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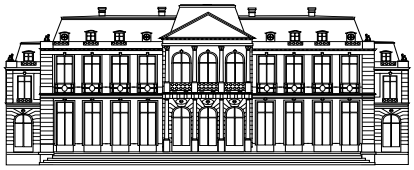

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CORPORATE GOVERNANCE IN LATVIA

by

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Seminar on
CORPORATE GOVERNANCE IN THE BALTICS
Vilnius, Lithuania
21-22 October, 1999

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SUMMARY*

I. Latvia emerged from its rather severe transitional recession with a relatively stable macro economy, which has been able to withstand two subsequent macro shocks. A principal current worry is continuing deterioration in the current account and a worsening of public finances.

II. The corporate governance environment has been shaped by the privatisation process with its emphasis on identifying a strategic investor for most privatised enterprises.

III. Corporate ownership is rather highly concentrated with very few listed companies being without a major shareholder i.e. with shares in excess of 30%. This is rather similar to other emerging market economies.

IV. Nearly half of Latvian shares are foreign owned. This could include 'offshore companies'.

V. Most of the top ten Latvian companies remain state owned, though Latvenergo, the Latvian Shipping Company and Lattelekom are slated for privatisation.

VI. The Riga Stock Exchange is in poor shape with low trading volumes, low market capitalisation and has relied very heavily on the privatisation programme for much of its impetus. OTC and dealings in non-listed shares dominate official RSE turnover.

VII. The banks own very little equity but are playing an increasing if still limited role in providing credit for fixed investment. The major banks are also taking a role in monitoring and restructuring of some enterprises.

VIII. At the end of the first quarter of 1999 6% of bank loans were regarded as "non-performing" and 5% as "close-watch".

IX. There is no significant institutional involvement in corporate ownership and control.

X. FDI has been a major source of financing investment in Latvia but declined significantly in 1998.

* The views in this report are those of the authors and do not necessarily represent the opinions of the OECD or its Member countries.

This background paper was prepared within a set of guidelines provided by the OECD, in order to ensure homogeneity and render cross-country comparisons easier.

The data and discussion focus on large, mostly listed companies and corporate groups, although some observations on smaller companies are also made. No original research, such as new data gathering or corporate surveys was required. Authors were asked to survey existing data and published materials. In some cases, complete and well-supported answers to questions were not possible, due to a lack of data or due to irrelevance of specific questions in the context of individual country environments.

XI. There is perceived to be a close relationship between business and politics and the business/political environment is perceived as dominated by groupings established in the relative free-for-all of the late Soviet and early independence periods.

PART I. INTRODUCTION

1. At a very general level the corporate governance environment of Latvia has been dominated by two factors. In the first instance events were shaped by the necessity to confront the problems associated with Latvia's disengagement from the economic and legal structure of the Soviet Union following the not entirely anticipated and somewhat abrupt resumption of independence in the late summer of 1991. The early post-independence period was marked much confusion and involved disputes concerning ownership and obligations of previously all-Union enterprises. For nearly three years independent Latvia's legislative agency remained the Supreme Council, inherited from the Soviet period, until the Council was replaced by the newly elected 5th Saeima in 1993. A number of early privatisations were undertaken on the basis of Soviet legislation. The early division of ownership of state property emerged from this rather turbulent and shifting environment.

2. In the subsequent period Latvia has taken on the difficult task of creating a market economy in a newly created country – something for which there was no theoretical or practical model. An important element in this task, and one that has impinged directly on the ownership and control of major Latvian enterprises, has been Latvia's privatisation programme. Many of Latvia's most important private companies are the product of this process as is the Riga Stock Exchange.

PART II. THE CORPORATE GOVERNANCE ENVIRONMENT IN LATVIA

THE GENERAL ECONOMIC CONTEXT

3. The starting point of the Latvian economy in 1991 was characterised by deep structural integration with the all-Union Soviet economy with something like 90% of trade conducted with the rest of the Soviet Union. Effectively, at the start of independence Latvia had no independent foreign trade. Much of the period since then has been characterised by the tensions which have arisen between the need to create an independent economy, oriented towards natural trading partners in the West, and preserving the advantages of traditional connections with equally natural, but now politically problematic, trading partners in the East. Today, the EU is collectively by far Latvia's biggest trading partner. However, with a trade share of around 15% Russia remains an important destination for Latvian exports and is of course a major supplier of energy and materials as well as being the origin of much of Latvia's important transit trade.

4. Latvia's macro-economy has been characterised by three shocks – one internally generated and two external shocks. These can be identified in Table 1 which shows the behaviour of some key Latvian macroeconomic variables since 1991.

Table 1: GROWTH RATES OF BASIC INDICATORS

	1991	1992	1993	1994	1995	1996	1997	1998
GDP at constant prices	-10.6	-34.9	-14.9	0.6	-0.8	3.3	8.6	3.6
Industrial output	-	-46.2	-38.1	-9.5	-6.3	1.4	6.1	2.0
Agriculture	-1.7	-28.6	-18.2	-15.0	3.1	-5.3	4.9	-4.8
Inflation	172	951	108	36	25	17.6	8.4	2.8
Current account (%GDP)	-	1.7	14.4	-0.2	-4.2	-5.5	-6.1	-11.1

Sources: Central Statistical Bureau and Ministry of Economics

5. The magnitude of the initial output decline illustrates the severity of the initial shock experienced by the Latvian economy – the cumulative output decline over 1990-93 was about 50% placing Latvia only just outside what Mundell (1997) has called the group of countries which experienced "high contractions". By comparison, Estonia experienced a cumulative contraction about 30% and Lithuania one of about 65%.

6. The second macro shock followed the collapse of Banka Baltija in the spring of 1995, which at that time was, by a large margin, Latvia's major bank with more than 40% of the population as depositors. This reversed the recovery of output that had started in the previous year – perhaps by as much as 2% of GDP. It also seriously damaged the fragile credibility of the banking system – Latvia remains very much a cash economy.

7. The Russian crisis in the late summer of 1998 was the third shock and severely affected trade with Russia with knock-on effects on growth. Latvian growth in 1999 is expected to be about 1%, much down on recent years, largely as a consequence of the crisis. Food processing and textiles are sectors that have been particularly affected. Latvia's banking sector was also heavily exposed to Russian paper and was badly affected with many banks posting losses and with the Riga Commercial Bank a notable victim.

8. Finally, the growing current account deficit accompanied by a worsening fiscal situation represent cause for concern. Last year the current account stood at over 11% of GDP and no longer appeared to be "financed" by the same levels of FDI, as was the case hitherto. The state budget, which for most of the post-independence period has been broadly in balance, is slipping into a 2% of GDP deficit in 1999.

CORPORATE GOVERNANCE CHARACTERISTICS IN LATVIA

THE CORPORATE GOVERNANCE AGENTS

9. Latvia's corporate and financial landscape has clearly been shaped by its privatisation process – by both its successes and its failures. Many of the most important private enterprises have been created by privatisation but some of the very largest enterprises remain in state hands because of disagreements about how they should be privatised. This section starts with brief discussion of the privatisation scheme. It then proceeds to a description of the current ownership structure of the most

important Latvian and enterprises and a discussion of the role of major shareholders, of banks, of the Riga Stock exchange and of foreign investment.

THE PRIVATISATION PROCESS

10. This Latvian privatisation process divides conveniently into two phases. In the first phase, which ran from 1991 to 1995 but was preceded by some de facto privatisation under Soviet co-operative arrangements, privatisation was mainly in the sphere of small enterprises, typically various kinds of service enterprise e.g. restaurants, which previously had been run by municipalities. The form of privatisation was typically a management/employee take-over. During this phase most such small and medium size state/municipal enterprises were privatised. At the same time, according to Jones and Mygind (1998), during this period 222 larger enterprises were also privatised, often by sale or lease to insiders. Typically, the task of preparing an enterprise for privatisation was left to the ministries that had been 'responsible' for the enterprise under the previous regime.

11. According to the results of a survey on ownership conducted by the Latvian Central Statistical Bureau and reported by Jones and Mygind (1998) the end product of this first phase of the privatisation process was an ownership structure in which the dominant form was majority insider ownership. Table 2 shows the ownership structure at the start of 1995 for all enterprises and also for larger enterprises i.e. those with a workforce in excess of 200.

12. Notable features of the structure reported in Table 2 include: i) that 51% of enterprises were owned by insiders and ii) a large proportion of larger enterprises remained in state ownership and iii) very few enterprises did not have a majority owner.

Table 2: ENTERPRISE OWNERSHIP STRUCTURE IN LATVIA JANUARY 1, 1995

	State	Foreign Outsider	Domestic Outsider	Insider	No Majority
All enterprises	16%	5%	26%	51%	2%
Enterprises with workforce > 200	41%	6%	29%	23%	0%

Source: Jones and Mygind (1998)

13. For reasons that were partly to do with the hitherto slow pace of large scale privatisation, unsatisfactory aspects of decentralised privatisation, and the realisation that there was potential for significant state revenues from privatisation, the Latvian Privatisation Agency (LPA) was created in April 1994 in order to take over centralised management of the remainder of the privatisation programme.

14. The creation of the LPA initiated the second phase of the privatisation programme which also coincided with the emergence wider concern about corporate governance, about the role of privatisation in creating capital markets and also about fairness in the distribution of hitherto state-owned property. It was by then recognised that simply to transfer ownership to any private owner may not be sufficient to ensure a well-functioning market economy.

15. These concerns took concrete form in two specific aims of the privatisation process – one of which has been achieved and the other not. One aim was to find for each enterprise strategic investors, thereby avoiding the kinds of corporate governance issues that were apparent in, say, Russia. This aim has largely been achieved. The other aim was to promote widespread share ownership through the privatisation certificate scheme that was intended to provide ordinary residents with the means of acquiring an interest in the privatised enterprises. In practice, this has not really been achieved with vouchers have trading at a heavy discount on their nominal value and with many of them remaining unused. Although at the beginning of 1999 there were 75000 registered shareholders in Latvia (three time the number in the previous year) "natural persons", i.e. individuals, owned only 17% of Latvia's shares by value.

16. This second phase of privatisation has achieved the divestiture of 95% of Latvia's state owned enterprises. Nevertheless, several of the biggest and most important state enterprises remain unprivatised, most notably Latvenergo and the Latvian Shipping Company, or only partly privatised e.g. Lattelekom.

OWNERSHIP STRUCTURE

17. The pattern of corporate ownership in post-independence Latvia has been shaped by two forces: i) the privatisation process as described above and ii) by the creation of new private companies. Table 3 shows the distribution of registered enterprises by type of enterprise since the creation of the State Enterprise Register. The table also indicates the average fate of each kind of enterprise and it can be seen that more than half of the enterprises originally registered in Latvia are no longer active and most of the inactive ones have definitely been terminated. The most popular type of enterprise in Latvia is and has been the "sabiedrība ar ierobežotu atbildību" or for short "SIA" which is a literal translation of "limited liability company". The other important form of private enterprise is the "akciju sabiedrība" or (A/S) which is literally "stock company" or joint stock company. Many of the larger private enterprises are in the form of an A/S which is a form akin to a Western public company. The SIA form is closer to a partnership or closed company and does not issue 'bearer shares". The A/S form of company can also issue a variety of other potentially marketable securities that are not allowed for a SIA.

18. The table 3 shows that currently there are just over 50,000 active registered companies in Latvia and nearly two thirds are of the SIA type. Mostly, these are small and also mostly newly created although some quite large and important enterprises are of the SIA type and some have also been important recipients of foreign investment.

Table 3: ENTERPRISES REGISTERED AT AUGUST 1 1999 (excluding rural enterprises)

Type of enterprise	Registered	Active	Inactive	Terminated
Total number	106,543	52,686	16,118	37,739
Limited liability company (SIA) (%)	65.6	64.8	54	71.5
Joint stock company (A/S)	2.1	2.7	1.2	1.7
State enterprises	1.2	0.3	0.1	2.8
Municipal enterprises	1.3	1.2	0.1	1.7

Individual enterprises	25.3	26.6	41	17
Other	4.5	4.4	3.6	6.3

Source: State Enterprise Register

19. Although state enterprises make up only 0.3% of enterprises by number, these include many of the very biggest enterprises in Latvia. Table 4 shows the top ten Latvian enterprises by revenue in 1998.

Table 4: TOP 10 LATVIAN COMPANIES IN 1998

Rank	Company	Sector	Revenue (million lats*)	Workers	Ownership status
1	Latvenergo	Energy	175.5	7,445	State
2	Latvian Shipping Company	Transportation	126.7	380	State
3	Lattelekom	Telecommunications	114.8	6,500	State (51%)
4	Latvian Railways	Transportation	113.2	18,483	State
5	Latvijas Gaze	Gas	87.3	2,817	Privatised (39% state interest)
6	Ventspils Nafta	Oil transport	79.3	869	Privatised (44% state interest)
7	Latvian Privatisation Agency	Privatisation	72.3	NA	State
8	Rigas Siltums	Energy	66.3	1,755	Municipal
9	Procter & Gamble	Trade	61.7	34	Foreign
10	Liepajas Metalurgs	Manufacturing	59.8	2,200	Privatised (83% foreign owned)

*NA= Not Available
Source: Dun & Bradstreet

20. It is interesting that, apart from Proctor & Gamble, which is a wholly owned Latvian subsidiary of the foreign parent, and Liepajas Metalurgs, which is 80% owned by a foreign strategic investor, all of the top ten are either wholly state owned or the state (usually in the form of the LPA) continues to have a significant interest. It is interesting also that the LPA itself is ranked at number 7 – it remains a significant owner in its own right. Latvenergo, Lattelekom and the Latvian Shipping Company have

* Exchange rate: 1 Latvian Lats = US$ 1.709

all been slated for privatisation or full privatisation for some time but especially in the case of Latvenergo, Latvia's biggest and most profitable enterprise, and the Latvian Shipping Company privatisation continues to be delayed by a political/commercial power struggle over the destiny of these enterprises.

21. The full privatisation of Lattelekom is also caught up in a political/commercial tangle. In the initial deal negotiated with its strategic foreign investor Lattelekom was granted a monopoly in Latvia to the year 2013 in return for the massive injection of foreign investment which has modernised the system. However, it now turns out that this is contrary to WTO rules and inconsistent with EU rules as well and the monopoly will now be terminated in 2003. Accordingly, the strategic investor – the Finnish owned Tilts Communications (and actually different from the original strategic investor), will need to be compensated. Naturally, there is great reluctance to offer straight cash or even shares of Lattelekom. One scheme under consideration by the LPA is to create a new holding company, which will own both Lattelekom and Latvian Mobile Telephones (LTM), and to compensate Tilts with shares in the new holding company.

22. Latvian Gas, another top 10 enterprise in which the state has retained a 39%, has been held up in its attempt to undertake two new share issues decided on in a July 1998 shareholders meeting. The meeting had proposed a public issue of state-owned shares on the Riga Stock exchange at 2.5 lats per share and a closed issue at 1.46 lats. This controversial scheme has been forwarded to the Latvian State Auditor who is due to pronounce on it shortly.

OWNERSHIP OF LISTED COMPANIES

23. An alternative measure of a company's importance is stock exchange listing. The Riga Stock Exchange (RSE) has 10 enterprises on its Official List (including the suspended Riga Commercial Bank) and 18 on its Second List (including the troubled Jekabpils Sugar Factory whose listing was suspended on 16th Sept). There are a further 42 enterprises on the Free List where listing requirements are less stringent.

24. The ownership structure of companies on the Official and Second Lists is shown in Table 5.

Table 5: SIGNIFICANT OWNERS OF LISTED COMPANIES

	State	Foreign	Latvian	None
Number of companies with >30% share	2	10	14	3

25. For the 18 companies on the two lists (including the two suspended ones) Table 5 shows the distribution of ownership of shareholdings in excess of 30%. Thus in two cases the state owns more than 30% of the shares, in ten cases there are foreign holdings in excess of 30% and so on. In three cases there is no shareholder with more than 30%. These figures are based on the shareholder information held by the RSE, but two comments need to be made: i) in some cases Latvian designated shares are held by companies which themselves may be owned by foreigners, and ii) even when there is no direct evidence of a single large shareholding two or more shareholders may actually be acting in very close liaison – a notable example here is Latvian Gas in which Gazprom and Rhurgas each own 16.25% of the shares but Rhurgas itself has a stake in Gazprom and the two enterprises have a long connection. Rhurgas was for many years a major importer of Soviet gas and has been closely connected with Gazprom since the incorporation of Gazprom in 1993. Moreover, the 16.25% shareholding s were allocated simultaneously as part of a direct deal with the LPA which by-passed the normal Public Offering scheme.

26. The distribution between foreign and local ownership for theses enterprises does not appear out of line with Latvian Central Depository (LCD) data for the whole economy in which it is reported that at January 1, 1999 52% of all shares (by value) in Latvian enterprises were held by Latvian residents and 48% by non-residents. Moreover, the concentration of ownership and the absence of dispersed shareholding indicated in Table 5 is in line with evidence on corporate ownership in countries with poor minority shareholder protection, as is arguably the case in Latvia, reported by La Porta, Lopez-de-Silanes and Shleifer (1999).

27. The most obvious systematic ownership tendency has been the emergence of large a Nordic stake in the Latvian banking industry. Thus, the Swedish Skandinaviska Enskilda Banken (SEB) after a rapid build up of purchases now holds just over 50% of Unibanka shares; the Finnish Merita Nordbanken Group own 70% of the Latvian Investment Bank and Swedbank are near majority shareholders in Hansabank, an Estonian incorporated bank, but listed on the RSE and active in Latvia.

28. Otherwise there are no clear ownership patterns and no obvious pattern of cross ownership or multiple ownership. Exceptions include: Staburadze, a confectionery company, in which Hansabank has a 37% holding and which in turn owns nearly 53% of Naruta – another listed confectionery company; Ave Lat Group, wholly owned by Prime Minister Škele and unlisted, which owns Latvian Balzam, a drinks producer and Kaiija a major fish products producer, both of which are listed; and Gesil Ltd, an Irish company, which is a majority shareholder in both Liepajas Metalurgs, a metals producer and the Liepaja Oil Extraction Factory which process edible oils.

MAJOR SHAREHOLDERS

29. The LPA policy of attracting a “strategic investor” as part of the Public Offering scheme has resulted in many important privatised enterprises that are dominated by a major shareholder. For other reasons, some important new private enterprises such as Parex Bank also have major investors. The corporate climate in Latvia is such that few local people would be willing to invest significant sums in enterprises in which they had little or no control – the idea of the “control packet” is very important.

30. On the whole the official view of major shareholders is positive and where the major shareholder is foreign this is perceived as helping in achieving access to cheaper foreign credit. In society as a whole, major shareholders do not have such a positive image – there is a view that the enterprises they control are instruments for the furtherance of personal ambition, both economic and political. Also, it is interesting that according to opinion polls the LPA, which has been responsible for creating much of Latvia’s corporate structure, ranks with the Latvian Customs Service as Latvia’s least trusted institution.

31. In private circles even foreign investors are sometimes regarded with suspicion. For example, there is a view that the drive by Swedish banks to control Baltic banking is motivated by a desire to protect their investments in Swedish industrial enterprises for which Baltic companies may be competitors. Thus the argument runs that Swedish dominated banks will refuse to support Baltic competitors of Swedish enterprises which are owned or funded by the Swedish banks.

BANKING SECTOR AND OTHER FINANCIAL INTERMEDIARIES

32. The banking sector in Latvia does not appear to be heavily involved in direct ownership of enterprises. In 1997 only 3% of banks’ assets were held in the form equity and this had fallen to just 1% by the end of 1998 (presumably because of the fall in equity prices). This was quite smart – had

the banks become seriously involved in equities then the near catastrophic fall in stock market prices over the last two years would have had serious repercussions on the banking sector itself. Only Hansabanka of the listed banks owns more than 5% of another listed company.

33. Until a couple of years ago the banks were extremely reluctant to lend to the corporate sector at all except for in the very short term – even now the ratio of short term to long term liabilities of all Latvian companies is about 2:1

34. Nevertheless, today the major banks do lend to the corporate sector. At the end of 1998 commercial loans accounted for 42% of the total assets of the banking system. Most credits were for working capital but 24% were for fixed investment and about 60% were for a term in excess of 1 year. It is also reported that the banks have collaborated in syndicated loans for some large projects.

35. Moreover, the banks do exercise some control and influence though their lending decisions. Thus the Singapore owned Toleram Fibers were forced to cease production in the summer after Unibanka decided not to renew credits and now in September the Jekabpils Sugar Factory has met the same fate as a consequence of a refusal to renew credits.

36. On the other hand, the largest enterprises also have power vis-à-vis the banks. For example, it was announced on Sept 17th that Parex Bank had won a tender to provide a 2million lats one year credit to Latvenergo in competition with four other major banks including Hansabank and Unibanka.

37. The major banks do not appear to be part of corporate groups and there do not appear to be many other important intermediaries such as merchant banks, finance and securities companies. Some non-bank financial intermediaries such as leasing companies are owned by the banks.

EQUITIES MARKET

38. The equities market in Latvia consists of the Riga Stock Exchange which deals in its listed securities and consists of 22 trading members there is also a set of 27 securities dealers licensed by the Securities Market Commission of Latvia (SMC) of which 4 appear to have had their licenses suspended. The official activity of the RSE represents only a small fraction of total securities transactions. According to SMC data (some of which are rather hard to interpret) the 1998 gross turnover on the RSE was 95.3 million lats. A further 205.6 million lats turnover in listed securities was carried out in the over-the-counter market; additionally there was close to 1000 million worth of turnover in non-listed securities. About 1/3 of intermediary turnover was on client's account and the remaining 2/3 was on own account i.e. purely between intermediaries

39. The role of the securities market in corporate finance is hard to quantify. The RSE in particular has in many respects been a creation of the privatisation process – most of the listing is the result of voucher privatisations and the public offering scheme. There is a view that the low liquidity (especially low in Riga as compared even with the other Baltic stock exchanges) makes the RSE a poor destination for small savings and that in any case the larger listed companies will seek to move to other larger Nordic or European exchanges. Market capitalisation on the RSE currently stands at just under 6% of GDP which is lower than (and in many cases – much lower) that of any other Eastern European exchange listed in the Central European Economic Review as is the average daily RSE turnover. Public confidence has not been helped by recent accusations by the head of the SCM that market manipulation is prevalent on the RSE.

40. There is not much evidence of take-over/merger as a discipline mechanism that is not surprising when there is almost no dispersed shareholding. Banking sector experience provides a couple of

exceptions to this. Thus, the Swedbank acquisition of Hansabank was regarded by its Estonian management as hostile. Possibly also the rapid build up of a majority holding in Unibanka by SEB can be seen as hostile – it certainly led to boardroom changes at Unibanka.

INSTITUTIONAL INVESTORS

41. According to LCD data as of Jan 1 1999 funds owned about 6% of Latvian shares by value – 17% were owned by "natural persons"; 10% by foreign holding banks and 67% by companies. Ownership data on listed companies does not show any significant equity holdings by insurance companies and the state pension fund is a smallish shareholder in a few instances. The potential for monitoring by institutional investors remains to be developed in Latvia.

THE STATE

42. As indicated above the state remains a significant owner of important enterprises. Yet, there is no evidence that the state has influenced corporate governance indirectly through its responsibility for supervision of the banking system nor is there evidence that credit has ever been rationed. In fact both supervision and monetary policy is in the hands of the Bank of Latvia which has "super independent" status. However, it has emerged that the Bank of Latvia is to inject 15m lats into the Riga Commercial as part of that bank's rehabilitation and thereby become a major shareholder. This is expected to be temporary but nevertheless involves a potentially serious conflict of interest.

43. Corruption and cronyism are central features of the political/corporate scene in Latvia. On most indicators of corruption Latvia usually comes out only just above Russia and much below many other Central and Eastern Europe countries. Banks and enterprises are widely suspected of money-laundering – most recently in September of 1999 there is a suspicion that a 3million lats employee life insurance proposal by Latvenergo has been intended to conceal a money laundering scheme. In January the chairman of Latvian Gas signed a contract without consulting the board – this was illegal according to the rules of Latvian Gas. Instead of a reprimand it was decided that in future the chairman could sign such deals without consultation. When the telecom regulator objected to Lattelekom tariffs the regulator was removed. And so on…

INVESTMENT AND FOREIGN INVESTMENT

44. In a market economy gross fixed capital formation is an important indicator of economic progress. In Latvia the ratio of gross fixed capital formation has been low but growing. This is illustrated in Table 6 that also shows the contribution of inward investment in Latvia.

Table 6: RECENT INVESTMENT DEVELOPMENTS IN LATVIA

	1996	1997	1998
Gross fixed capital formation as % of GDP	18.1	18.7	20.1
Foreign Direct Investment as % of GDP	6.7	7.0	2.5
Total foreign investment as a% of GDP	16.7	20.7	5.5

Source: Ministry of Economics

45. Despite ambivalence by some in the private sector, the official attitude to foreign investment in Latvia has always been very positive. Indeed, a major function of the government funded Latvian Development Agency (LDA) has been to promote inward FDI. For the record, the cumulative per capita FDI of 720bn USD is among the high figures for central and Eastern Europe. Table 7 shows the destination by company of the most important FDI.

Table 7: Companies with Cumulative Foreign Direct Investments (in excess of 5m lats) in millions of lats as of 9th June 1999

Company	Investment
LATTELEKOM SIA	96.2
LATROSTRANS SIA	36.6
SHELL LATVIA, SIA	18.8
KELLOGG LATVIJA	17.9
RIETUMU BANKA,	17.4
TOLARAM FIBERS A/S	17.3
LATVIJAS UNIBANKA A/S	16.4
PAREKSS-BANKA A/S	15.3
HANSABANKA A/S	14.5
LINSTOW VARNER SIA	13.0
LATVIJAS GÂZE A/S	11.7
LATVIJA STATOIL	10.4
BANKA BALTIJA A/S	10.0
RÎGAS TRANSPORTA FLOTE A/S	9.6
AIR BALTIC CORPORATION A/S	7.6
NESTE LATVIJA	6.9
RĪGAS KOMERCBANKA A/S	6.7
PROEXPO SIA	6.5
KÂLIJA PARKS A/S	6.2
LIEPÂJAS METALURGS A/S	6.1
TELIA LATVIJA SIA	6.1
ALDARIS A/S	5.6
SOFTWARE HOUSE RÎGA A/S	5.4
ALDARIS-UB SIA	5.4
AGA SIA	5.1

Source Lursoft Ltd

CORPORATE BEHAVIOUR, FINANCE ND RESTRUCTURING

46. Since many of the most important Latvian companies have had a rather short existence as private enterprises it is rather difficult to make generalisations about corporate behaviour in Latvia. Most

have been privatised since 1995 usually on the basis of restructuring with the help of a strategic investor. The 1998 Russian crisis is the first regular recession to have hit Latvian industry and its effects are still working through the system. Thus Latvian industry has not yet experienced a full normal business cycle.

47. Structurally, diversified groups do not appear to be important in Latvia at present. Where there are groups or holding companies they appear to be concentrated in a sector e.g. Ave Lat group in food and beverages.

CORPORATE FINANCE

48. As indicated in Table 6, fixed investment in Latvia has been at about 18% of GDP, rising to 21% of GDP in 1998. This is rather low for a country like Latvia that is engaged in a fundamental restructuring of its economy. Until 1998 something like one third of fixed in vestment was financed by FDI. But in 1998 fixed investment rose and FDI fell so investment must have been increasingly financed from local savings – presumably, in many case the source of funds was internal. The stock exchange is not regarded as a major source of new finance because of abysmally low stock prices although Latvian Gas is about to launch its third new issue of the year on October 11th.

49. Banks so far have not been major sources of long term corporate finance in Latvia. The debt/equity ratio for all companies in Latvia is currently at about 0.48, slightly up from 1998. The ratio of long to short term liabilities is about 1:2. Data for 23 non-financial listed companies shows that 11 had equity/assets ratios in excess of 0.8 and in several cases above 0.9. This suggests rather low levels of leverage. In 7 cases, the equity/asset ratio was below 0.5 – two of these were pharmaceutical companies, two were owned by the same foreign strategic investor and one Jekabpils Sugar Factory which had the lowest equity/assets ratio at 0.26 has just been forced to cease operations when bank credits were not renewed. As of the end of the first quarter of 1999 it was reported that 6% of bank loans were non-performing and that 5% were close watch. Total special provisions stood at 5% at the end of 1998.

RATE OF RETURN ON EQUITY

50. Precise figures are not available on the rate of return to equity in Latvia but the holding rate of return has clearly been dominated by the calamitous fall in the RSE since Oct 1997. For example the RICI (Riga stock exchange index) today stands at 156 down from a lifetime high of 1015 on 12th September 1997. Similarly, the Rietuma Banka indexes, one for all listed companies and the other for the top16 companies are down to less than a quarter of their October 1997 peaks. It is interesting that the Riga stock price slide followed the Moscow slide in autumn of 1997 i.e. it preceded the onset of the Russian crisis proper in 1998. However, in contrast to Moscow the RSE remains in the doldrums not having followed the recent Moscow resurgence.

RESTRUCTURING AND EXIT MECHANISMS

51. Many enterprises have been newly restructured through the privatisation process. The Russian crisis has had significant effects in some sectors e.g. food processing and textiles and there is concern about the effects of failing enterprises in depressed regions. Thus the difficulties of Tolaram Fiber in Daugauvpils where unemployment is in excess of 20% have prompted an initiative for a deal between government, the banks and the owners to trade tax relief on the part of the government for new investment and renewal and extension of bank credit on the part of the company and the banks. Similarly, there is political pressure to “do something” about the failed Jekabpils Sugar Factory. Thus in some cases a government/enterprise/banks solution is being sought.

52. Merger and take-over do not appear to have emerged as significant mechanisms for change of corporate or management direction except for the case of the banking sector. It is unlikely that these

mechanisms will ever be important unless or until the stock market deepens and dispersed shareholding and/or shareholding by institutions becomes much more important than it is today.

53. The evidence suggests that traditional exit mechanisms work reasonably well for small enterprises but for the larger traditional ones this is not clear. Thus about 35% of Latvian enterprises have been terminated since registration. Most of these are of the SIA variety and many may have never been active but many have been terminated through insolvency. However, for big enterprises insolvency proceeding can take years, e.g. the Banka Baltija proceedings that commenced in 1995 are still not complete.

PART III. THE REGULATORY FRAMEWORK AND THE ROLE OF POLICY

54. The present legislation governing the issues of Corporate Governance has been developed during the first years of independence – from 1990 till 1993. The main laws regulating the public companies are the Law on Entrepreneurial Activity, Law on Enterprise Register, Law on Joint Stock Companies and Law on Securities. These laws, except the Law on Joint Stock Companies, are rather outdated, therefore the necessity for modern legislation has been acknowledged by the Government already back in 1994 when the first workgroup of draft Commercial Law was established. In 1995-1996 the draft was finished but it did not provide for a qualitative development. It was rather codification of the existing legislation into a single legal act without adding value necessary for the development of modern legislation. In 1997 a new workgroup was established the task of which was to reform the existing legislation in line with modern tendencies, including the approximation with the law of European Communities.

55. The draft Commercial Code was drafted by the end 1998. It is harmonised with the law of European Communities, particularly in areas of information disclosure, equity capital, protection of shareholders in cases of reorganisation, protection of creditors. For the time being it is passed by the parliament (Saeima) in the first reading. The draft might be adopted by the end of 1999. In comparison with the old legislation, it provides for better protection of third parties and minority shareholders and simplifies formation process of the companies.

EQUITABLE TREATMENT OF SHAREHOLDERS

SHAREHOLDER PROTECTION

GENERAL PROBLEMS

56. In general the present laws provide for rather adequate rights of shareholders and equal treatment of them. Nevertheless, there are some exceptions that may infringe their position. The following are the examples, where the shareholders rights can be ignored, manipulated or where the protection mechanisms do not function properly:

- Firstly, the pre-emption rights to the shares of a new issue of a public company applies only to the so-called “closed issue”, not to publicly issued shares. It means that there is a possibility, which sometimes is utilised in practice, that majority of shareholders holding public issue shares become minority after issue of closed issue shares. This has been corrected in the draft Commercial Code by providing pre-emption rights to all the shareholders.

- Secondly, unfortunately one of the mechanisms designed for protection of shareholders, namely law suits against company officials, for some reasons are not utilised in practice (see 2.3. below). Nevertheless, there are cases where such lawsuits would be successful from the point of view of shareholders.
- Thirdly, there are rather cumbersome procedure of general meetings: the law requires presence of at least 50 per cent of the paid-up capital in order to hold the annual General Meeting (in some cases as statutory changes, reorganisation, liquidation – 75 per cent); if there is no quorum, the next meeting is convened with no quorum requirements. For extraordinary meetings in case of lack of quorum the next meeting is convened with less quorum requirements (25 per cent), if there is no quorum in the second case, another meeting is convened without quorum requirements. This leads to the problem when a group of shareholders can totally disorganise the meeting by not showing up. Without the required quorum the meeting cannot adopt any resolutions.
- Fourthly, position of shareholders may be indirectly weakened by the existing unclear classification of shares into classes and categories which often in practice is misleading for the shareholders (see 1.2. below). The draft Commercial Code provides only for the classes of shares in order to clear out the present situation.
- Fifthly, under the existing legislation there is a rather peculiar mechanism of waiving the liability of directors which removes some mechanisms for protection of shareholders (see 1.7. below).
- Sixthly, minority shareholders are not protected in case of reorganisation (merger or division) of the company. All the reorganisation is carried out as decided by majority. The same problem appears also in cases of groups of companies with parent-subsidiary relationship.

57. Crisis did not have direct impact on legal development in the area of corporate governance, nevertheless the legal development in this area is evolving through the draft Commercial Code. The draft Commercial Code provides better protection of shareholders, particularly of minority shareholders. Thus, general pre-emption rights for the existing shareholders are provided, general waiver of liability of directors is replaced by waiver of liability for specific activities, minority rights are significantly improved in case of reorganisation by providing them with right for compensation and/or exchange of shares.

REGISTRATION OF SHARES AND VOTING RIGHTS

58. Share registration in the company is applicable only to the registered shares and “closed-issue” shares as opposite to the bearer shares and public issue shares that are not registered. The registration of shares has two consequences: first, the person who has acquired registered shares acquires the rights of the shareholder from the moment of registration; second, the holder of registered shares is entitled to vote in the general meeting only if their shares have been registered at least 10 days before the meeting. The law does not provide for publicity of the register. It is the duty of the Board of Directors to carry out the registration.

59. There is a different kind of registration of shares. The shares of the public joint stock companies are registered, besides the registration of the registered shares in the company, at the Central Depository. The Central Depository does not have data on distribution of shares among all the shareholders, but just on the depositories – banks and brokerage companies that hold securities accounts of their clients. There is one-share-one-vote principle.

60. The shares are divided into categories and classes. The category of shares is about group of shares carrying equal rights. There are shares of the following categories: with voting rights; without voting rights; with restrictions of voting rights; with restrictions of alienation; with fixed dividend;

with special conditions in case of liquidation of the company. The classes of the shares are the following: ordinary, privileged and personnel shares.

61. The distinction between classes and categories is vague causing misinterpretation. The draft Commercial Code clarifies the issue by providing only for classes of shares.

62. Voting by proxy is possible in presence of a written authorisation. Board of Directors members Supervisory Board members and auditors of the company may not be representatives of a shareholder of the company.

63. During the General Meeting each shareholder has right to freely express his/her views.

64. Electronic voting, even though not explicitly prohibited, is not exercised basically due to lack of technical solutions and related legal issues (such as electronic signature).

SHAREHOLDERS' RIGHTS ON MAJOR ISSUES

65. Shareholders are not required by the law to approve the major transactions of the company. Nevertheless, the law provides that the statutes of the company may set forth requirements that major transactions or transactions outside the ordinary course of business must be approved by the Supervisory Board which, according to the law, represents the shareholders in between the General Meetings.

66. Pre-emption rights on the new issue of shares are not adequately governed in the present legislation. Only holder of so-called closed issue shares has the pre-emption rights when new closed issue takes place. Holders of public issue shares do not have pre-emption rights neither when a new closed issue nor when a new public issue is performed. In practice it means that holders of public issue shares are not protected against changes in the ownership structure and proportions of votes of the company. Particularly dangerous in this context is the power of the Board of Directors, if in general provided for by the statutes of the company, to increase equity capital at its discretion once a year up to 30 per cent. Through this the ownership structure may be changed impairing the interests of the existing shareholders.

67. Changes in the conditions of the investments by the shareholders are usually done by increase of equity capital or by changes of the statutes. These issues are under control of shareholders participating in the General Meeting adopting these changes. Shareholders not satisfied with the changes may contest the respective resolutions in general procedure described in (1.7.) below.

CONFLICT OF INTERESTS

68. The conflict of interests between managers or major shareholders and the company is being solved by several mechanisms. One mechanism is enacted by providing transparent transactions. The second mechanism is restrictions on voting rights of a board member being in conflict of interest. The third mechanism is restrictions to occupy certain positions, to have different, than the company's, economic interest, and related disclosure requirements.

69. If the company, within two years after its registration, acquires property from a founder of the company in excess of 10 per cent of the equity capital, the acquisition must be checked by independent experts appointed by the Enterprise Register (Art.32). The report of the expert has to be approved by the General Meeting and published in the official gazette. This rule does not apply if the property is acquired through an ordinary civil law transaction, in accordance with a court resolution or acquired in stock exchange (if the last two conditions of inapplicability are acceptable, the first one is extremely vague)

70. The law (Art. 59) implicitly provides for a possibility that the transaction between the company and a shareholder is accepted by the General Meeting. Nevertheless there is no clear requirement, the article just stipulates that in case of voting for acceptance of a transaction between the company and a

shareholder, the shareholder shall not have voting rights in this issue of the agenda. In principle this is an issue that may be regulated by the statutes of the company.

71. There are two restrictions regarding the voting rights of a board member in the board meeting in presence of conflict of interests. The Board of Directors and Supervisory board members, as well as the auditors of the company do not have voting rights if there is voting for his/her dismissal, bringing a claim against him/her or waiver of liability. Also the board member does not have voting rights deciding on issues if there is a conflict of interests between him/her (or his/her close relatives) and the company. In such cases the board member has to disclose the relevant information on the conflict of interests. Failure to disclose leads to unlimited liability of the board member towards the company for all the losses sustained to the company by such behaviour.

72. The law provides for a possibility to control the conflict of interests between the board members and the company, which may arise from a board member being involved in other types of activities outside the company. Thus, the General Meeting may stipulate that a board member may not be a shareholder of another company or owner of an enterprise, or be employed by another company or enterprise. Such a restriction may be extended also to the positions in state and municipal institutions. Even if there is no such restrictions imposed by the General Meeting, each appointed board member has to disclose information regarding his/her employment or ownership, as well as positions held in other companies or enterprises. The same information has to be disclosed also regarding the close relatives of the board member.

PROTECTION OF SHAREHOLDERS IN CASE OF TAKEOVERS

73. Protection of shareholders in case of take-overs is different in case of shareholders holding public issue shares and shareholders holding closed issue shares.

74. With respect to the shareholders holding public issue shares the Law on Securities provides thresholds of 1/10, 1/5 and 1/3, reaching which the acquirer of the shares must notify the company. Failure to disclose the acquisition of shares results in lack of voting rights assigned to the shares acquired.

75. Recent amendments to the Law on Securities provide that a person, who has acquired public issue shares, which exceeds 1/2 or reaches 2/3, 3/4 or more votes in the General Meeting, the person has to offer to purchase all the shares held by other shareholders.

76. With respect to the shareholders holding closed issue shares, there is a different protection mechanism. If a person acquires closed issue shares from a shareholder, other shareholders have pre-emption rights towards these shares proportionally to the amount of shares they are already holding. The offer to other shareholders is done by the Board of Directors pursuant the application of the shareholder intending to sell his/her shares.

77. In practice hostile take-overs are not very common. There have been some unsuccessful attempts that failed due to unwillingness of the existing shareholders to co-operate with an outsider.

INSIDER TRADING REGULATION

78. The insider trading regulation is divided between two laws. General clause contained in the Art.34 of the Law on Joint Stock Companies provide that a person selling the internal information of the company, or using it for private enrichment covers the damages of the company in the triple amount.

79. Specific regulation is contained in the Law on Securities (Art. 26, 35, 48, 60) and is applicable to persons related to the publicly tradable shares – officials and employees of the issuer, stock exchange, Central Depository, brokerage companies and the supervisory body – Securities Market Commission.

MECHANISMS OF PROTECTION OF SHAREHOLDERS

80. In principle, there is no minimum percentage of shares needed to obtain general information from the company through participation in the General Meeting. The law provides that shareholders are entitled to obtain information on the both before general meeting (on issues of the agenda) and during the meeting. During the meeting shareholders may request any information from the Board of Directors. The Board may reject the request only if commercial secret would be disclosed thereby.

81. Shareholders representing at least 5 per cent of the paid-up capital (or less if provided by the statutes) may request the Board of Directors to convene extraordinary General Meeting proposing the agenda. (Art.51)

82. Shareholders may vote for dismissal of company officials (Art. 54). Even if the issue of dismissal is not in the agenda of the General meeting, the Meeting may vote for dismissal upon proposal of a shareholder (Art.57 (4)).

83. Any shareholder may contest the resolution of the General Meeting under any of the following circumstances(Art.63):

- if the shareholder was present at the Meeting, voted against the resolution and requested to include his/her protest in the minutes;
- if the shareholder without legal ground was not admitted to the Meeting;
- if the Meeting was convened in violation of the law.

84. The court, pursuant the claim of a shareholder, may declare the resolution void under any of the following circumstances (Art.64):

- the resolution contradicts with the law or the statutes of the company;
- the resolution was adopted as a result of exercise of voting rights by a shareholder in order to acquire unjustifiable privileges;
- the resolution contradicts to the interests of the company.

85. Any shareholder may petition the court to declare the company void if: (Art. 94)

- the statutes of the company contradict the law;
- the foundation of the company contradicts the law.

86. All the lawsuits, including those against officials of the company are to be brought to the local courts. There is no system of specialised courts, such as commercial courts or bankruptcy courts, in Latvia.

87. The members of the Board of Directors and Supervisory Board of the company are jointly and severally liable towards the company, its shareholders and creditors for losses caused by illegal or *ultra vires* action, by negligence or with malicious intent. This liability is somehow limited in cases when the above mentioned officers, carrying out the examination of the foundation procedure of the company, were not acting in good faith; in such a case they are jointly and severally liable if the losses cannot be recovered from the founders of the company.

88. According to the law, the annual general meeting has to decide on the waiver of liability of the Board members for the previous year. It means that after such a resolution is passed, the company may not sue the Board members of the company, even if the losses from the action are sustained later. Usually general meetings waive this liability without going into many details and it is regarded

just as a necessity to fulfil the requirements of the law, not as a protection mechanism. The new draft Commercial Code provides that the General Meeting may waive the liability of the Board of Directors members towards the company only for their specific actions, not in general for the whole period.

89. The auditors of the company are jointly and severally liable towards the company, its shareholders and creditors for losses caused by failure to carry out their tasks intentionally or due to negligence.

90. There are two mechanisms of protection of shareholders against intentional or negligent action by the company officials: (1) direct protection – a claim of a shareholder against officials; (2) indirect protection through the company – a claim of the company against its officials:

- The law provides for liability of Board of Directors and Supervisory Board members against the shareholders (Art. 96). It means that a shareholder may bring a claim against board members if the shareholder can prove the damage that resulted from illegal or negligent action of the board.
- It is also possible that the company brings a claim against company officials (Art. 100). The decision of the General Meeting passed by simple majority of votes, or a request by minority shareholders representing at least 10 per cent of the paid-up capital is required to bring the action.

91. A lawsuit against officials of the company can be triggered by simple majority of votes at the general Meeting or by request of minority shareholders representing at least 10 per cent of the paid-up capital. This minority may nominate its representatives in the court case, but it is discretion of the court to confirm the representation (Art.100).

92. Waiver of the claim against or settlement with the officials is not allowed if there is an objection to it by minority shareholders representing at least 20 per cent of the paid-up capital (Art.100).

BALANCE BETWEEN PROTECTION OF SHAREHOLDERS AND SMOOTH RUNNING OF THE COMPANY

93. There are some balancing devices for the purpose to ensure the effective running of the company and possible obstacles to that created by shareholders misusing their rights.

94. One of such devices is the limitation period to the right of shareholders to propose amendments to the agenda of the General Meeting – 7 days after publication or receipt of announcement. (Art. 55). This ensures timely preparation and receipt of the agenda by all the shareholders.

95. Another mechanism is - if the court reject the claim by minority shareholders against the officials of the company, the minority shareholders who triggered the claim must cover the court expenses. In addition to that, if the person against whom the ungrounded claim was triggered has suffered damages, the shareholders who have triggered the claim are jointly and severally liable for the damages if they acted in bad faith or by gross negligence.

THE ROLE OF THE BOARD OF DIRECTORS

COMPOSITION OF THE BOARD OF DIRECTORS

The limits to the size of joint stock companies are established by the law. The minimum number is 3 and the maximum – 12. In practice most of the large public companies have the number in between 7-10.

96. There is no legal requirement to have representatives of employees, creditors or major clients on the Board of Directors. In practice there have been cases when a major creditor has been represented on the Board of Directors.

CONSIDERATION OF MINORITY SHAREHOLDERS BY THE BOARD OF DIRECTORS

97. Minority shareholders have the following rights to which the Board of Directors has to give consideration:

- to request the Board to convene extraordinary General Meeting of the Company within one month from such a request (Article 51 Paragraphs 1 and 3);
- within 7 days after the receipt of the notice on the General Meeting to request the Board to include any additional items in the agenda of the General Meeting; no specific form of such a request is required by the Law (Article 55 Paragraph 7);
- to request from the Board any information relevant to the issues included in the agenda of the General Meeting; such a request must be submitted to the Board not latter that 7 days before the date of the General Meeting; Board may reject the request only if commercial secrets are disclosed thereby and such a dispute between the Board and the Shareholder may be resolved by a resolution of the General Meeting (Article 57 Paragraph 5);
- 3 days from the date of the General Meeting to request the Board the list of shareholders entitled to participate in the General Meeting;
- to request the Board during the General Meeting the information on economic situation of the Company; the Board may reject the request only if such a disclosure may cause losses to the Company or it's contractual partners (Article 60 Paragraph 7);

INTERLOCKING DIRECTORATES

98. The law does not restrict a person to be a member of the Board of Directors of more than one company. The only device to protect the interests of the company is the limitations imposed by the General Meeting and disclosure requirements, as described in (1.4.) above.

99. Development of interlocking directorates is no a common practice in Latvia, although they sometimes do exist. Particularly these practices exist among holding companies and their subsidiaries.

LIABILITY OF DIRECTORS

100.The law provides that directors are liable towards the company, its shareholders and creditors for illegal, *ultra vires*, negligent or intentionally malicious action (see also 1.7. above).

101.Civil liability: directors are jointly and severally liable with all their property towards the company, its shareholders and creditors under above mentioned conditions.

102.The following penal sanctions provided for by the Criminal Law may be applicable to directors:

- Fraud (Art.177)
- Misappropriation of entrusted property (Art.179)
- Negligence (Art. 197)
- Commercial bribery (Art.199)
- Unlawful acquisition or disclosure of commercial secret (Art.200)
- Negligent and fraudulent bankruptcy (Art.213)

103.In principle the legal provisions of both civil and criminal liability of directors are acceptable, but they are practically not applied basically due to failure to provide sufficient evidence to be recognised by courts.

ELECTION OF DIRECTORS AND THEIR FEES

104.The Board of directors is elected by simple majority of votes by the General Meeting, even though the Company has the Supervisory Board. This is different approach from what is used in other countries with two-layer system. It results in a smaller role of the Supervisory Board.

105.The cumulative voting does not exist, but there are amendments to the law drafted to provide for it.

106.Outside directors are allowed by the law, but after their appointment they have an obligation to buy shares of the company in the amount as provided by the statutes of the company.

107.Boards of internal audit and different committees are established by the General Meeting, therefore they are not subordinated to the Board of Directors.

108.Compensation may take form of stock options. Usually this is done in form of closed-issue shares that the acquirer may not alienate within six month from the date of subscription.

109.Directors' fees usually are not publicly disclosed, except state owned joint stock companies.

REGULATION WITHIN THE AREA OF CORPORATE GOVERNANCE

110.The main rules on corporate governance and the role of boards are included in the company law. The general company law sets rules for all types of both private and public companies. Law on Securities just provides for additional, usually just more specific, regulation for public companies.

111.There are no voluntary corporate government guidelines developed, nor have there been serious attempts to do it. In general self-regulation, if not backed by a legal act, is regarded to be rather inefficient instrument.

THE IMPORTANCE OF TRANSPARENCY AND DISCLOSURE

112.The accounting law and law on annual accounts generally correspond to the systems used in western countries. For the time being, there are two developments taking place: first, the law on consolidated accounts is in the parliament for adoption; second, Latvian Accounting Standards, on the basis of International Accounting Standards, are being developed by the Sworn Accountants Board.

113.The present legislation on consolidated accounts provides for consolidation, if one company holds more than 50 per cent of equity in another company. There is no provision on multi-layer groups, only two-layer group is covered by this requirement.

114.The annual accounts must be audited by a licensed sworn accountant appointed by the General Meeting. This does not apply to small companies, where internal audit is sufficient. The accountant is liable for damage done by his/her negligent action or intentionally towards the company, its shareholders and creditors.

115.The annual accounts must be publicly disclosed by submitting them to the Enterprise Register. Any person is free to examine the registration file, or any documents contained in the file, of any company and to request copies thereof, officially certified by the Enterprise Register.

116.Any changes in the Statutes, Board of Directors, seat of the company must be disclosed by registration with the Enterprise register within 14 days after the changes have taken place. An administrative sanction of LVL 250 is provided for failure to comply with the disclosure requirement.

117.Ownership links among the companies is rather difficult to monitor. There are two possibilities: first, monitoring through disclosed consolidated accounts; second, monitoring through research in Enterprise Register by examining registration files of different companies. The first approach at the present moment does not give a complete picture because, as described above, only holding more

than 50 per cent of equity by another company is the criterion for preparation of consolidated accounts. The second method is very time consuming. The draft Commercial Code provides that the decisive influence, if there is such, must be disclosed as a separate item in the registration file of a company.

PART IV. POLICY CONCLUSIONS

118.The financial crisis did not affect corporate governance in general. The main consequence of the crisis has impaired the general financial situation of many enterprises, which resulted in rather serious problems in the state budget. Therefore the main activities of the Government were oriented towards solution of the budget problems, not to other related issues.

119.Latvia's capital market and corporate government environment remain firmly in the emerging markets category with all the problems that entails. For example just recently the Securities Market Commission invoked a regulation requiring shareholders which have acquired more than 50% of a company's shares to offer to buy out the remaining shareholders or else divest itself of some given proportion of shares. This has been applied to SEB's recently acquired majority shareholding in Unibanka. Since the stipulated share price is much above the market price for Unibanka shares this has come as an unpleasant surprise to SEB and is interpreted in the Latvian press as a gift to some Unibanka minority shareholders.

120.At the same time, it is also recognised that existing laws fail to fully protect the interests of minority shareholders and changes are in process to remedy this – especially in the ability of minority shareholders to elect representatives to management and supervisory boards. These moves are to be welcomed. The draft Commercial Code, settling many problematic issues has been developed, approved by the Cabinet of Ministers and passed at the first reading by the Saeima (the Parliament).

121.The reform undertaken by the adoption of the draft Commercial Code envisages some important changes in corporate governance. First of all, it provides for better protection of shareholders by establishing general pre-emption rights for new issues of shares and clarifying some issues that created misinterpretations and, sometimes, misuse of unclear legal provisions. The reform is directed also toward better protection of minority shareholders.

122.The role of the disclosed information about companies and their management has been clarified and legal consequences of publicly disclosed information is better determined in the new draft Commercial Code. It will provide for better protection of third parties dealing with Latvian companies.

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