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SHAREHOLDER, EMPLOYEE vs MANAGEMENT
-OLD AND NEW RELATIONS IN A TRANSITIONAL ENVIRONMENT-
by Lidija Bizic

Shareholding, its development and protection in the past period has become a theme which takes more and more attention of all relevant institutions on the capital market of Serbia. In the conditions in which, by means of a massive privatisation and free distribution of shares, several hundreds of thousands of "small" shareholders have been created, who at the same time represent the owners of the majority part of the capital in the companies privatised in the above mentioned manner, the problems caused by the lack of qualitative corporative governance, have become unavoidable in everyday life. This in particular when one takes into consideration that these companies today are in the process of shares concentration through the secondary market, in which the activities of the management are concentrated on finding ways to preserve and reinforce acquired positions and influence through 1) eliminating or reducing the influence of new shareholders, who by acquiring significant shares of the capital of the company, at the same time become a more "serious" management structure of the company, as well as 2) takeover of the companies by purchase of shares from existing shareholders, or 3) imposing limitations in the sale of the above, represent a special factor.

In that sense, the aim of this presentation is to point out, as much as possible, at the same time taking into consideration the regulatory and real environment, the practical examples, which represent illustrations of the above mentioned claims, and study the undertaken, planned and possible activities to overcome the problems.

The regulatory framework of corporate governance is in its major part governed by the regulations of the Enterprise Law. Among other, it regulates the issues of election, authorities and responsibilities of the management bodies, the issue of realization and protection of shareholders rights as well as issues of acquiring a significant participation in the capital of the company. The basic principle accepted by the Law determines that "the company is governed by its owners", and following this logic the Law in its greatest part leaves to the owners of the capital themselves, to regulate the issues of management of the company through the Articles of Incorporation and Articles of Association, in a way which best reflects their interests. Without the intention to burden this presentation by a lengthy listing of law regulation, it can be concluded that the legal framework, although not perfect, still gives far more possibilities for the implementation of the principles of corporate governance, than it is today in practice applied. Everyday life, unfortunately shows us that we face a big problem when efficient mechanisms of implementation of legal regulation is an issue, and that the basic principle given in the law – that it is the owners who govern the company, has been in practice substituted by the principle that the management of the company governs the owners.

In order to correctly recognise the above claim at the beginning it is necessary to make a short overview on two basic categories of participants in the stock corporation: shareholders/owners of the company and management.

The shareholding structure of the company is mostly composed of a wide circle of minority shareholders, who have acquired their shares free of charge, on the basis of their work. In that sense, when we talk about decision making, practice has shown that it is important to make the

difference between the shareholders who are at the same time employees in the company and those who are not. Irrelevant of which of these two groups we discuss, the common characteristics which have been noted are unfortunately: disinformation, disinterest and uneducation even about the basic terms related to shares and the rights which they bear. Also, when we talk about shareholders who are at the same time employees of the company, it is common that the rights related to ownership of the shares are identified with the rights from the working relationship, which often results that in the decision making related to the governance of the company, the key influence is related to the fear of eventual loss of jobs. This and such shareholding structure, which in its greatest part does not know, or has a very limited knowledge of its rights and possibilities, is unfortunately not ready to entirely use on its own all that the legal framework enables and in that sense regulate the management relationships in the companies in a way which best reflects its interests.

On the other hand, the category of management can be characterized by its dominant interest to preserve and reaffirm its position, in particular by directing the process of concentration of the capital through secondary trading in the direction of taking over the company, taking advantage of the non-existence of efficient mechanisms of implementation of legal regulations and their frequent infringement. At the same time, in most companies the structure of the management itself has mostly not suffered significant changes. Also, the connections of the management with political structures of different influence is still very present, as well as with the banking sector often necessary for the financing of undertakings with regard to the takeover of companies. An important role in this entire framework is also played by the numerous consultants who, with their advices (often in complete conflict with provisions of the law), give this entire procedure the necessary "professional" support.

The results of such an unevenly distributed awareness of the meaning of capital property, are some evident forms which are directly related to the constraint and manipulation of the rights of shareholders to govern the company and freely dispose of their shares.

The constraint of the right of governance is usually achieved in the form of a permanent long term transfer of the right of governance to persons who are, by the nature of their positions, close to the management, and in that sense issue and implement decision with the management, without problems. The forms of these "powers of attorney" with future shareholders with the list of persons to whom they can be given, have been given in the first phase, during the privatization of part of the socially-owned capital of the company – together with the contracts with which shares have been acquired, leaving them the "free" choice to choose their representative from the list.

It has not been proven whether some of the shareholders has used the "casual choice method" when choosing their representative, but it is most probable that very few shareholders knew who the people on the list were, in particular in the case of shareholders who are not employees of the company or former employees of the company. Nevertheless, in order to be fair in these statements, it must be admitted that on some of the offered lists, it was noted in the footnotes that election of a representative is not mandatory, but it must also be admitted that the majority of future shareholders regarded the lists as a integral part of the contract (which was undoubtedly in interviews with a significant number of shareholders). With regard to this issue, the **crown of** "inventiveness" represents the power of attorney in which a shareholder transferred his governance and decision making rights on the shareholder meetings to the

Director of the Company, irregardless of the fact that the law prohibits the representation of a shareholder in general shareholder meetings by a member of the management. This is how, in practice, the situation has been created that the only right of governance and decision making belongs to the management.

Unlike the constraint of the right of governance, the constraint or limitation of the right to dispose of the shares is something which is characteristic for the current situation. The "target" here are usually the shareholders who are at the same time employees of the Company, although the percentage of cases of former employees and retired persons is not neglectable. The way of realization of these activities usually includes the taking and "keeping" of the certificates of share ownership in the company, with the declaration of the shareholders that they renounce to the right to dispose of the shares in a certain period. These "prevention mechanisms" are usually motivated by the great "dangers" which would be imposed on the company if having a new external owner of a significant portion of shares. In addition to the aforementioned, cases are known, where the shareholders renounce their right of disposal of the shares from simple fear that if they do otherwise, they will loose their job. With this kind of pressure, it is completely clear why most of the shareholders are ready to give such information only anonymously, which in return, makes it more difficult to undertake any kind of prevention measures.

Finally, to make the presented picture, at least when we talk about shareholder rights, complete, it must be added that there is a **total lack of information** of the shareholders with regard to the operation of the company, irregardless of the fact that the right of information has been granted by the law. The majority of the shareholders, according to the current state of things, probably do not even know when the general meetengs are held, not to mentioned the fact that only their long-term representatives are informed about the issues which have to be decided, which in addition to what has already been stated, represents an additional security for the management that their proposals will be adopted as "the expression of the will of the owners of the company".

Such a situation represents an almost ideal base for the realization of the interests of the management and its action in the direction of preservation of their key influence on decision-making related to the management of the company, at least with regard to the existing shareholders of the company.

At the same time, in the conditions in which the remaining part of the socially-owned capital in these companies is being sold, as a rule to one investor, as the substantial stock of shares, this situation has in great part helped to efficiently create and implement a model which will, through the **dilution** of capital, decrease the participation in the capital of the company, of external shareholders who can influence decision-making. In this particular case, on the basis of the model determined by the law known as conditional increase of capital, the possibility to transform, under certain conditions, (on the basis of a decision of the owners of the company), the credits towards the company in share capital. A situation which occurred in practice in which part of the profit determined in the annual **balance sheet** and distributed to the employees (by decision of the assembly of shareholders) was transformed into the credit of shareholders towards the company, and thereafter, (also by decision of the assembly), into shares of the company. The consequence of the above procedure, is certainly the significantly altered percentual participation in the capital of two categories of shareholders, namely through the

increase of participation of shareholders who are employees of the company and decrease of participation of external shareholders. The procedure itself basically entirely follows the provisions of the law, but the question which imposes itself is "does the decision of the shareholder meeting on the basis of which this procedure has been implemented, reflect the real will of the shareholders" and in particular of those whose rights have been altered by this decision.

Although it is clear that only the shareholders can give an answer to this question, there is a great degree of certainty that it is negative. It seems that the above mentioned decisions are most useful for the management, as is the decrease of participation of external shareholding structure in the capital of the company.

Beside the fact that by transformation of part of the profits distributed to the employees their participation on the capital of the company itself is increased (in proportion to the salaries more than in the case of other employees), the incentives for the management certainly lie in the fact that by decreasing the influence of external shareholders in decision-making, in confront to the shareholders who are employees of the company, decreases the possibility of adoption of decisions which are not in their interest. If in such a situation, we imagine an investor who has "dared" to buy shares on the secondary market, in the value which enables a more active influence on decision-making, and if beside that the above mentioned investor "dared" to know and want to manage his shares, this is only one more reason for the management to react "quickly" in order to prevent any kind of "unwanted" consequences.

This is how we come to the question of what has to be done? The defining of the problem can not be an aim to itself, but it can certainly be and has to be the beginning of its resolution. The protection of the rights of shareholders and the necessity of fair, safe, transparent and equal conditions for all investors are tasks which all relevant institutions on the Yugoslav capital market are aware of. In this sense joint activities in the direction of their resolution are primarily directed towards the strengthening of the probably most important "spiritus movens" in this entire process – the shareholders. The increase of interest, education, information and in general awareness of weather a share represents part of the property, and that the protection of the rights which derive from it, is in the hands of the owner, are the basic aims of the above mentioned activities. Changing the relationship of the shareholder towards the share which he possesses, will also change his relationship towards the decisions of the management, and it is certain that from the moment when the shareholder will start to pose questions and demand and realize the protection of the rights which he has according to the law, the management will no longer have the same position as now.

Of course, in the conditions in which shareholding as a term, was until recently only a »modern« seldomly used term, these processes require a lot of work, time and efforts. Nevertheless, what is important, and what proves that the situation is improving are the results which can already be seen and which can be recognised through the foundation of more and more shareholder associations, aimed to improve the realisation and protection of their rights, and in that sense not only the creation but also the use of more efficient connections of communication with the institutions which can be of help to them in that process.