



Organisation for Economic Co-operation and Development
In co-operation with the World Bank Group

A Flagship Regional Program of the Investment Compact for South East Europe

Investment Compact
South East Europe

**THIRD SOUTH-EASTERN EUROPE
CORPORATE GOVERNANCE
ROUNDTABLE**

**“The responsibilities of the board
and the role of stakeholders”**

Meeting Hosted By

The Zagreb Stock Exchange



ZAGREBAČKA BURZA
THE ZAGREB STOCK EXCHANGE

Sponsored By

Deutsche Gesellschaft Für Technische Zusammenarbeit (GTZ)
and

The Global Corporate Governance Forum

SYNTHESIS NOTE

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Palace Hotel Zagreb
Strossmayerov trg 10

I. General

The South-Eastern Europe Corporate Governance Roundtable was established in September 2001, and is organised by the OECD in co-operation with the World Bank Group and key regional partners. It is also a Flagship Regional Program of the Investment Compact¹ and receives financial support from the Deutsche Gesellschaft Für Technische Zusammenarbeit (GTZ) and the Global Corporate Governance Forum.

The third meeting took place on 21-22 May 2002 in Zagreb Croatia. It was hosted by the Zagreb Stock Exchange. The meeting focused on the responsibilities of the board and the role of stakeholders, corresponding to the third and fifth chapters of the OECD Principles of Corporate Governance.

The Roundtable brought together a group of over 100 highly qualified senior policy-makers and private sector practitioners from a number of countries: Albania, Bulgaria, Croatia, FYROM, Bosnia-Herzegovina, FR Yugoslavia, Romania, Belgium, Germany, Greece, Hungary, Portugal, Spain, Turkey, UK, US and Russia. Participants from international organisations included experts from the OECD secretariat, the World Bank, the Global Corporate Governance Forum, the European Bank for Reconstruction and Development, the Stability Pact for South-East Europe, as well as the Center for International Private Enterprise.

The meeting was opened by: Mr. Marinko Papuga, Chairman of the Zagreb Stock Exchange; Mr. Rainer Geiger, Deputy Director of the Directorate for Financial, Fiscal and Enterprises Affairs at the OECD; Mr. Darko Marinac, CEO, Podravka d.d. Croatia; and Alex Berg, Senior Private Sector Development Specialist, Corporate Governance Unit, World Bank. The opening remarks emphasised the central role of corporate governance for financial market development and access to capital. Hence corporate governance is a key element of the Stability Pact for Southeastern Europe.

Documentation from this and previous meetings, including agendas, presentations, background papers and the draft White Paper, can be found on the OECD Corporate Affairs website at www.oecd.org/daf/corporate-affairs.

II. Discussions and Main Conclusions

The meeting dealt with two main topics: The responsibilities of the board, and the role of stakeholders. Three sessions dealt specifically with boards:

- The responsibilities of boards in corporate governance;
- The work of boards;
- How to develop board professionalism.

Two sessions dealt with stakeholders:

- The role of employees in corporate governance;
- The role of creditors as stakeholders.

In addition there was also a session on the role of institutional investors in corporate governance.

¹ The Investment Compact, adopted in February 2000, is a vital part of economic reform activities to be carried out under Working Table II of the Stability Pact for South Eastern Europe, dealing with Economic Reconstruction, Co-operation and Development.

Each session included presentations by, and discussions among, regional and OECD country experts. There was general agreement on the importance of strengthening boards; and the need to clarify the role and protect the rights of employees, creditors and other stakeholders. Specific issues highlighted in the discussions include:

1. The critical role of the board in overseeing the strategic direction and governance structure of the company;
2. The need to clarify the accountability of board members to all shareholders;
3. The importance of increasing board professionalism;
4. The growing importance of institutional investors in South East Europe;
5. The role of mechanisms to more actively involve employees in wealth creation;
6. The need to improve the enforcement and implementation of legal protection for employees and creditors

1) The critical role of the board in overseeing the company

In OECD countries the responsibilities, and potential liabilities, of board members are greater than ever. Directors are increasingly required to take active steps to ensure transparency, protect the rights of shareholders and guarantee compliance with legislation. Independent directors on certain committees, especially the audit committee, may have even greater responsibility and liability.

In practice, the role of the board in most SEE companies has been very limited, with important decisions generally made by management and controlling shareholders. This has prompted reform. For example it was noted that Bulgaria, making explicit use of the OECD Principles of Corporate Governance, has recently changed its company law with respect to responsibilities of the board and individual directors to shareholders.

Participants agreed that while this and other discussed reforms are very much welcome, problems remain in the region. Qualified independent directors and board committees, both of which play a central role in the reform going on in OECD countries, are largely absent in South East Europe. Their role in overseeing management and external auditors remains limited. In addition board members often do not acknowledge any duty to stakeholders, and do not see themselves as having a role in legal compliance.

2) The need to clarify the responsibility of board members to all shareholders

There was substantial discussion of board member loyalty to some, versus all, shareholders. Board members in many SEE companies often owe their position to controlling shareholders, and in many cases feel loyal to them, not to the company or shareholders at large. One participant pointed out that in their country directors receive only a nominal sum from the company, and are paid directly from the controlling shareholder. One response to this has been greater use of cumulative voting. While this can allow for directors chosen by minority shareholders, it may exacerbate a sense that board members represent certain shareholders, not all shareholders. The participants in the meeting concluded that the loyalty of directors to all shareholders must be clarified and implemented.

3) The importance of increasing board professionalism

Techniques to increase director professionalism were discussed, particularly different kinds of director training. While lecture based classes can be useful for directors, it was emphasised that the most effective director training was hands on, with a heavy emphasis on learning by doing. There is a strong interest in the region in creating institutes of directors, in part to facilitate director training. The practicalities of this were discussed, as were some other functions of institutes of directors. One potential function being considered in some countries is certification, or “chartering” of directors.

4) The growing importance of institutional investors in South East Europe

In most SEE countries, institutional investors have played a limited role in corporate governance. The main domestic institutional investors have been official privatization funds. These have either had a very limited role, often being required by regulation to hold small stakes in companies, or on the other hand have transformed themselves into holding companies that have been questioned for their own corporate governance practices. There are also some institutional investors backed by USAID, IFC, and the EBRD, but again their role is limited.

It was noted that the limited presence of institutional investors has begun to change. For example, some funds have been very successful in pursuing an active investment strategy focused on turning around underperforming and poorly governed companies. Another important development is the creation of official pension funds in a number of SEE countries. On current plans, these will be in a position to invest substantial funds in local stock markets over the coming years. These funds could be significant drivers of capital market development. However, the main goal of these funds must remain providing retirement income for their beneficiaries.

5) The role of mechanisms to more actively involve employees in wealth creation

Actively involving employees and other stakeholders in the process of mutually beneficial wealth creation should be a goal of any successful company. Various mechanisms to facilitate this were presented, many of them variations on employee ownership. Relevant legislation in SEE countries normally provides for some form of worker consultation in relevant company decisions, and the region has a history of employee ownership, a widespread by-product of privatisation. The importance of clarifying the relative roles of the owner and the employee was emphasised. The general consensus was that employee ownership must be approached carefully, with participating employees having a clear idea of their risks and responsibilities.

6) The need to improve the enforcement and implementation of legal protection for creditors

The legal framework in SEE countries addresses insolvency and provides basic protections for creditors. However, many participants noted that these protections are not implemented effectively. For example, creditors will often go out of their way to avoid initiating bankruptcy, even for insolvent companies, because of the perceived costs and inefficiencies. While creditors have found alternate mechanisms, the weakness of the insolvency framework has certainly hindered the flow of capital to SEE companies.

III. Next Steps

The Roundtable will issue a White Paper that will propose a set of practical recommendations and serve as a means for setting priorities and implementing reform at both the national and corporate level. Drafts of the first two chapters of the White Paper (on shareholders rights and equitable treatment) have been reviewed by the Roundtable. A draft of the third chapter, on transparency and disclosure, was discussed at the Zagreb meeting. Additional written comments will be received until 13 December. A first discussion was also held on chapters four and five, which deal with the role of stakeholders and the responsibilities of the board.

In January, a draft of the two chapters on the responsibilities of the board and the role of stakeholders will be submitted to the Roundtable's participants for their written comments. The White Paper will be finalized at a meeting in Sarajevo, which will take place 6-7 March 2003. Mr. Edib Basic, President of the Securities Commission of the Federation of Bosnia and Herzegovina, concluded by announcing that the Commission would host the Sarajevo meeting.