

MANAGEMENT IN THE PROCESS OF THE CORPORATE GOVERNANCE

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Abstract: *Generally, the process of privatization of former state and social enterprise in the post-socialistic countries has up to now reaffirmed institutional basis of the capitalistic model of enterprise and entrepreneurship. However, except the small number of countries, it has not resulted in adequate reform effects, more precisely; the effects are still far below the expectations of the employees even in the privatized enterprises and citizens in all.*

Key words: *Corporate governance, management, privatization, transition.*

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1. Introduction

Faith in privatization as political, economic, ideological and cultural project has appeared as a global phenomenon of the nineties. Namely, not only in the countries of the East and Central Europe, but all over the world the national governments return in »private hands« abundant and diverse state assets, starting from electric power stations to prisons, from telecommunications to the kindergartens, from railways to educational institutions. On the world level, the politics of privatization as a coordinated activity of certain west government became noticeable through the realization of economic politics by conservative government of M.Thatcher in Great Britain, at the end of the seventies. Basically, the said program was aimed at liquidation of state enterprises or their sale to the shareholders.

Possibility for the privatized enterprises to achieve long term success when, in most cases, the employees are at the same time the shareholders, places a variety of questions among the most important ones refer to the creating conditions in terms of safety of employment, salary, owners' remunerations and potentially long-lasting profit from retirement programs and alike. At the same time, low achieved level in competition and the overall unsatisfactory outputs resulting from former state and social en-

terprises speak in favor of distorting the process of corporate governance as far as the economies in the transition are concerned. One can get an impression that little attention has been called to this problem or that the definition of "good corporate governance" has not been defined yet.

With respect to the above mentioned, the author of this text sets as his objective to open the "black box", of already present bad corporate governance in the transition economies, in a manner to point out and analyze a number of reasons and consequences of this kind conduct. In this sense, mostly relying on the experience of other countries rather than Montenegro, the problems aroused in the privatized companies will be analyzed.

2. How to grasp the problem of the corporate governance

A decade long transition experience indicates that the concept of "corporate governance" has not so far become clear enough, particularly referring to different modalities of governance and control at newly established corporations in transitional economies.

Corporation or Shareholding Company is very old institution the roots of which go back to the Middle Century although its role comparing to present times was somewhat different. In the 18th century due to the speculations, dishonesty and financial commitments it was so discredited that, starting from 1720 it was prohibited in countries where English was an official language. At the beginning of the 19th century, it reappears

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in the United States and Great Britain with certain limitations while, in the half of the same century it was widespread way of collecting capital for business ventures. Finally, with the beginning of 20th century it became “a commercial instrument” of the tremendous financial power and efficiency. Besides, ownership and control in corporation were separated; professional managers, not necessarily the owners of shares, are performing the control while the owners lose the control over the company. Knowing that today some authors claim that the ownership in Modern Corporation faded away in the sense of Roman law, it comes as no wonder that the things are getting more complicated as far as the operation of the privatized companies in transition countries is concerned.

In the broadest sense of the word, the corporate governance can be understood as a system with the help of which the owners of the enterprise (shareholders or portion owners) control management in order to ensure the efficient operation of that company as well as provide for the maximum wealth of its owners. In one of the recent reports it is stated that “good corporate governance takes into account all participants in the corporations (stakeholders) to the greatest extent.”¹ In this sense, the corporate governance means management, power, duty and impact, accountability and supervision.

With respect to the above ideas, the following question seems logical: Do the shareholders use their property efficiently, in what manner and do they control the management who is acting or should act only in the interest of capital owners?

The placed question is particularly significant if we ascertain, in our opinion acceptable statement that the reasons for insufficient recovery of some enterprises and economy in all, mostly lie in the fact that management fails to perform their job properly and so the system of corporate governance has not been established.

The experts of the World Bank are of the opinion that corporate governance is one of the key assumptions of successful privatization. In other words, privatization has to provide for a sufficient number of owners stimulated to use their resources efficiently. In addition, changes in ownership structure won't influence the conduct of management unless the new owners possess enough power, initiative, and capability to supervise and direct their work in accordance with

their interests. Regarding this, it can be said, that the main objective of privatization in transition countries is not to eliminate state or social property but primarily, to merge new ownership structure with the efficient management structures what should result in the corresponding corporate success.

West experiences clearly demonstrate that privatization itself won't solve the problem of corporate governance and managerial motivation. Besides, there are numerous examples that countries of the market economy, particularly in the last five years, realized the gravity of the problem referring to corporate governance, emphasizing two important questions: The relation between management and shareholders and the problem of transparency. To serve as an example, starting from the nineties to the present date, the burning issue of the American business and professional circles has been the discussion on the efficiency of the American model of “corporate governance”. The basis for the discussion was the thesis of M. Porter² that the American model of corporate governance was, due to its “short - term business moves” and deficiency in long term vision in the deep crisis and as such a represented a key factor for reducing American competition in relation to other competitive economies.

Therefore, the issue regarding corporate governance is far more serious than it was considered under the fossilized leftovers of democratic centralism and prolonged self-government in the form of shareholding, to which the insider privatization greatly contributed. Namely, we are faced with a global problem, which represents a synthesis of all other problems that had arisen in the process of transition and economic management on a micro – level in all. The cases of “Enron”, Worldcom³, “Parmalat”⁴, Skandia Liv⁵ confirm that it is not only a case with tran-

² The discussion was, mainly induced by recognized Harvard professor M. Porter and his study on “America's Falling Capital Investment System”, Harvard Business Review, 5/1992.

³ “Worldcom”, the second largest giant in the United States (after ITT), employing over 60.000 workers, annual turnover about \$40 billion, requested legal protection from the creditors due to the accounting malversations \$3.8 billion worth.

⁴ The overall debts of the Italian company are estimated at, up to the present insight into the investigation, at about €14.3 billion, exceeding eight times the sum reported in September last year.

⁵ Skandia” was at the center of attention at the end of the 2003 after the information on misuse of positions in the company were disclosed. The information included frauds,

¹ Committee on Corporate Governance, London, 1998.

sition countries. Consequently, we may come to the conclusion that according to the main goals of privatization and in this course social fairness in redistribution of state (social) property, efficient corporate governance in the new-established private enterprises should taken the highest place.

3. Limitations of the proces corporate governance

Radical critic of state intervention in economy, P. Drucker comes out with three basic incentives of privatization in developed countries: 1) failure of state programs and state actions after the Second World War; 2) governments reached the utmost level in taxation and spending; 3) the achieved limit the governments attained in regard to raising taxes. Also, after the success of "tatcherism" it became apparent both to theoretic analysts and pragmatists that the economic policy based on Keynes's theory was worn out and that governments of developed countries can not treat state assets as "the saint cow of salvation"⁶. In close relation with this, due to the fact that even the models of west corporate governance were affected by outstanding changes, it seems logical to place the question whether we can talk about clearly differentiated models at all. Lastly, it is appropriate to conclude that the privatization in western countries has been developing within the developed institutions of parliamentary democracy, institutions of developed market system and in line with the rather fast adaptation of system to growth crises occurrences.

Relevant to the post privatization experiences of the group of countries, what comes as a unambiguous conclusion nowadays is a conclusion that privatization by itself doesn't solve the problem of the corporative governance and managerial motivation for better effects. In that way, the previous experiences demonstrate that the weak performance of countries in regard to their stability and economic growth refers to those countries that, during the initial years of transition, were recognized by the institutional vacuum. It is the period of time between social-

business statements adaptations and paying extremely high bonuses to its directors.

⁶ J. Moore, the former minister in the government of M. Thatcher, and the person responsible for the first round of privatization, reminds that government unanimously found out that the collapse of British economy in the nineties was resulted by state economy oversight.

ism and civil society, by a number of authors defined as "system" or "privatization vacuum". In this respect, in order to eliminate this kind of limitation, the fast privatization process was seen as a necessity.

Some of the most distinguishable weaknesses directly referring to management quality and corporative governance, and that affected the work of management in transition countries during the last period are:

- management, in other words, its individual members have a poor knowledge of their company (chain of values)
- the new class of entrepreneurs "buying" enterprises does not have a sufficient knowledge about necessary skills and in this way rely on "non-managerial" factors; better to say we are still far away from the competitive governance of the most knowledgeable individuals (P. Drucker);
- while the criterion of outputs in a commanding economy was quite simple, it will be necessary to come out with the new patterns for measuring outputs, taking into consideration both financial and non – financial considerations of value. (e.g., knowledge of the employees);
- management and managers, particularly those at large corporations are often connected with the financial institutions, legal counselors and auditors, frauds and scandals of huge dimensions come as no wonder;⁷

⁷ We will take as an example the problem of business statements adaptations and "cooking" the books in Hungary. In December 2002, Hungary's special police forces unit arrested fugitive auditor Agnes Kalacsi, a primary suspect of helping dozens of companies manufacture fake invoices for tax evasion purposes. Together with her Ukraine partners, she was running an auditing business, allegedly by Mafia connections. Together with the beginning of the transition process a considerable number of transitions related scandals came to the surface, especially in the course of conducting property assessment at the privatized companies. This was the case in 1993, when the shareholders of Hungarian Airlines voted to cut connections with the office of "PriceWaterHouseCoopers' Budapest Office. They charged the auditing company with having too cozy relations with the management, and with a "lax attitude" in evaluating the financial the airline's 1992 financial report. .Deloitte and Touche" were also charged with being accomplices of the former Postabank's management. . "Postbank's" 1996 and 1997 annual reports were falsified, the state- were misled "Postabank", the forth largest commercial bank in Hungary accumulated huge debt, which came to light owing to the large scale investigation carried out by newly elected government's in 1998. (6: p.3).

- there is a notable lack of transparency relating to the equitable accessibility of information to the minority shareholders and public;
- the majority shareholders often tend to change the ownership structure through the emission of new shares;
- management in the majority of enterprises didn't accept a change as a norm, that is, a norm as a positive force and maneuvering space what, consequently, reflected in the low level of realization of those activities undertaken in the field of company restructuring;
- management and members of the management have not developed adequate compensational strategies;
- the power of majority managers is based on the past times, on the political premises at present time;
- management is rather "turned" to the Government and state then to the consumers;
- domestic leaders lack skills and basic knowledge in management and entrepreneurship⁸;
- enterprises are "falling into" businesses rather than getting into them fully prepared;
- management minds its own business, energetic people leave the enterprises. Consequently, it is very difficult to come to terms with the fact that first place won't be occupied with the financially stable enterprises but those with "the smartest heads";
- management forgets that it is necessary to plan morals and discipline as well as support self-confidence etc.

The above mentioned might be summarized in a famous statement of T. Peters: "Today, love for changes, turmoil and even for disorder is a condition for a survival but also a success." Therefore, we can conclude that the initial non-existence and then wandering is a slow adoption and sometimes an unnecessary change of the market behaviour rules⁹, resulted in numerous

and mainly negative consequences of the enterprise's management in terms of quality and overall performance. This period, in the process of transition has been marked by the reformers as objectively conditioned transition crisis.

4. Lessons for transition economies

Corporate governance and the control is for the majority of new shareholders, owners of private business, state and alike in transition countries still an abstract and vague concept. Corporate governance is among pragmatists and the experts often confused with strategic and operative management. This concept is in literature usually seen as dealing with problems resulted from separation of ownership and control. Seen in this light, corporative governance relates to: internal structure and working procedures of the directors' board, establishing independent committees/auditors, rules on information disclosure to shareholders and creditors, and management control. Shortly, this is focused on the model that includes the following:

- The shareholders choose the directors (board) who represent them.
- The directors vote for the key problems and make the most important decisions.
- The decisions are made transparently, so that the directors are responsible to shareholders and the others.
- The company accepts accounting standards with the information necessary for decision making by directors, investors and shareholders.
- The policy and performance of the company is in accordance with the state and local laws.

Evaluating the quality of management operation and, broader, the domain of corporate governance in the transition economies, it is necessary to mention that an overall economic background in the last decade has radically changed, whilst the considerable number of citizens acquired a status of a shareholder, and the institutional and strategic investors has appeared. Also, the problem of corporate governance couldn't be reduced only to establishing the adequate network of institutional infrastructure, and couldn't be completely identified with the connotation of "good corporate governance" in the

⁸ According to a research published by Swedish Royal Academy of Industrial Sciences, the knowledge that managers achieved in 1994 made in 2000 only 20 % of their overall knowledge. The difference was to be balanced by permanent education.

⁹ The change of certain economic system regulations, more precisely passing a new Law on the economic societies in Montenegro. Passing this law means that we are not only farther from European Union because it means the acceptance of the American concept, but also places a question, what was it for except for satisfying the demands of the foreign consultants. At the same time we should ask whether the American concept exists, being that the United

States have the state model of the law, and what is more, each state has its own corporate regulation.

countries of market economies. Namely, the very change in the institutional basis (corporate right), that is, management and control function, the set of questions dealing with the need of establishing a new indicator regime, then, in general, the experience in this kind of business practice, business norms in general, business ethics etc.

Management within the domestic framework is very important because the majority misses it. Owing to the construction fault in the self-regulation socialism, the global estimate of management could be expressed as amateurish, unprofessional activity, yet without knowing to whom in the enterprise it “belongs”¹⁰. With the view on the above said, what follows are the essential observations related to the domestic management:

- In our understanding of “management”, as a society we are a whole century behind;
- Management and entrepreneurship proficiency are far more deficient resources than capital;
- We still have not experienced so called “managerial revolution”;
- Present “managers are somewhere between the former executives of unlimited privileges and new owner’s interest”;
- The meaning and knowledge of manager has not settled yet, what is more, the word has been taken out from some other field and taken on a vulgarized character;
- The concept of manager as an adroit cheat is still prevailing;
- Management is tried to be introduced by means of laws and decrees (mere laws copying and, what is more, the worse application).

Having in mind the above said, we may draw the conclusion that, development of management is intended to change the awareness and induce the market economy revival, and so that all the companies will go through the transition process, but it depends on their managers’ proficiency if they are going to survive.

Apart from the importance of good-quality management performance; it is inevitable to mention that the underlying system of the national laws regulates this field. (National corpo-

rate laws). However, the qualitative content of this process relates, for us, to its more significant, economic side, and means management performance in the process of directing and controlling the company, in order to maximize residuals and company’s values for its shareholders, including all interested (stakeholders concept): workers, management, buyers, suppliers, creditors, local government and so forth. According to a number of estimates, starting from 1998, the same ten companies have been among the best. The key for this obviously lies in the way the company is conducted, as well as the capacity of its managers to keep the continuity of success, regardless of the economic circumstances and company’s problems¹¹. Different to this, bad corporate governance means that management hasn’t succeeded in fulfilling both of these previously stated requirements¹².

In those transition countries in which the ownership structure has not been clearly defined, while the most enterprises are directly or indirectly controlled by a state, where capital market and work force doesn’t exist and political insta-

¹¹ According the research of “PriceWaterHouseCoopers” and British “Financial Times”, the well-known company “General Electric” has been enjoying the highest reputation in world business circles for the last six years, “Microsoft” is second on the list, Toyota the third, IBM the fourth. The Selection criterion was not only the business success of the enterprise but also its social responsibility, integrity, management policy and its relation to the shareholders.

¹² The review of the largest bankruptcies in the United States in last few years is given in the table:

Company	Date of bankruptcy	Company’s value (billion)
WorldCom Inc.	21.07.2002.	107,000.00
Enron Corp.	02.12.2001.	63,392.00
Texaco Int.	12.04.1987.	35,892.00
Financial Corp.	09.09.1988.	33,864.00
Global Crossing Ltd.	28.01.2002.	25,511.00
Adelphia Communications	25.06.2002.	24,409.66
Pacific Gas and Electric Co.	06.04.2001.	21,470.00
MCorp	31.03.1989.	20,228.00
Kmart Corp.	22.01.2002.	17,007.00
NTL Inc.	08.05.2002.	16,834.00
First Executive Corp.	13.05.1991.	15,193.00
Gibraltar Financial Corp.	08.02.1990.	15,011.00
FINOVA Group Inc.	07.03.2001.	14,050.00
HomeFed Corp.	22.10.1992.	13,885.00
Southeast Banking Corp.	20.09.1991.	13,390.00

¹⁰ With regard to the managerial awareness of business people engaged in management and domestic practice, the four groups of managers are to be identified: raised awareness managers, quasi managers, lacking awareness managers, and self-grown managers.

bility is present, corporate governance process couldn't unfold to its end. Furthermore, the privatization is used to cover up personal failings, implicating that the funds collected in this way are to be used to fill up the budget and settle social problems, but not intended for capital increase and enterprise's recovery. On the other side, Enron¹³ is an example that even the large corporations' top management is associated with financial and legal counselors, inclined to cook the books and come out with deceptive disclosure of their financial statements, that auditing companies tend to "counsel" rather than control, producing a bad effect for its shareholders¹⁴. For this reason, the example of "Enron" and the chain of following scandals, (Worldcom, Global Crossing) deserve to be communicated and serve as a lesson for transition economies (more. info. 6; 1-10)

1. Genuine transparency is necessary. Enron's financial statements were neither clear nor open and were misleading and deceptive. Owing to the incorrect statements the reported profit for third-quarter 2000 – third-quarter 2001 comparing to the actual profit was \$1 billion larger. By creating hundreds of so-called special entities – purpose enterprises, Enron kept debts off the company's balance sheets and financial statements, while the entities existed as a means of Enron's capital increase, not including debts in financial statements.
2. Stronger Government Oversight is Necessary. Accounting reports have to give a clear picture on the company's operation as well as of its financial structure¹⁵. Accounting

regulations oversight including self-control as well as disclosure rules, are mostly conducted thanks to the SEC, founded after the 1933/34 depression, that has created an accounting body to thoroughly review and supervise the existing accounting control system. A lot of organizations established to conduct the accounting bodies oversight, don't have much influence on the accounting bodies' members and have not given much of a contribution in this sense. Moreover, the accounting firms tend to give the passing marks to the company they are working for, meaning that self-regulation and audit reports they conduct are inefficient, that is - futile.

3. Sources of Conflicts of Interests Should Be Eliminated. Conflict of interest may appear between company and its accounting firm, because the accounting firm often depends from company's income, and thus likely to endanger the safety of shareholders interest. It has become clear that the accounting firm may perform lucrative management services for its company or bear responsibility for the internal auditing, as it was the case with Enron¹⁶. Besides, banks and financial analysts see their interest in creating a good picture on the company, having in mind that negative statements may aggravate relations with the company.
4. Promoting Accounting Standards. The Enron case will undoubtedly have a considerable impact on the accounting and auditing profession in the United States¹⁷. The FASB often needs a lot of time to develop extremely elaborate standards and many of them lag behind the "events" as it is the case with companies in off balance sheet reporting.
5. An Advanced Auditors' Training. The example of Enron confirmed that auditors

¹³ Enron, the seventh largest company in the United States, employed over 21.000 workers, \$63 billion worth of assets and earned \$100 billion in 2000. After the affair was made public, company's share value dropped from \$90 to \$0.80 per share.

¹⁴ Intended to bring to end the growth of financial deceits that affected "Enron", "Worldcom" and other companies undermined investors' confidence and resulted in huge drop of share value, on 27th June 2002 SEC (Securities and Exchange Commission) brought the ordinance obligating the executives to take on oath on adequate business statements disclosure. On this occasion, the president of the United States, George Bush said to believe the managers of the American companies to be "good and honest people" and that his government "won't allow to the few to destroy the reputation of the many". A month later, Congress adopted the strict laws on stamping out the offenses.

¹⁵ The greater part of the institutions have introduced the practice of repeated information oversight by the authorized person and investigation system as well, on the basis of what the institutions decide how to act even in usual, habit-

ual situations. They are analyzing the outstanding outcomes likely to result in different financial outputs and send them to the superior analyst, what proved to be good in shareholding governance. CALPERS (Californian Retirement System for Public Sector Employees) for example, claims that activities to enhance management increase the value of individual portfolio for about \$150 million.

¹⁶ The consequences of performing both consulting and auditing services are to be seen on the example of Arthur Anderson who got \$27 million in consulting fees from Enron in 200, plus \$25 million for the Enron audit.

¹⁷ FASB (Financial Accounting Standards Board), is responsible for accounting standards development and the AICPA is responsible for auditing standards.

need to have knowledge far beyond accounting and auditing scope. This will certainly enhance the auditing quality, in particular if the accounting training was good and carried out “in depth”. Also, a good training should pay more attention to ethics (codes and conduct) Although the Audit Committee of Enron’s Board of Directors had plenty of knowledge, obviously it did not appropriately reviewed the financial and accounting situation, for example the disclosure of some “financial connections” to directors.

With respect to the previous and many negative experiences in developed countries, we may assume there is a strong need to redefine the problem of corporate governance in transition countries. In doing this, the most crucial step would be to renew foreign investors’ trust and the problem would be focused on how to best respect the following principles:

- fairness- minority shareholder protection;
- transparency- promoting transparency, adequate statements disclosure to shareholders and other interested groups;
- accountability- management is to conduct invoices control and oversight, takes care about relations and authorities between board and managers, shareholders and auditors, shareholders’ accountability and so forth;
- Responsibility – management is responsible to act in accordance with the law and observe current social norms (ethics, social responsibility);

To sum up, we may conclude, that the current situation in developed market countries is strikingly different in comparison to five years ago. Hence, it is obvious that the words as – “disclosure”, “transparency” and “shareholder value” make the framework of shareholding governance nowadays and are the most common words in the World Bank, International Monetary Fund and OECD. These institutions look critically on the improved corporative governance standards, in particular on facilitating developing markets to re-establish competition, gain investors’ confidence and promote national economical growth. In addition, the World Bank and IMF are conducting governance reform in still young and “unhealthy” markets and develop policies to prevent future possibilities for finan-

cial crisis in other countries. For instance, a lot of countries nowadays have company and stock exchange regulations similar to the United States ones, thus restricting companies to get shareholders approval for the suggested business.

6. Conclusion

The common heritage in the most socialistic countries was a command economy and in this sense, these countries faced difficulties in the competitive environment. At the very beginning of the privatization process, the passive role of managers in the enterprises turned out to have rather destructive character. With a view to numerous barriers of privatization, we have to admit that it was difficult to establish the new market mechanism at the remains of former system, so that, if we are to evaluate the achieved level and quality of corporate governance, the process is still in its adolescent phase. Further, to sum up, the problem of privatized enterprises’ competition remains open and in most cases relates to low management quality and corporate governance. As a result, within the newly created conditions, it is the necessity to establish skillful management in the privatized companies.

Finally, what we wanted to point out in this study is to the crucial importance of the corporate governance in line with the arising competitive advantages of some enterprises and economy in all, and the reserves which used on those basis can best result in positive outputs. In such a way, we opened the “black box” and warned the reformers and companies’ management about one of the major aspects, being at the same time the spotlight and source of many problems. Secondly, we find it necessary to emphasize that the concept of good “corporate governance” should be redefined in line with the concrete situations and adjusted to transition economies, rather than lost as “something between”, or badly copied as “something” that has been already successfully operating in the market economies countries.

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MENADŽMENT U PROCESU KORPORATIVNE VLADAVINE

Rezime: Generalno posmatrano, proces privatizacije bivših državnih i društvenih preduzeća u postsocijalističkim zemljama je do sada reafirmisao institucionalnu osnovu kapitalističkog modela preduzeća i preduzetništva. Međutim, osim u malom broju zemalja, to nije rezultiralo u adekvatnim reformskim efektima. Preciznije, efekti su još daleko ispod očekivanja zaposlenih u privatizovanim preduzećima i građana u cjelini.