

CORPORATE GOVERNANCE INITIATIVE FOR BULGARIA

**CORPORATE GOVERNANCE
ASSESSMENT REPORT: 2000**

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Introduction

The present report has the objective to provide an overview of the general framework and practical dimensions of the corporate governance in Bulgaria. *It is published for the first time and the authors intend to continue its publishment on annual basis.* In its present form, the study contains information so far unavailable for the professional community and the media. The evaluations and analyses herein are the first attempt to outline the achievements and the problems in the filed of corporate governance in Bulgaria in the years of transition. The authors of the report lay the objective to induce thus a wider discussion on the subject and resultantly practical improvement action to be undertaken.

At the end of the past year the *Corporate Governance Initiative* conducted a pilot study for corporate governance assessment in Bulgaria. It is a part of the activities under phase II of the project aiming at the elaboration of recommendations for practical measures for improvement of the corporate governance, including diagnostics and analysis of the existing corporate structures.

The survey was conducted by Vitosha Research and covered all listed public companies with authorized capital over BGN 200,000. The sample comprised 268 companies, while the number of the surveys responses was 158. The research method applied is a standard interview with representatives of the companies managing bodies and senior management. Based on the survey results, the first index of corporate governance in Bulgaria was calculated. The index has values between 1 and 5, the lowest value of 1 indicating unfavourable legal and institutional frame and internal factors of the corporate governance, and the highest value of 5 – ideal conditions and good practice of corporate governance.

The report has been prepared mainly on the basis of the results of the pilot study, compared and partially supplemented by conclusions and assessments of other studies, publications in the press and international sources.

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1. Legal and institutional framework of the corporate governance

This section of the report presents analysis of the regulatory and institutional environment for the corporate governance development in Bulgaria, based on the results of the pilot study. These results comprise assessments of the role of the judicial system, capital market development and efficiency of its institutions, and above all the extent in which the existing legislative framework facilitates or constrains the development of corporate governance.

The index value for this section is **3.26**. It is certainly a very positive and high assessment, attributed predominantly to the high index values in the part of the regulatory framework. Most of the questions in this part received assessments close to or exceeding 4.

Along with that, considerably lower are the assessments for the efficiency of the capital market institutions /State Securities Commission, Bulgarian Stock Exchange-Sofia and Central Depository/. It should be outlined here that the assessment for each of the three institutions should be analyzed separately rather than in comparison due to the substantial differences in their functions and tasks. They are grouped together under a generalized question as long as their integrity and interrelation has an impact on the creation and functioning of a developed capital market in Bulgaria.

Out of the three institutions constructing the capital market infrastructure – the State Securities Commission /SSC/, Bulgarian Stock Exchange /BSE/ and Central Depository /CD/, the highest assessment for efficient functioning received the Central Depository. It is the only institution ranked above average (the average value is calculated at 3.38), while the efficiency of the other two is assessed below the average value (2.83 for SSC and 2.55 for BSE). The explanation relates mainly to the scope of activities and different responsibilities of the three institutions. The Central Depository has an important but to a certain degree predominantly technical role in the capital market functioning. This makes its work relatively easier compared to the role of the other two institutions. The relatively high assessment for the Central Depository reflects both its proper functioning and the generally successful solution of the problem related to the registration of holdings in listed companies in Bulgaria. The establishment of the Central Depository and its functioning has facilitated securities transactions and eliminated numerous difficulties experienced by other transition economies that did not have institutions of an analogous kind. This is obviously appreciated by the respondents to the study.

The lower assessments for the efficiency of the other two institutions result both from the relatively higher complexity of their responsibilities and from the specifics of the companies' perception of their public statute. The responsibilities of these institutions have relatively higher complexity compared to the activities of the Central Depository, are of larger scale, involve more complicated interaction with the market agents, and have relatively higher requirements for resources, qualifications and experience. As a result their

successful functioning is more complex and is likely to suffer relative delays in time. It should be however noted, that the activities of the State Securities Commission, which carry highest responsibility and complication, are nevertheless assessed higher than the activity of the BSE.

On the other hand a very important factor for the institutions appraisal by the listed companies is their own perception of the capital market. Due to the specifics of their genesis, presently a substantial part of the Bulgarian listed companies is not interested in its public statute. These companies find no benefit in it, whilst complying with the regulations entails costs in one or other form. Thus this statute is assumed as imposed and even temporary, as a result of which they assess the activity of the institutions as not particularly efficient from their point of view.

Unsatisfactory are also the assessments of the objectivity and the activities of the judicial system in the corporate governance part /ranging from 1.82 to 2.68/. These assessments have been based on respondents' opinion for the process time horizon and related expenses for the court settlement of disputes.

The larger part of the questions in this section aims to assess the presently effective regulatory framework in Bulgaria in terms of existing environment for corporate governance development. It should be noted, however, that such an approach has its natural limitations as the corporate governance development level depends on both the availability of a good and modern regulatory framework, and, more important, the way in which it is applied. A discrepancy arises in this context between the relatively high assessments under most of the survey questions in this part, and the practically unanimous opinion among professional circles for the relatively low level of corporate governance development in Bulgaria. The assessments for the regulatory framework were given in the highest values of the range /close to the highest possible assessment 5/ among all other sections of the survey.

Several evaluations under the scope of particular questions of the pilot study are presented in more detail here. The respondents assessed positively the regulatory framework in its part concerning shareholder rights. The currently effective legislation /the Law on Public Offering of Securities – LPOS/ adequately provides for the exercising of the shareholder voting rights, including through a representative, and a proportional share in the company's earnings in the cases when dividend pay-out is resolved.

There are certain opinion divergences in the assessment for the quality of the regulatory framework concerning the prevention of insider information misuse. In that aspect the LPOS strictly follows the European standards. The restrictions envisaged for insiders provide for the equitable treatment of shareholders in respect to their access to information.

The divergence in the responses most probably relates to the efficiency levels of the practical enforcement of the restriction envisaged in the law. In that aspect indeed there is

much to be desired, moreover that revealing the misuse of insider information by definition entails a factual and legal difficulty in theory and practice. This relates to the issue of the further enhancement of the securities market institutions – Bulgarian Stock Exchange-Sofia AD, Central Depository and State Securities Commission, and particularly the implementation of efficient procedures for securities trade monitoring and supervision in order to provide timely and efficient detection of the cases when the regulations have been violated concerning insiders and insider information.

A high assessment is given also to the quality of the regulatory framework in terms of control exercising over conflicts of interest, including the cases of property handling and transactions with related parties. Indeed, the LPOS envisages that the managing body of a listed company may not execute without the explicit consent of the general meeting any transactions that would lead to the transfer of ownership or other rights over assets that exceed fifty percent of the value of the total company assets as accounted on its books. Furthermore, the general meeting can approve such resolution with a majority of three quarters of the capital present, if at least three quarters of the authorized stock is present or represented at the meeting, and under the conditions of a descending quorum – at least a half of the capital. This regulation is limited however to transactions with property handling. Besides, the relatively recent introduction of the regulation is still a reason for the lack of any practice whatsoever on its enforcement. The violations under this rule are merely sanctioned with administrative-penal liability envisaging fine to the amount of BGN 2,000 up to BGN 10,000 (in case the deed does not represent a crime), but so far no sanctions have been enforced. On the other hand, transactions between related parties are not regulated at all by the legislation on the listed companies and are not subject of any control. The same applies to the conflicts of interests. The only regulation concerning conflicts of interests is included in the Commercial Act and relates to the exercise of the voting right at the general shareholders' meeting. According to that regulation, a shareholder or its representative cannot participate in the voting of resolutions for:

1. filing claims against him/her;
2. initiating actions for enforcing his/her liability to the company.

The study attempts to assess the legislative framework in terms of providing the objective evaluation of the board of the corporate activities, independent of the executive position. Such legal possibility and moreover such practice are a definitive sign for good corporate governance. In this aspect, the assessment in the study is high (3.59), but it should not be accepted without any reservations and is most probably due to the lack of understanding on the part of the respondents. Generally, the Bulgarian legislative framework does not provide the necessity to include in the board the so-called outside directors, nor concerns the internal distribution of the functions between the board members. In fact, in some companies a part of the board members are outsiders for that company (i.e. they are not employees of the company), but in most cases they are representatives of persons related to the company or the controlling shareholder and therefore they do not satisfy the requirement of independence in the sense of good corporate governance practice. Besides,

there are no specific rules or procedures enacted to guarantee such independent evaluation. Whenever some companies are doing this, it is on a purely voluntary basis. Therefore, it cannot be asserted that the legal framework guarantees the board's objective evaluation for the corporate activities, independently of the executive position.

Similarly, it cannot be asserted to the extent revealed by the results of the study, that the legal framework guarantees the implementation of the board's functions related to the preparation of the company's strategy, action plans, annual budgets and business plans. The revue of the legal framework shows that the board's functions and powers are not subject of regulation, except in most general aspects. The legal framework even does not oblige the company to approve such documents as company strategy, action plans, annual budgets and business plans, and even lesser indicates which body is empowered to approve such acts. Whenever such documents are discussed in some companies, this is done on the basis of internal company documents, such as the Articles of Association.

2. Internal factors of the corporate governance

This section focuses on evaluation and analysis of three key corporate governance fields /equitable treatment of minority shareholders, members and functioning of the managing bodies, and disclosure of information/. The general index has the value of **3.11**. The assessment should be considered in the context of the research method applied and the objective development of corporate governance in Bulgaria.

2.1. Equitable treatment of shareholders and protection of the minority shareholder rights

The attempt to create an index providing a measure of the corporate governance development level necessitates the inclusion of the issues concerning the equitable treatment and protection of minority shareholders. To a certain extent these questions represent the essence of the corporate control as, by definition, in the environment of separation of ownership and control, the corporate governance is intended to provide submergence of the managers' activities to the shareholders interests. In Bulgaria, which is characterized by a significant concentration of ownership in the listed companies with managers practically identifiable with the controlling shareholders, the corporate control problem is projected into a problem of protection of the minority shareholders interest to that of the controlling shareholders.

When determining the role and the participation of the minority shareholders, numerous formal and informal issues are interrelated. The present research is predominantly directed to the formal aspect – how frequently the capital is increased in divergence of the pro rata principle, are there cases of legal action undertaken etc., but it also provides a number of interesting informal evaluations as the issue of the minority shareholders activism or their representation in the managing bodies.

The research results with direct relation to the evaluation of the minority shareholders' protection have definitely an unearthing value despite the fact that the pilot nature of the study has imposed certain limitations. The responses reflect with a high degree of exactness the situation in this issue. Above all, the set of questions for the equitable treatment of minority shareholders and protection of their rights has lowest value – 2.42 among all other sections. Further, it is the only section indexed below the average possible value of 3.00. This means that within all components of the corporate governance study, the direct evaluation of the equitable treatment of minority shareholders is lowest. A major influence has the low assessment for the minority shareholders representation in the managing bodies with value of 2.08. Closely two thirds of the interviewed representatives of listed companies have stated that minority shareholders are either inadequately represented or not represented at all.

The low result can be interpreted in two directions. On one hand, it is induced by the suppressed minority shareholders activism in the election of the board members, which could be affected by either their amorphous structure or the objective impotence to influence the nomination process, regardless of the willingness and attempts for concerted action, resulting from their restrained access to the nomination procedures and to the general meetings for shareholders. From a different perspective, it also reveals the level of board identification with the interest of the minority shareholders. Since, after all, a nominated by the minority shareholders board member, with his or her passiveness, incompetence and lack of interest, could be far less efficient in following the corporate governance principles and protecting the interest of the nominating shareholders, than board members, nominated by the largest (or controlling) shareholders solely, which however protect on best efforts the rights of all shareholders.

Similar meanings have the responds concerning weak minority shareholder activism in relation to discussing the strategic directions for the company's activity and decision-making by the general meeting – 58% of the respondents assess it below the average level of activism, which in combination with the 22% that assessed it at the average level, draws a very impressive picture of inadequate activism. A certain role for the low index value for minority shareholders protection have also the responses concerning proxy voting – the few cases of such voting and the predominantly low assessment for the minority shareholders activism. The evaluations on both issues have close values – 2.31 and 2.45.

The above problem is of paramount importance despite that the LPOS regulates proxy voting quite comprehensively. This regulation is prevalently directed to the limitation of the improper use of proxy voting and is restrictive in nature, e.g. the requirement for an explicit power of attorney with fixed contents. At the same time it leaves untouched the problem for the broader involvement of investment companies and especially banks in the accumulation of minority shareholders' votes and the active voting on their behalf.

It should not be overlooked, that the above issues vastly depend on the shareholder culture and the activism of the shareholders themselves, and not merely on the adopted internal corporate documentation and practice. This draws on the conclusion for the necessity of continuous practical measures directed to increasing of the shareholder culture in Bulgaria in terms of corporate governance issues and the specific shareholder rights.

The issue concerning the minority shareholders rights is most condensly highlighted by the responses to the question: "Does your company have an investor relations department?" Positive responses are not reaching even 20%, and even those should be addresses with a certain dose of skepticism. A certain portion of the respondents are likely to have meant investor relations departments that often have very limited scope of duties. Some responses contain explanations that experts from different departments or the chief accountant, financial officer, or legal advisors respond to inquiries upon the resolution of the executive director. Considering that by virtue of the revoked Securities, Stock Exchanges and Investment Companies Act, companies with more than 50 shareholders were deemed

public, and particularly in this case these are companies from the real sector and former privatization funds that took part in the first wave of the mass privatization, and that have significantly more than 50 shareholders, it is obvious there is a lack of an efficient mechanism for maintaining relations with minority shareholders and providing a timely supply of the necessary information to interested parties.

Capital increases in divergence of the proportional participation principle are a classic example of violation of the minority shareholder rights. The question whether the company's capital has been increased in divergence of the proportional participation principle has been answered by 129 companies and 27 former privatization funds, namely: positively – 14 companies (11%) and 1 former privatization fund (4%); negatively – 98 companies and 26 former privatization funds; the board representatives of 17 companies did not know. The next question – how many times has the capital been increased in divergence of the proportional participation principle, directed to those who answered positively to the above question, 12 companies and 1 former privatization fund indicated once, 2 companies – twice, and the representative of 1 company answered that he does not know how many times exactly the capital has been increased in divergence of the proportional participation principle.

The clearest positive part in the protection of the minority shareholder rights has had the discontinuation of the practice for non-proportional capital increases, which is a merit of the LPOS. The same proposal was among the measures for improvement of the corporate governance in Bulgaria, developed by the *Corporate Governance Initiative* in its Action Plan. Capital increases are one of the “narrow” issues, which even in a well functioning economy present a real threat to minority shareholders, the least in respect of the “dilution” of their interests. In this sense, the limitation of the capital increase cases in divergence of the proportional participation principle is an important step towards greater respect of their rights, although not solving all “narrow” issues that still exist in this process.

Along with the possibility given by the new LPOS, in force since February 2000, to delist the companies with capital less than BGN 200,000 upon on a resolution of the general shareholders meeting from the registrar of the publicly traded companies (“delisting”) – a possibility that numerous companies and former privatization funds have taken and continue to take advantage of, the non-proportional capital increase is the most striking example of bad corporate governance, moreover regulated in the legislation in force. These two possibilities have an extremely adverse effect on the ongoing second wave of the mass voucher privatization, as well as on the development of the capital market in Bulgaria, because of the investors' uncertainty for the efficient protection of their interests, resulting in low liquidity of the shares acquired. They restrict the possibilities for the pension funds to participate in the voucher privatization and in the trade on the stock exchange, as these institutional investors are minority shareholders in the company's capital and their interests are equally exposed as the interests of the individual investors.

If summarized, the survey results in the present part clearly reveal the still weak protection of the minority shareholders, the possibility for violation of their rights or more specifically their factual inability to exercise their rights, which above affects the level of their activism and resultantly the entire investment process in Bulgaria.

There are also several other aspects of the minority shareholder rights, which did not find a place in the present survey. First of all is the right of dividend – it is not a secret that a large number of the listed companies are not taking an endeavor to fix any relation between financial results and dividend policy. This is the major impediment for an efficient interest on behalf of portfolio investors. In the corporate control theory the issue is not among the most discussed problems all long as in many cases the shareholder interest is adequately protected by capital gains. This is not however the case of our economy in which the vicious circle of the lack of dividend, lack of liquid market, lack of capital gains and in addition the existence of transfer pricing for draining of the companies, does not allow the dividend policy issue to be overlooked. Despite the significant complexity of this issue, it would be viable to consider incentives for the companies towards a more liberal dividend policy. In the first place such measure could be providing an equal tax regime for dividends and income from government securities and bank account interest, i.e. elimination of the 15% profit taxation, but probably other measures will also have to be enacted.

2.2. Board Composition and Functioning

It is accepted in the global theory and practice to consider the board of publicly traded companies as the symbol of corporate governance. A predominant number of researches point out into prime importance the issues of the managing bodies. In the theory and in the practice, the evolution in the methods of research and the practical development of these bodies is clearly outlined. The interest on these issues is not merely from a legal point of view. More and more economic and management problems are considered in relation to board composition and functioning. The predominant interdisciplinary method in the theory and practice should be also present in the Bulgarian environment.

The second point of peak importance in the rationalization of the modern tendencies is the explicit relation between the issues of the composition of the managing bodies and the effect of the “principal-agent” institution functioning. In the Bulgarian practice the issue of the managing bodies and their composition is still not considered in its systematic relation, as with the principles of corporate governance.

Generally, the assessment for the board composition and functioning has the highest aggregated value (3.47) in relation to the other issues of the pilot study. This value is substantially above the average (3.00), as are also six of its nine components, while the other three are very close to it. This fact demonstrates that all aspects included in the study concerning the board composition and functioning are valued relatively high individually and in comparison to the aspects of corporate governance, examined in the different blocks of the study.

This assessment should be considered in the context of the study. As far as it has been conducted among the members of the listed companies boards or in some cases among people involved in the management structures of the companies, it is possible that some overvaluation has taken place as a result of the “self-evaluation effect”.

In this block relatively high is the assessment for the aspects of board functioning, related to the qualification of its members, the exercise of shareholder control and the differentiation of the authorities and the responsibilities among the members. Relatively low is the assessment for the practice of the board on cooperating with external experts, the binding of the board with the shareholder participation, the control of the board by the specialized internal committees and procedures. The low assessment for the last two aspects of the board functioning is another empiric confirmation of the observations and conclusions made in other studies on these problems.

Definitive for the managing bodies of a listed company is the level of the protection they provide to the principal interests. The effect of the actions of each managing body depends on how the interests of the shareholders are represented and protected. In the specific case of the Bulgarian publicly traded companies, the assessment on whether the board members representing the shareholders interests effectively control the managers activities, is the

second highest out of the nine components in that part of the study and is lower only than the assessment for the board members qualifications. Such an assessment is objective and can be explained by the ownership structure in the listed companies. The presently dominating model in the publicly traded companies in Bulgaria shows a high ownership concentration and a tendency to involve in one way or another the controlling shareholders in the company management. Therefore, it is natural that the board effectively controls the management of the company and that there are no impressive “principal-agent” problem at this time.

This high assessment however should be considered rather in general as an effective control by the shareholders. As for the minority shareholders’ effective control and representation, the assessment should be considered in the context of section 2.1. In that section in the same aspect, but considered from the point of view of the minority shareholders, obtained much lower assessment (2.42 for the block). The results of the study in this part are not homogenous, i.e. there is a significant dispersion in relation to the extent of the protection of the minority shareholders’ interests. The fact that 42% of the answers reveal a low level of protection and representation of the shareholders interests means that in Bulgaria the institution of the “agent” still does not operate effectively. Frequently, the board members are rather managers than directors (in the sense of corporate governance). Further efforts should be focused in that direction for the establishment of the good practice of corporate governance in Bulgaria.

With a relatively high value is indexed the separation of authorities and responsibilities within the board. In almost half of the cases such a separation can be observed and in a quarter of these the separation is described to be in “a large extent”. Certainly, this is a positive fact, as the existence of such separation is one of the substantial elements of the good practice in corporate governance. Along with that, the answers to this question are rather non-concentrated and in many cases (around 30%) this practice vaguely exists or is unavailable.

The lowest assessment in this block received the collaboration of the board with outside experts (2.79). Merely in one quarter of the respondent companies the board collaborates intensively with outside specialists, who by their expertise assist the process of taking management decisions. In many companies the managing bodies use the services of outside experts rather rarely, and 10% of the respondent companies do not use such at all. This fact testifies the possibility that in some cases the managing bodies do not take well-informed decisions and therefore miss opportunities for their respective companies. But the fact is becoming increasingly important in the context of the present specific concrete composition of the managing bodies in Bulgaria. As a result of the specifics of their genesis, the managing boards of the Bulgarian listed companies frequently have inhomogeneous composition, and some of the members have poor experience in the respective sector. Therefore, it can be expected that involving outside experts in the activities of the managing bodies can generally contribute for a better management of the companies. Still, such a practice is uncommon and the explanation of that fact can be

found in two directions. The first direction is the unwillingness of the firms to disclose information to outsiders (excessive of the legally imposed requirements), even if these outsiders are consultants. The other direction is the poor development of the consultancy services market.

Bordering on the average (2.99) is the assessment for the outside directors. The analysis of the answers shows that most cases can be grouped around the average value (3.00) and almost symmetrically around it. That fact points out the significant heterogeneity in the practice of individual companies. In a large number of them the participation and the role of the outside directors in the managing bodies is considerable and is evaluated as efficient. But in another broad number of the companies, the work of those directors is considered to be inefficient. Obviously in those companies the benefit of their participation in the management is not clearly perceived or these directors do not understand their functions personally. It is also obvious that the specific controlling role of the outside directors in these companies over the inside directors and the management are not well understood.

The results of the pilot study confirm the conclusion that in Bulgaria the institution of the outside directors is not yet established. There are no clear and strict criteria for an outside director and their role, as a part of the “checks and balances” system is not fully understood. In many cases they have a formal political role. Additional information on the effect of this institution is provided by the data on the cross-participation: the requirements for non-participation in the managing bodies of more than one listed company are still not in force. Only a third of the respondents have formulated requirements to the directors for that participation. The outlined aspects of the outside directors’ activities give reasons to recommend to direct in future a more significant part of the promotional activities to the outside directors – their status, regulation, promotion and education.

A positive trend in the principal-agent relations represents the ascertained separation of the positions chairman of the board and executive director. In the Bulgarian listed companies this is a dominating tendency with positive consequences expected in connection with the institution of the agent and the principal-agent problem.

The separation of the board chairman and executive director positions is the practice of a considerable number of the respondent companies (over 82%). This is a positive fact, as it guarantees the partition of functions and responsibilities, as well as a more efficient organization of the work of the managing body itself. This formulation corresponds to the spirit of the international experience and recommendations for good corporate governance.

Unfortunately, the comparison between this and previous analyses and conclusions, gives us the reason to believe that this separation still has a rather formal character. When evaluated in the light of the global practice, these conclusions and results should not be considered as dramatic – this separation is not always effective in the listed companies even in the countries with developed corporate governance. The separation should be

considered positive, although the practical results can be expected after the accumulation of experience and after the implementation of adequate educational initiatives.

The motivation of the board members is a problem repeatedly studied by the modern theory and practice. The picture in Bulgaria is pronouncedly diverging from the global tendencies.

The assessment for the board members and the managing teams remuneration dependence on the companies' financial results is relatively high (average of 3.37). In slightly over a half of the companies this dependence is clearly outlined. For the rest it is vague, and in 17% of the companies such practice does not exist. In other words, the practice on that issue is heterogeneous as well. Many companies have accepted this motivation mechanism, but also many companies do not apply it. For the second category this fact could represent either a management problem, caused by the lack of understanding of the motivation mechanisms, or the existence of motivation mechanisms of another nature.

In this context board remuneration issues should be considered, such as the use of management & employee stock option plans. With a few exceptions the practice is not applied. It exists in only 3.2% of the cases for the managing bodies and 1.3% for the employees. A discrepancy can be observed here between the practice of stimulating the board members through relating their remuneration to the company's results, on the one hand, and the possible realization of this practice through the company stock on the other. The latter would be the most natural motivation mechanism, which is also widely applied in the international practice. The reason for that discrepancy can be found in the legal difficulties for remuneration in the form of shares, as well as in the low liquidity of the Bulgarian capital market.

Along with that, some attention should be paid to the social and economic climate in Bulgaria as a whole. The total lack of stock compensation is a reason for concern. Only three percent of the respondents answered that they follow that principle. In Bulgaria's case the specifics are multiple: deviation from the global practice, lack of connection between directorship and ownership, lack of effective principal-agent relations and last but not least deviation from the principle and the aim to work in the interest of the shareholder. This issue should be analysed from now on and evaluated in future. Other studies show that even the big international companies privatizing Bulgarian listed companies do not follow these corporate governance principles in respect to the company managing bodies. And this reveals a paradox – the parent companies follow these principles in the countries having developed capital markets and corporate governance, but underestimate them in the transition economies.

The effectiveness of the internal procedures for revelation and avoidance of conflicts of interests is indexed above the average (average value of 3.28). But this index includes only the companies where such procedures exist. Actually, a large number of the companies (29.9%) do not have procedures for avoidance of conflicts of interests at all. And the

evaluation of the general picture requires taking into account the situation in all of the companies. After adjusting the average value by the part of the companies not having procedures for the revelation and avoidance of conflicts of interests, the assessment falls to 2.68, which would be the lowest value in this block. This can be considered as a more accurate value for the efficiency of these procedures, as a lot of evidence has been already accumulated that the conflict of interests represents a main problem for many listed companies in Bulgaria.

This fact reveals the necessity to undertake concrete measures for clarification of the type of conflict. Along with that, it can be easily foreseen, that part of the problems would be solved after the introduction – by law or by self-regulated organizations, of requirements for widening the scope of the information disclosed by the board members in relation to their material interests in the listed companies they head. The global practice in this field is categorical. To the opposite – the Bulgarian practice is far from perfect to the disadvantage of the shareholders. This is exactly the objective for the work for improvement of the corporate governance practice in Bulgaria.

The effectiveness assessment for the internal corporate rules and procedures for corporate governance should be interpreted in a similar way to the assessment for the efficiency of the internal procedures for revelation and avoidance of conflicts of interests. Many companies (21.7%) do not have such procedures. If the average value of the assessment for the companies, where such procedures exist, were adjusted, the total value for all companies of the sample would have the average value of 2.79. Such relatively low value gives a more realistic idea on the efficiency of the internal corporate rules and procedures. At the same time, these rules and procedures are perceived to be, although by little, still more effective than the rules for revelation and avoidance of conflicts of interests. Internal corporate rules and procedures exist in more companies than the rules for revelation and avoidance of conflicts of interests.

The vast majority of the listed companies (75.8%) do not have auxiliary committees at their managing bodies. Where such committees exist, the assessment for their efficiency is relatively low (average value of 2.94). Obviously, at this stage the good practice of corporate governance involving the functioning of such committees is not frequent and in use in Bulgaria. This might be due to the fact that the shareholders are not familiar with it or that the interested shareholders cannot impose it to the board. The second hypothesis is referring to the dominating model of ownership structure.

The assessment for the level of the requirements applied to the board members represents a separate homogenous block. According to the answers of the study, the requirements at the appointment of the board members are relatively high. The most important requirement is the educational census (average value of 4.55) and the least important is the non-commitment to other companies through participation in their managing bodies (average value of 3.46). The distribution of the assessments for the block has a similar profile

showing the lack of asymmetry and grouping to a large scale around the assessment that the stated requirements are applied to a large extent.

Unfortunately, the practice often demonstrates that the principles of the corporate governance in this aspect are only formally applied. In this case the matter in hand is the content of these requirements.

The general assessment for the managing bodies should take into consideration the fact that the one-tier structure is dominating: 66% of the respondents have one-tier system. The additional studies show that the one-level system is typical for the listed companies in the real sector and the two-tier – for the holding structures. This is not just a legal issue but also a specific corporate governance issue in holding companies and deserves separate research and respective proposals.

2.3. Disclosure of Information

The pilot study of the corporate governance development in Bulgaria had the objective to evaluate and analyze the legal and regulatory framework and practice relating to the disclosure of information. The results reveal relatively high assessments in both sections, which however imposes the necessity for some additional clarifications. The respondents evaluated the regulatory framework with an index of 4.13 as adequate to secure the shareholders right of regular and up-to-date information for the company in which they have securities holdings.

Considering the rulings of the LPOS for mandatory filing into SSC of the annual, semi-annual and quarterly financial reports of the companies and for disclosure of the so called “material information”, the respondents’ evaluation reflects accurately the actual conditions in relation to the requirements set by the regulatory framework.

A high assessment is also given to the practical application of the rulings related to the disclosure of information in terms of annual, semi-annual and quarterly financial statements – 4.60. This reveals that the self-evaluation of the large number of listed companies is related to meeting the requirements for periodical disclosure of information. It is a different question for the quality of these filings and the extent in which they comply with the requirements of the LPOS in terms of contents and exhaustiveness. In any case however the companies have high self-evaluation for the exhaustiveness and accessibility of the information disclosed – 3.87 and 3.80 respectively. Concerning accessibility, the self-assessment is relatively fair as long as the regulatory framework contains explicit requirements in that aspect and the compliance with it is guarded by the SSC.

A notable development is the respondents’ strengthened understanding of the necessity the listed companies to provide and disseminate in addition to the required by the LPOS standardized and timely information, and more particular the company’s financial statements, resolutions of the general meeting, the management’s resume and analysis for the annual operations and results, etc. Probably it is considered that the information for the specific issues listed above should be made accessible through the use of modern methods, in addition to the explicitly prescribed by the LPOS, like Internet for instance. Such an understanding is certainly welcome, as long as practical steps are undertaken in that aspect.

The availability and accessibility of information are by far the soundest protection of the minority shareholders rights. In that relation noteworthy is the relatively high average assessment under the questions included the Disclosure of Information block – 3.43. At first sight such an assessment runs into an inconsistency with the low average evaluation of the minority shareholders rights protection. The result is however explicable with the fact that the factors included in the disclosure of information section concern exclusively trailing information that covers decisions already taken, reports and assessments, but not the method of organization and conduction of the general meeting itself. Comparing these assessments with the relatively high evaluation of the legislatively provisioned right of the

shareholders of regular and up-to-date information on the company whose securities they hold – 4.60, the interpretation of the results could go in the direction of the somewhat formal disclosure of information aiming to “comply with the words of the law”, whose volume and content is not sufficient for a more profound analysis of the company’s current performance and the quality of its management. Despite the relatively high assessment for the accessibility and sufficiency of the disclosed information as well as for its compliance to the international standards – 3.80, 3.87 and 3.84 respectively, the doubts for formalism cannot be excluded, as the questionnaires were filled by the board members who have a direct influence on the type and content of the information disclosed, so that their assessment would not necessarily correspond to that of the minority shareholders who are the consumers of that information. And the conduct of the minority shareholders could be considered also as a “reaction in response” to the quality and the sufficiency of the information disclosed as the inadequately informed holders of securities are unable to take active and competent strategic decisions for the future of the company at the general meeting. In connection with the above lies the explanation of the divergence in the assessment for the compliance to the legal requirements for disclosure of information – 4.60 – that is substantially higher than the assessment for the quality and timeliness of the information disclosed.

Conclusion

The Corporate Governance Assessment Report does not pretend to be exhaustive. It is an attempt to present in general the basic characteristics and problems in the corporate governance in the country, based on the results of the pilot study. Generally, the results confirm the presence of trends, following the global practices and trends reflecting the transition spirit. There is still a discrepancy between the wording of the law and its specific content, between the legal requirements and their application.

Along with that, the report comprises some of the most important directions for the improvement of the corporate governance practices in Bulgaria. The report shall give the basis for an active and informed professional debate on the issues, and also a departure point for undertaking the necessary practical steps for bringing Bulgaria closer to the modern standards and become a more attractive place for investing.