeastern and Eastern European countries (Crotty & Jobomem, 2004). Stiglitz, (1999) argues that the aspects of corporate governance in these countries were underestimated for a long time.

In countries characterized with poor institutions with low capacity and readiness for law enforcement usually was manifested with high corruption and high informality and this was associated also with poor corporate governance practices. There are also opinions that the sequence could have been reversed, in order to begin with strengthening the institutions first and then privatizing next. It is considered that this sequence (privatization in the conditions of fragile and weak institutions) also created a vacuum in terms of corporate governance (Crotty & Jobomem, 2004). This has even stimulated the behavior of those who have acquired controllable ownership blocks to take control of public rent as a result of a ‘destructive restructuring (Black et al., 2000). The genesis of this destructive restructuring lays at manipulated privatization. Good corporate governance is therefore considered a prerequisite of constructive restructuring in transition economies (Crotty & Jobomem, 2004). Thus, for example, (Berglof & Pajuste, 2002) consider that traditional methods of company behaviors in the owner-manage relationship in many Central and Eastern European countries were unsuccessful in the conditions of new and owners (large block- holders). In fact, regarding the difficulties of the functioning of corporate governance in transition countries, the problem does not appear to be the codes, as they mostly reflect codes practiced in developed economies. These codes have also been drafted with Western expert’s assistance, engaged consultants. More than that, the problem lies in the business environment and the institutional context and the need for an evolution of business culture (Mustafa, 2018).

2 Short comparative overview

Following literature evidence, partially presented above we looked at developments and characteristics related to certain features of corporate governance in Kosovo, Bulgaria, Croatia and Albania and international ranking of these countries regarding business environment, corruption, and informality (Mustafa, 2018)

Croatia and Bulgaria are EU countries but they have differences in their path toward EU integration and different context in which transition and EU integration was managed. Bulgaria experienced very fierce transition in its own beginnings, similar to Albania in its early years. Rapid structural reform, and heavy international assistance to build market economy and corporate structure and governance went along with faster EU integration process.

On the other side Croatian context (business culture, enterprise and tradition) had more features of a Central European country. Having experienced war toward its independence Croatia , had a longer process to the EU integration process, experiencing post-war reconstruction and transition and EU integration in the same time (similar to Kosovo). All these countries have adopted practices in their legislation in accordance with European directives and OECD principles on corporate governance.

Albania and Kosovo experienced different path. In both countries there is still a long lasting transition, with similar problems in functioning of institutional structures although i a very different political context and background. Albania embarked in transition and in building market economy coming out from orthodox socialist and autarchic system. In this path almost all industrial structure and infrastructure physical and institutional collapsed. Domestic supply was radically reduced and new emerging industrial structure has been developed with difficulties. Kosovo , coming out from the war, in a process of building its statehood and reconstruction to eliminate heavy war consequences and in building democratic structures and market economy under UNMIK- administration almost for a decade, before it proclaimed its independence. Having more tradition in entrepreneurship and private sector development compare to Albania and Bulgaria as well it had to deal also with building new emergent industries almost from the screech.

As we will see from the data bellow these differences has been reflected in the characteristics and in the stage of corporate development.

This short comparative overview is based on a data from secondary sources, mainly from the European Bank for Research and Development (EBRD), World Bank Doing Business Ranking, Transparency International, research reports on the size of informal. Based on the EBRD Country Assessment Report 2017, which assess the development of corporate governance in its member countries and, linking these data with some other studies and rankings regarding business environment, transparency and corruption it is possible to see relationship of corporate governance features with some components of business environment and capacity of countries to implement rule of low. As EBRD has used the same approach to assess the development of corporate governance for its member countries and the same is true for World Bank and Transparency International for all countries these analyses can lead to some consistent conclusions.

The methodology used by the EBRD for assessing the level of Corporate Governance in its member countries consists in assessing the legal and institutional framework and its implementation by comparing it with best practices (OECD Principles, Financial Institutions, in particular International Finance Corporation (IFC), EBRD and World Bank). The methodology used is identical in each country (EBRD, 2017, Mustafa, 2018). This study uses five areas to assess the framework and practices of corporate governance where a summary assessment is provided on these aspects:

(1) Structure and operation boards

(2) Transparency and Disclosure (Publication)

(3) Internal control

(4) Shareholders Rights

(5) Stakeholders (stakeholders) and institutions

Each of these fields is divided into constituent elements which are numerically 1-5 evaluated and correspond to the qualitative estimates of 5 good and very well (darker green colors), good average 4 (lighter green color) correct 3 (yellow color), weak 2 (orange color) and 1 very poor (red color). For example, the assessment of ‘Board structure and functioning consists of the following elements: Composition, Gender Diversity, Independent Directors (s), Effectiveness and Responsibility of the Board. Estimates were made on the basis of questionnaires answered by lawyers, regulators, auditors, large and listed companies and stock exchanges. Questionnaires were then evaluated by EBRD experts for corporate governance and then textual reports and 15-20 page graphs for EBRD member countries were compiled. Below we give the summary table without further stopping in the methodological explanations that can be found in the EBRD (EBRD, 2017).

Table 1: Ranking/ assessment regarding specific areas of corporate governance

	Structure and board function	Transparency and Disclosure (publication)	Internal Control	Shareholders Rights	Stakeholders (stakeholders) and institutions
Croatia	2/3	4	3	4	4
Bulgaria	2	3	2/3	4	2/3
Albania	½	2	2	3	2
Kosovo	½	3	2/3	2	2

Source: Author based Corporate Governance Sector Assessment, EBRD, 2017, Mustafa, 2018

Evaluation - 5/ very well, 4/good, 3/correct, 2/weak and 1/very poor

Looking at this ranking/ assessment regarding specific areas of corporate governance the main challenge for all four countries seems to be the structure and functioning of Boards. This is related also to the diversity regarding professional competence, gender aspects and with the presence of independent experts, out of owners and also political affiliations and influences. This is equally true in a case of Bulgaria, Albania and Kosovo when it comes to internal audit control and assessment for stakeholder's role and role of institutions.

Croatia achieved significant progress, with certain problems in the structure and functioning of boards and internal control. Bulgaria, though earlier integrated into the EU, is obviously standing behind Croatia and in some areas closer to Kosovo and Albania. Although Croatia joined EU one decade later than Bulgaria, it seems it had a more mature institutional structure, more developed tradition of corporate and industrial organization much closer to Central Europe in many more aspects than Bulgaria. Albania and Kosovo have a similar rating, with a better rating for transparency in Kosovo and for shareholder rights in Albania.

Tabela 2: World Bank Doing Business Index

	Ranking in Doing Business 2017 *	Protecting Minority share-holders	Contract Enforcement	Resolving insolvency
Croatia	51	29	30	60
Bulgaria	50	24	40	50
Albania	65	20	120	41
Kosovo	40	89	49	49

Source:*World Bank, 2017

Looking at table 2 and we these are related these data presented at e table 1 there could be envisaged that general ranking at World Bank Doing Business Index doesn’t correspond with EBRD basement on the level of development of corporate governance. While Kosovo is best ranked among these countries in Doing Business Index the opposite is when it comes to assessment of corporate governance. But the situation is different when you compare the EBRD assessment with ranking regarding on specific components of doing business index such as protecting minority rights and contract enforcement.

There ranking is much more in the line of corporate governance assessment by EBRD. The explanation could be that general index on Doing Business is complex index, where are considered as well some components that are not relevant for corporate governance standards (e.g. procedures for business registration, building permits etc.)

Table 3. Rank of countries based on perception on corruption and % (size) of informal economy

	TI Index of perception for corruption*	Informality (% of firma that think that they compete with informal firms)**	Informal Economy in % of business transactions ***
Croatia	57	48	30
Bulgaria	71	59	31
Albania	91	40	33
Kosovo	85	66	35

(Sources: *Transparency International 2017; ** Meduza L. 2017; *** Riinvest, 2012, 2015)

In continuation of this short comparative overview when we look at Table 1 and Table 3 it can be concluded that rankings regarding perceptions on corruption and the size of informal economy are much more in the line EBRD assessments for corporate governance (Table 1) compare to ranking on global index of Doing Business. The perception on the level of corruption and on the size of informal economy is in the heart of Rule of Low implementation, and also equally important fair competition and compliance of managerial and governance structures with ethical principles. Indirectly it illustrates also the nature of relations of governmental institutions and businesses. Thus is not surprisingly that rankings/ assessments in table 1 and 3 are similar. Croatia is leading and it is followed by Bulgaria, Kosovo and Albania.

3 Conclusions

In a line with theoretical discussions achievements in building corporate governance structures and practices in accordance with international; standards, primarily OECD principles depend more on maturity of democratic institutions and their capacity and willingness to implement rule of low, fight corruption, and informality and stick to ethical behavior. Similarly to other transition economies, our short comparative overview for four Western Balkan countries prove the same. Although Croatia, Bulgaria, Kosovo, Albania have developed similar legal framework for corporate governance assessment of their achievements in corporate governance based on EBRD country evaluation is very different and very much in a line with their ranking in Transparency International Index on Perceptions about corruption, that is seems related also to the size of informal economy, followed by protection rights of minority shareholders (investors) and contract enforcement.

The short comparative analysis suggests that further efforts for development of sound corporate governance in Croatia, and especially in case of Bulgaria, Albania and Kosovo focus should be in creating meaningful difference in institutions ability and readiness for law enforcement and law and for ensuring transparency and accountability which supports fair competition, reducing corruption and reducing the size of informal economy.

4 References

Berglof, E. & Pajuste A. (2002). What do Firm disclose and why? Enforcing corporate governance and transparency in central and east Europe. Oxford Review of Economic Policy, Volume 21, No. 2. 178 – 197. DOI:10.92/oxrep/gri009

Black, B. Kraakman R. Tarassova, A. (2000). Russian privatization and corporate governance: What went wrong? William Davidson Institute at University of Michigan, Business School, Working Paper 269.

Carlin, W., Schaffer, M., & Seabright, P. (2003). A Minimum of Rivalry: Evidence from Transition Economies on the Importance of Competition for Innovation and Growth. *Contributions in Economic Analysis & Policy*, Volume 3 No.1. DOI: https://doi.org/10.2202/1538-0645.1284.

Crotty, J., & Jobome, G. (2004). Corporate Governance in Transition Economies: A Synthesis of the Evidence.

Estrin, S. (2002). Competition and Corporate Governance in Transition. *The Journal of Economic Perspectives,* Volume 16, No.1. 101-124.

European Bank for Reconstruction and Development. (2017). *Corporate Governance in Transition Economies Croatia Country Report*" Available: http://www.ebrd.com/what-we-do/sectors/legal-reform/corporate-governance/sector-assessment.html: Access: February, 2018

European Bank for Reconstruction and Development. (2017) "*Corporate Governance in Transition Economies Bulgaria Country Report*". Available: http://www.ebrd.com/what-we-do/sectors/legal-reform/corporate-governance/sector-assessment.html. Access: February 2018.

European Bank for Reconstruction and Development. (2017). *Country Assessment Report.* Available: http://www.ebrd.com/what-we-do/sectors/legal-reform/corporate-governance/sector-assessment.html). Access: April, 2018

Fideorczuk, M. (2017). The Specificity of Boards of Directors in Russian Companies. *Journal of Management and Business Administration Central Europe*. Volume 25, No. 4. 96-118, DOI: https://doi.org/10.7206/jmba.ce.2450-7814.209

Hashi, I. (2002).The Restructuring and Privatization of Utilities and Large Companies in Kosovo. International Conference on Privatization of SOEs and the Reform of Utilities in Kosovo. Riinvest Institute, Kosovo.

Marcincein, A. & Wijnbergen, S. (1997). The Impact of Czech Privatization Methods on Enterprise Performance Incorporating Initial Selection Bias Correction. *Economics of Transition.* Volume 5, No. 2. 289 – 304. https://doi.org/10.1111/j.1468-0351.1997.tb00018.x

Mustafa, S. (2018). *Corporate Governance and Company Performance in Kosovo*. Doctoral Thesis.

Mustafa S. (2018) Some Corporate Governance specifications in economies in transition

URI: https://dspace.aab-edu.net/handle/123456789/1185

OECD.(1999). *Principles of Corporate Governance.* Paris. France. Available: https://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=C/MIN(99)6&docLanguage=En

Riinvest Institute. (2013). *To pay or not to pay*. Pristine. Kosova. Available: http://riinvestinstitute.org/uploads/files/2016/October/17/Business_Informality_5mm_bleed_no_inside_ENG_FINALV_313964385731476693005.pdf

Riinvest Institute. (2017). *Business Clime in Kosovo.* Pristine. Kosovo. Available: http://riinvestinstitute.org/uploads/files/2017/May/19/Klima_e_Biznesit1495199071.pdf

Riinvest Institute. (2006). Privatization and Post-Privatization in Kosovo. Pristine, Kosovo. Available: http://riinvestinstitute.org/uploads/files/2016/October/17/english_en1476702396.pdf

Riinvest Institute. (2002).

Stiglitz, J.E. (1999). Wither Reform? Ten Years of Transition. Keynote Address at Annual Bank Conference on Development Economics, World Bank, Washington DC, 28-30. April 1999. http://www.scirp.org/(S(lz5mqp453edsnp55rrgjct55))/reference/ReferencesPapers.aspx?ReferenceID=1901497

Transparency International. (2017). *Corruption Perceptions Index 2017*. Retrieved from https://www.transparency.org/news/feature/corruption_perceptions_index_2017

World Bank (2017). *Economy Rankings*. Retrieved from http://www.doingbusiness.org/rankings