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EDITORIAL

Historical, cultural, political and economic realities play a crucial role in modelling systems of corporate governance. Corporate governance can be defined as a sort of *management of management* or *metamanagement*, since it incorporates the set of relations between the management, board, shareholders and stakeholders of a firm, and defines the framework for setting goals and determining the means to achieve those goals, as well as for monitoring the performance and efficiency of the firm.

A closed system of corporate governance, characteristic of Continental Europe, is defined by a myriad of legal, cultural and institutional relations, through which the influence of individual stakeholders on setting goals and supervising the firm's business policy are determined and is based on the activities of blockholders and banks. Good corporate governance is based on adequate combination of the legal protection of investors and the level of ownership concentration.

South East Europe is a region full of surprises; conflicts and wars in past, on the one side, but huge growth potential on the other side. The history of SEE countries, their characteristics, their resources, their cultural roots and their political structures shape their paths. They have been passing through a difficult transitional period in the past twenty years, burdened with myriads of different post-socialist problems and slow adaptation to the western economic system. In almost all countries of the region, rapid privatization led to a range of long-term problems from which a significant number was related to corporate governance issues. Substantial efforts are required to improve corporate governance practices and even though noticeable improvements are seen in recent years, there is still much work ahead.

South East Europe Corporate Governance Academic Network (SEE CGAN) was initiated and founded in 2012 with the aim to connect scholars in the region, promote joint research projects and papers by focusing on specificity of corporate governance and management practices in the South East Europe region.

This special issue of *Montenegrin Journal of Economics*, titled "Corporate Governance Practices and Problems: Research from the South East Europe", portrays some of the challenges, problems and corporate governance issues in this region.

The focus of the papers was devoted to interesting questions such as the role of boards and top management teams in corporate governance; financial, institutional and legal aspects of corporate governance in SEE region; social responsibility and ethics; transparency and disclosure issues; corporate crises and corporate governance and several other problems in corporate governance and management.

We hope that papers in this special issue are interesting and beneficial for all those engaged in the areas of corporate governance, from academia and the corporate world.

Professor Darko Tipurić, Ph.D.
Professor Veselin Drašković, Ph.D.

Editors

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EXPLORING THE LINK BETWEEN EXECUTIVE COMPENSATION PACKAGE AND EXECUTIVES' PAY SATISFACTION IN CROATIAN COMPANIES: AN EMPIRICAL STUDY

DARKO TIPURIĆ[1], DANICA BAKOTIĆ[2], and MARINA LOVRINČEVIĆ[3]

Abstract

The executive compensation package can, and most often does, contain many elements. These elements have differing effects on executive motivation and risk taking propensity, and they impose different costs for the company. In that sense, the aim of this paper is to investigate the components of executive compensation packages in large Croatian companies as well as to identify the level of executives' satisfaction with their compensation packages.

The research was conducted in 2010 via mail survey. The questionnaires were addressed to the Presidents of Management Boards of 500 of the largest Croatian companies. 72 questionnaires were collected so that overall response rate was 14.4% (which is considered to be highly acceptable having in mind the delicacy of the issue of managerial compensation).

Our research results suggest that besides base salary, other components of executive compensation package are not adequately represented. Bonus is the most common form of variable pay, whereas stock options and stock grants are not included in executive compensation packages in large Croatian companies. Even though structure of executive compensation packages in large Croatian companies is, for the most part, not in line with theoretical postulates, top managers seem to be satisfied with their pay and other elements of their compensation package.

Keywords: *Compensation package, Executives, Satisfaction.*

JEL Classification: G30; J33; M12; M52:

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1. INTRODUCTION

Understanding the executive compensation package and its role in the modern companies requires a basic understanding of corporate governance. In the modern companies the ownership and management functions are separated. This separation leads to principal-agent problem. In basis this problem concerns the difficulties in motivating one party (the "agent"), to act in the best interests of another (the "principal") rather than in his or her own interest. In the context of executive compensation, the issue is motivating the executive of the company (the agent) to act in the best interest of the principal (the shareholders) (Garen, 1994). The existence of this problem drives shareholders to design optimal compensation packages to provide executives with incentives to align their mutual interests (Conyon, 2006).

Additional aim of the companies is to design the compensation packages which will attract, retain, motivate and satisfy their executives (Jensen et al., 2004). So the question is which components of compensation package companies need to choose in order to design the effective compensation package. The literature indicates which components should be included in executive compensation packages in order to resolve principal-agent problem and also to obtain their motivation role.

So the aim of this paper is to explore the extent to which large Croatian companies use theory postulates when designing their executive compensation package. In other words, the aim of

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this paper is to investigate the components of executive compensation packages in large Croatian companies as well as to explore the level of executives' satisfaction with their compensation packages.

2. THEORETICAL FRAMEWORK

A well-designed executive compensation package is important because it rewards both executives and shareholders, whereas a poorly designed one, wastes corporate resources without motivating the executives. At the extreme, poorly designed incentive system can cause the executive to take actions that reduce shareholders value – for example, cutting back on long-term profitable investments to increase current compensation.

The executive compensation landscape has changed dramatically in recent years driven by the focus on shareholder value creation and the continued rise in stock markets. It is safe to say that having an effective total compensation package has never been more important to satisfy increasingly knowledgeable and vocal shareholders, directors, executives, and various political and public groups.

There are many details that must be attended to in designing the executive compensation package of any company, large, or small. These range, from relative simple questions of how closely the base salary and annual bonus reflect the market to the more arcane but significant issues surrounding stock option valuations and the latest accounting changes.

Firstly, the compensation package should be used to align the interests of shareholders and executives. Properly designed, the compensation package can be a tool for mitigating the conflict between shareholders and executives. It does so by rewarding executives for taking actions that increase shareholder value. Unfortunately, owners have incomplete information about the actions of executives. Further, they may not have the expertise to evaluate those actions, even if the actions are observable. Thus it is difficult to base compensation on actions alone. Rather, compensation is often tied to measures that are positively correlated with managerial effort, for example, accounting income share price, or market share (The WorldatWork, 2007, pp. 289). By creating a pay-performance linkage in compensation contracts, executives have more incentives to maximize shareholder wealth (Core et al., 2003). Moreover, the risks between the principals and agents can be shared more equitably (Jensen and Meckling, 1976; Cordeiro and Veliyath, 2003). In this context, Jensen and Murphy (1990) find that increases in shareholder wealth are positively related with CEO pay. Main et al. (1996) find that the relation between pay and performance becomes more significant when executive options are included in total compensation.

Secondly, compensation packages should be designed to attract, retain and motivate. In this context the expectancy theory rises up. This theory stress the importance of individual differences in designing the executive compensation package which will attract, retain and motivate the best executives. Some executives might prefer deferred compensation. Other might prefer golden parachutes as a protection against unemployment. Still others might prefer risky stock options. Some executives might even prefer nonfinancial rewards, such as time for family, sabbaticals, and a variety of other perks.

But the most important factor is that there be absolute clarity on the purpose and objectives of the compensation packages (Berger and Berger, 1999, pp. 340). One key step a company can take to achieve clarity of purpose is to articulate a meaningful compensation philosophy. The philosophy is an embodiment of organizational beliefs and values in the area of compensation practices, but it should be also a practical guide that links those values to the strategy and direction of the business, as well as a way to coherently bring together the various elements of compensation.

So the executive compensation package can, and most often does, contain many components. These components have differing effects on executive motivation and risk, as well as different cost for the company. The major and most common components of executive compensation package are: base salary, bonus, stock options, stock grants, other stock based forms of compensation, pensions, benefits and perquisites, severance payments (The WorldatWork, 2007).

Base salary is the fixed contractual amount of compensation that does not explicitly vary with performance. It takes into account the specific tasks and challenges of executives, their seniority and experience (Goergen and Renneboog, 2011). Today, in western economies the base salary is only the tip of the iceberg of total executive compensation (Hendreson, 2003). Bonus is a form of compensation that may be conditioned upon individual, group, or company performance. The performance conditions used to determine the bonus can be implicit or explicit, objective or subjective, and financial or nonfinancial. In some cases, bonuses can be based upon one factor whereas in other cases, they can be based upon a combination of factors. In addition, bonuses can be based upon short-term or long-term measures. The researches indicate that today executives have the opportunity to earn an annual bonus of up to 120% of base salary (Frydman and Jenter, 2010). Stock options as additional component of executive compensation package is the right (not obligation) to purchase a stated quantity of stock at a stipulated price (strict price) over a given period of time (exercise period) following certain eligibility (vesting) requirements (Milkovich and Newman, 2005, pp. 468). During the 1980s and especially the 1990s, in U.S., stock options surged to become the largest component of top executive pay. Today, they account for over one half of total executive compensation (Frydman and Jenter, 2010). Stock grants occur when company gives shares to their employees. They differ from stock options in that they have no exercise price. Whereas a stock option only has value if the company's share price is above the exercise price, a stock grant has value as long as the share price is above zero. Other stock based forms of compensation include stock appreciation rights, phantom stock, and equity units. Stock appreciation rights are the right to receive the increase in the value of a specified number of shares of common stock over a defined period of time. Phantom stock are units that act like common stock, but that do not constitute claim for ownership of the company. Equity units entitle the holder to purchase common stock at its book value, and then resell the stock to the corporation at its book value at a later date. Pensions are a form of differed compensation, whereby after retirement from the company, the employee receives a payment or series of payments. The researches about pensions are very rare, but there is some evidence about them. Namely, Sundaram and Yermack (2007) calculate the pension values of about 10% of total pay for Fortune 500 CEOs. Additionally, Bebchuk and Jackson (2005) discovered the significant pension values in a sample of S&P 500 CEOs. Benefits and perquisites which are also category of compensation package component usually include company car, the use of company airplanes and apartments, special dining facilities, country club membership, health, dental, medical, life and disability insurance. Rajan and Wulf (2006) report that 66% of the employers offer their executives access to the company plane, 38% chauffer service, 56% a company car, 47% country club membership, 48% lunch club membership, 17% health club membership. And finally, severance payments as compensation package component are fairly common and have become very controversial. Severance payments occur when an executive leaves the company under pressure or is fired without cause; consequently while they are sometimes included in the executive's employment contract, severance payments at most happen one at the end of the executive's tenure with the company. Yermack (2006) finds that severance payments are common, but usually moderate in value.

All these components of the compensation package have different effects on executive incentives, risk, political cost and tax payments, as well as on company financial reporting, political costs, and tax payments. More commonly compensation packages include both fixed and variable components. Fixed components are included to reduce risk to the executive and guarantee a standard of living, whereas variable components are included to provide incentives and align the interest of executives and shareholders. Assuming that the executive compensation package will include both fixed and variable components, the company has to decide how much of each to include, and what forms they should take. Fixed components might include salary and benefits, such as employer-paid life insurance, health care and pensions. Variable components might include bonuses, where the payout may be based on reported accounting numbers, market share or customer satisfaction; and stock compensation where the payout is based on stock prices. When a company is determining the variable components of its compensation package it must realize that different forms of variable compensation provide different incentives.

The company should also realize that the structure of an incentive plan can yield very specific orientation and behaviors. A bonus plan based upon accounting numbers lead to higher reported accounting income, but not necessarily lead to higher shareholder value, as executives may make cosmetic changes to its financial statements to increase its bonuses. Similarly, if executives are rewarded for increasing market share, the company may get increased market share, but at the cost of reduced profits and reduced shareholder value (The WorldatWork, 2007).

3. METHODOLOGICAL FRAMEWORK AND RESEARCH DESIGN

The research was conducted in June 2010 on the population of 500 of the largest Croatian companies (by total revenues). The Presidents of Management Boards were asked to answer series of closed format questions. 72 questioners were collected via mail survey, so that overall response rate was 14.4%. SPSS 18 for Windows was used for statistical analysis of the data collected.

For the purposes of our research, we have identified six industries: financial (15.3% of the companies in the sample), construction (19.4%), food and beverages (15.3%), trade (15.3%), manufacturing (19.4%), and other services (15.3%). By type of ownership, distribution of companies is as follows: predominantly privately-owned (62.5% of the companies in the sample), completely state-owned (12.5%), predominantly state-owned (8.3%), predominantly privately-owned, but under substantial Government influence[4] (8.3%), predominantly foreign-owned (8.3%). Companies in the sample are on average 46.8 years old (youngest company in the sample is only 4 years old, while the oldest one is 150 years old) and have on average 2.83 executives appointed to the Management Board (Board size varies from minimum one to maximum six members of Management Board). Further, just over half of the Presidents of Management Boards (56.9%) in the sample have Master of Science (arts) or doctor of philosophy academic degree, while 38.9% have university diploma. Only one respondent (1.4%) has high school diploma, while 2.8% of the respondents have college diploma. Educational background analysis by primary field of education reveals that 63.9% of the respondents have undertaken education in the field of business, while 23.6% of the respondents have undertaken education in engineering. 4.2% of the executives in the sample have undertaken education in the field of law, while other fields of education (medical studies, arts, other social studies fields) are less represented (8.3%). Additionally, the greatest proportion of respondents (48.6%) have reported tenure on current position (President of Management Board) up to 5 years, while third of the respondents have reported tenure longer than 5 years but lesser than 10 years (33.3%). 12 respondents (16.7%) have reported tenure longer than 10 years.

4. RESULTS AND DISCUSSION

Since variable pay is an important reward element, we analyzed variable pay of Presidents of Management Boards of Croatian companies in the sample (Table 1). The results of our research clearly demonstrate that variable pay is inadequately represented reward element in compensation package of Croatian top managers. Almost half of the Presidents of Management Boards from our research sample (48.5%) have reported proportion of variable pay lesser than 5%, while only two Presidents (2.9%) have reported share of variable pay that exceeds 50%. On the other hand, there is almost equal distribution of respondents whose variable pay proportion in compensation package varies from 5% to 10% (14.7% of the respondents), from 10% to 20% (16.2% of the respondents) and from 20% to 50% (17.6% of the Presidents of Management Boards in the sample). Having in mind that our research sample was drawn out of the population of 500 largest Croatian companies by total revenues, presented figures not only are insufficient but also in collision with global trends in executive compensation.

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[4] In Croatia, as well as in other (post) transition countries, this is not unusual in strategically important sectors such as energy sector or shipbuilding industry.

Table 1: Distribution of Presidents of Management Boards by proportion of variable pay

		Frequency	*Percent*	*Valid percent*
Valid	Less than 5%	33	45.8	48.5
	5% to 10%	10	13.9	14.7
	10% to 20%	11	15.3	16.2
	20% to 50%	12	16.7	17.6
	More than 50%	2	2.8	2.9
	Total	68	94.4	100.0
Missing	System	4	5.6	
Total		72	100.0	

Next, we were interested in the most frequent form of variable pay in our research sample. Results in Table 2 show that just over three quarter of the respondents (77.8%) have reported receiving bonus as a form of variable pay, while 20% of the respondents have reported to participate in a profit-sharing scheme. Only one President of Management Board (2.2%) has reported compensation in stock options as a form of awarding. While most of the respondents felt free enough to report the actual proportion of their variable pay in overall compensation package (94.4% of the respondents answered when being asked about proportion of variable pay), they seem to be not responsive enough when being asked about the form of variable pay (37.5% missing observations).

Table 2: Distribution of Presidents of Management Boards by type of variable pay

		Frequency	*Percent*	*Valid percent*
Valid	Bonus	35	48.6	77.8
	Stock options	1	1.4	2.2
	Profit-sharing	9	12.5	20.0
	Total	45	62.5	100.0
Missing	System	27	37.5	
Total		72	100.0	

Further, we analyzed if managerial contracts of top executives in the research sample include severance pay (Table 3). Just under two thirds of the respondents (63.1%) said that their contract include severance pay, while 36.9% of the respondents have reported no severance pay included in their contract.

Table 3: Distribution of Presidents of Management Boards by severance pay

		Frequency	*Percent*	*Valid percent*
Valid	No	24	33.3	36.9
	Yes	41	56.9	63.1
	Total	65	90.3	100.0
Missing	System	7	9.7	
Total		72	100.0	

As a next level of analysis, we examined if managerial contracts of Presidents of Management Boards in the sample include any additional benefits, namely life insurance programs or pension programs. Results presented in Table 4 show that 65.6% of top executives in the sample have no additional benefits included in their contract, while 34.4% of respondents have reported to have life insurance programs or pension programs as a part of their managerial contract.

Table 4: Distribution of Presidents of Management Boards by additional benefits (life insurance programs/pension programs)

		Frequency	*Percent*	*Valid percent*
Valid	No	42	58.3	65.6
	Yes	22	30.6	34.4
	Total	64	88.9	100.0
Missing	System	8	11.1	
Total		72	100.0	

Next, we were interested to find out if Presidents of Management Boards in large Croatian companies included in the research sample receive rewards (and incentives) in the form of managerial ownership. Results presented in Table 5 suggest that third of the respondents participate in ownership structures of their companies, while 66.7% of the respondents are not participating in managerial ownership scheme.

Table 5: Distribution of Presidents of Management Boards by managerial ownership

		Frequency	*Percent*	*Valid Percent*
Valid	No	46	63.9	66.7
	Yes	23	31.9	33.3
	Total	69	95.8	100.0
Missing	System	3	4.2	
Total		72	100.0	

In case that top managers participate in ownership structure (Table 6), most often they report 5% or lesser equity share (47.8% of the respondents). Just over quarter of respondents (21.7%) have reported substantial participation in ownership (20% to 50%), while respectable number of respondents (17.4%) has reported dominant position in ownership structure (more than 50%). Only one respondent reported participation in ownership in range from 5% to 10%.

Table 6: Distribution of Presidents of Management Boards by proportion of share ownership

		Frequency	*Percent*	*Valid Percent*
Valid	Less than 5%	11	15.3	47.8
	5% to 10%	1	1.4	4.3
	10% to 20%	2	2.8	8.7
	20% to 50%	5	6.9	21.7
	More than 50%	4	5.6	17.4
	Total	23	31.9	100.0
Missing	System	49	68.1	
Total		72	100.0	

Since compensation package satisfaction is one of the important facets of overall job satisfaction and is closely related to structure and quality of overall compensation package, we asked respondents to rate their compensation package satisfaction level (relatively to other Management Board members' compensation packages in their industry). Research results presented in Table 7 show that just over half executives in the sample (55.7%) are satisfied with pay and other elements of compensation package, while respectable proportion (28.6%) of executives have reported neutral feelings toward compensation package satisfaction (not satisfied, but not even dissatisfied with pay and other elements of compensation package). 8.6% of respondents have reported to be very satisfied with compensation package, while on the other hand we have identified 7.1% of the respondents who are dissatisfied or very dissatisfied with compensation package (when comparing themselves to other executives in their industry).

Table 7: Distribution of Presidents of Management Boards with respect to compensation package satisfaction level

		Frequency	*Percent*	*Valid Percent*
Valid	Very dissatisfied	1	1.4	1.4
	Dissatisfied	4	5.6	5.7
	Not satisfied, nor dissatisfied	20	27.8	28.6
	Satisfied	39	54.2	55.7
	Very satisfied	6	8.3	8.6
	Total	70	97.2	100.0
Missing	System	2	2.8	
Total		72	100.0	

We have analyzed respondents' compensation package satisfaction level according to ownership structure. Results of analysis of variance (ANOVA) show that the difference between compensation package satisfaction level with respect to type of ownership is not statistically significant (F=1,844, df=4, sig.=.131), even though descriptively observable. Our findings demonstrate that compensation package satisfaction level is highest in predominantly state-owned companies (4.00), while is lowest in completely state-owned companies (3.11). This could mean that privatization processes, as answer to the failure of state ownership, are positively related to compensation package satisfaction of executives in partially privatized firms.

As for the post hoc ANOVA (LSD) test results, executives in predominantly privately-owned companies are significantly more satisfied with pay and other elements of compensation package than executives in completely state-owned companies (sig.=.031). Furthermore, the level of compensation package satisfaction of executives in predominantly state-owned companies is significantly higher than the level of compensation package satisfaction of executives in completely state-owned companies (sig.=.041).

Analyzing compensation package satisfaction level of Presidents of Management Boards in Croatian companies in the sample with respect to tenure for the current position, we determined statistically significant difference between compensation package satisfaction levels with respect to tenure for the position (F=2,899, df=3, sig.=.042). As a further level of analysis, we determined that compensation package satisfaction level is highest for Presidents of Management Boards who are on the current position for more than ten years (4.17), while the level of compensation package satisfaction is lowest for reported tenure lesser than one year (3.33).

Table 8: The level of Presidents' of Management Boards compensation package satisfaction with respect to type of ownership

	N	*Mean*	*Std. Dev.*	*Std. Error*	*95% Confidence Interval for Mean*		*Min*	*Max*
					Lower Bound	Upper Bound		
Predominantly privately-owned	44	3.73	.758	.114	3.50	3.96	1	5
Completely state-owned	9	3.11	.782	.261	2.51	3.71	2	4
Predominately state-owned	5	4.00	1.000	.447	2.76	5.24	3	5
Predominantly privately-owned, but under substantial Government influence	6	3.33	.816	.333	2.48	4.19	2	4
Predominantly foreign-owned	6	3.83	.408	.167	3.40	4.26	3	4
Total	70	3.64	.781	.093	3.46	3.83	1	5

POST HOC ANOVA TEST (LSD)

(I) Ownership	(J) Ownership	Mean difference (I-J)	Std. Error	Sig.	95% Confidence Interval for Mean	
					Lower Bound	Upper Bound
Completely state-owned	Predominantly privately-owned	-,616*	,279	,031	-1,17	-,06
	Predominately state-owned	-,889*	,425	,041	-1,74	-,04

* The mean difference is significant at the 0.05 level.

Table 9: The level of Presidents' of Management Boards compensation package satisfaction with respect to tenure for the current position

	N	Mean	Std. Dev.	Std. Error	95% Confidence Interval for Mean		Min	Max
					Lower Bound	Upper Bound		
Less than 1 year	9	3.33	1.000	.333	2.56	4.10	1	4
1 to 5 years	25	3.68	.690	.138	3.40	3.96	2	5
5 to 10 years	22	3.45	.800	.171	3.10	3.81	2	5
More than 10 years	12	4.17	.577	.167	3.80	4.53	3	5
Total	68	3.65	.787	.095	3.46	3.84	1	5

POST HOC ANOVA TEST (LSD)

(I) Tenure on the position	(J) Tenure on the position	Mean difference (I-J)	Std. Error	Sig.	95% Confidence Interval for Mean	
					Lower Bound	Upper Bound
More than 10 years	Less than 1 year	,833*	,333	,015	,17	1,50
	1 to 5 years	,487	,265	,071	-,04	1,02
	5 to 10 years	,712*	,271	,011	,17	1,25

* The mean difference is significant at the 0.05 level.

Results of post hoc ANOVA test (LSD) show that Presidents of Management Boards who are occupying current position for more than 10 years have a significantly higher level of compensation package satisfaction compared to Presidents of Management Boards occupying current position for less than 1 year (sig.=.015), compared to executives who are on the current position from 1 to 5 years (even observed differences are being statistically significant only at the 10% level – sig.=.071), and compared to managers who are on current position from 5 to 10 years (sig.=.011).

We also tested differences in compensation package satisfaction with respect to managerial ownership. Participation in ownership by leading executives is an object of many controversies. It is an important incentive alignment mechanism that reduces agency problem while at the same time improves company's efficiency. Even if managerial ownership – efficiency relationship is controversial in many ways, available empirical findings suggest that managerial ownership undoubtedly increases managerial discretion and power and contributes managerial entrenchment by reducing the odds of inefficient top managers' replacement.[5]

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[5] Even in Croatian settings, the nature of managerial ownership-efficiency relationship remains (for the most parts) unclear, but managerial ownership significantly reduces chances of replacement (dismissal) of poorly performing managers. See more in Tipurić, D., Slišković, T., Daraboš, M. (2011): Menadžersko dioničarstvo, djelotvornost poduzeća i

Table 10: The level of Presidents' of Management Boards compensation package satisfaction with respect to managerial ownership

	Participation in ownership	*N*	*Mean Rank*	*Sum of Ranks*
Pay satisfaction	No	46	31,49	1448,50
	Yes	23	42,02	966,50
	Total	69		

Test Statistics[a]

	Pay satisfaction
Mann-Whitney U	367,500
Wilcoxon W	1448,500
Z	-2,287
Asymp. Sig. (2-tailed)	,022

a. Grouping Variable: Participation in ownership

Results of our research clearly demonstrate that there is statistically significant difference between compensation package satisfaction levels with respect to managerial ownership (Z= -2,287, sig.=.022 for Mann-Whitney test), whereas participation in ownership contributes to lower levels of compensation package satisfaction of Presidents of Management Boards in the sample.

5. CONCLUSION

The motivation behind this paper was to investigate and critically evaluate the components of executive compensation packages in large Croatian companies as well as to identify the extent to which large Croatian companies use theoretical prescriptions when designing executive compensation packages. Our research results show that the most used components of executive compensation package in large Croatian companies are severance pays and bonuses. Stock options and stock grants are not adequately represented in their compensation packages. Regarding the satisfaction with compensation packages, research results show that the majority of executives are satisfied with their compensation packages. Furthermore, the research results indicate that there is a statistically significant difference in the level of executives' satisfaction with compensation package regarding the ownership structure whereas the compensation package satisfaction level is highest in predominantly state-owned companies. Also, we found statistically significant differences in the level of satisfaction with the compensation package regarding tenure on the position of the President of Management Board whereas compensation package satisfaction level is highest for managers occupying their positions for more than 10 years. Finally, our research results demonstrate that managerial ownership contributes to lower levels of compensation package satisfaction.

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CORPORATE RISK MANAGEMENT AND VALUE CREATION

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Abstract

This paper explores relationship between risk management activity and company's value. The main purpose of this paper is to get a deeper insight into the research problem, as well as to reach better comprehension of a relationship between risk management and value creation at the corporate level. The paper is aiming to (1) explain the clash between theory and practice by presenting benefits of risk management; (2) present results of empirical research on corporate risk management rationales in large non-financial Croatian companies; (3) explore how risk management can influence company's value and its drivers.

The literature survey has shown that risk management can enhance company's value by decreasing costs related to financial difficulties, agency cost of debt, taxes, and costs of external financing. The evidence based on the multivariate empirical relations between the decision to hedge in Croatian non-financial companies and financial distress costs, agency costs, costly external financing, and taxes supports tested hypotheses related to the investment expenditures to assets ratio and total debt to assets ratio. Therefore, it can be concluded that companies that are more leveraged and have more investment opportunities have more incentives to manage corporate risk. By using Risk adjusted value approach, paper has shown that efficient risk management can influence company value drivers and positively affect overall enterprise value.

Key words: *Hedging, Risk management decision, Croatian companies, Value drivers, Value creation*

JEL Classification: G320, G390

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1. INTRODUCTION

For a long time, corporate risk management was considered to be irrelevant to the value of the firm and the arguments in favour of the irrelevance were based on the Capital Asset Pricing Model (Sharpe, 1964; Lintner, 1965) and the Modigliani-Miller theorem (Modigliani and Miller, 1958). The arguments for the corporate risk management relevance and its influence on the company's value are revealed in this paper. The paper aims to present the extensive survey of literature based on theoretical rationales for risk management at the company's level as well as the empirical evidence, which supports the implications of the theory. By using unique Risk adjusted value approach, which combines risk management with corporate evaluation, paper will explore corporate value determinants and explain how risk management activities can affect these drivers in order to enhance the value.

2. THEORISING THE FRAMEWORK

The capital asset pricing model (CAPM) commonly used to assess the risk-adjusted return on a particular stock, separates risk into two components: (1) systematic risk, which captures the variation in a stock's return ascribable to market-wide forces and (2) business, or unsystematic, risk, which reflects the variation in a stock's return ascribable to firm-specific forces. According to the CAPM, since investors can diversify away business risk by holding well diversified portfolio, they only worry about the market risk of a stock, which is measured by beta coefficient. Thus, under the assumptions of the CAPM, corporate managers should not be concerned with reducing

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their firm-specific business risk since it should have no effect on the market value of company's stocks. There is no reason for the corporation to hedge on behalf of the investor. Or, put somewhat differently, hedging transactions at the corporate level sometimes lose money and sometimes make money, but on average they break even. The conclusion is that companies cannot systematically make money by managing risk. Unlike individual risk management, corporate risk management does not hurt, but it also does not help (Froot, Scharfstein and Stein, 1994). From this perspective, expected net present value of business risk management on the efficient capital market should be zero. Hence, a decision of financial manager to insure or hedge future company's cash flows would be just "a neutral mutations" which do not influence the company's value, while in the worst case, a decision to manage risk would be an irrational behaviour because it has caused certain costs which lower the shareholders wealth (Shapiro and Titman, 1998). It could be concluded that business risk management is unnecessary from the perspective of the CAPM.

Miller and Modigliani's "MM" proposition supports these findings (Modigliani and Miller, 1958). According to the classic Modigliani and Miller paradigm, risk management is irrelevant to the firm and, under perfect market conditions, the corporate capital structure decision is irrelevant. The key insight of Franco Modigliani and Merton Miller is that value is created on the left-hand side of the balance sheet when companies make good investments that ultimately increase operating cash flows. How companies finance those investments on the right-hand side of a balance sheet - whether through debt, equity, or retained earnings - is completely irrelevant (Froot, Scharfstein and Stein, 1994). In the "frictionless" MM framework, management can not increase a firm's value by changing either capital structure or hedging policy. These are purely financial transactions that do not affect the value of a company's operating assets. Investors can adjust their own holdings of debt and equity to create whatever capital structure they desire; and they can also do their own hedging against corporate risks. The stockholders of the airline, for example, can diversify their holdings into oil companies, hedging themselves against the risk of oil price increases (Culp, 1994). The conditions underlying MM propositions also imply that decisions to hedge corporate exposures to interest rates, exchange rates and commodity prices are equally irrelevant – because stockholders already protect themselves against such risks by holding well-diversified portfolios. Indeed, once the transaction costs associated with hedging instruments are factored in, a Modigliani-Miller disciple would argue against risk management at all.

The MM propositions were intended to hold only under a restrictive set of conditions, the most important of which are that there are no bankruptcy or financial distress costs, no taxes or transactions costs, that corporate investment decisions are not influenced by financing choices, including decisions to hedge various price risks, that reliable information about the company's prospects is freely available to all investors and managers alike, and that individuals and firms have equal access to all security markets, including the ability to issue identical securities on the same terms (Culp, 1994). It should be noted that, thirty years after the MM propositions were created; even Merton Miller (Miller, 1988) has written that the view that capital structure is literally irrelevant to corporate finance is far from what Modigliani and Miller ever actually have said about the real-world applications of their theoretical propositions.

In the real world, financial managers and treasurers give a great deal of thought to matters of capital structure and securities design. And the risk management at the company's level is widespread and growing. Bartram (2000) suggested that managing corporate risk lies in the heart of a competitive strategy. Moreover, experts argue the management of corporate risk is central to organisational evolution, a determinant of which organisations survive and grow and of which decline and die. The positive import of the MM framework, and its main message to corporate practitioners, is presented by several theories suggesting that risk management is a value-increasing strategy for the firm. Modern financial theory defines the value of a firm as the sum of the expected discounted cash flows that grow continuously in the future (Miloš Sprčić and Orešković, 2012). Thus, a reduction in corporate risk may affect the market value of a firm through either expected cash flows or through the weighted average cost of capital that presents the discount rate in the model.

$$V_C = \frac{CF_0 \times (1+g)}{WACC - g}$$

V_c = present value of the company

CF_0 = company cash flow

$WACC$ = weighted average cost of company's capital (discount rate)

g = expected growth rate

By managing corporate risks, firms can decrease cash flow volatility, what leads to a lower variance of firm value. This means that not only a firm value is moving less, but that the probability of occurring low values is smaller than without hedging (Miloš Sprčić, Tekavčič and Šević (2008)). Research in the 1980s and 1990s has extended the knowledge on risk management by examining the unique characteristics of large, widely held corporations. Based on work by Mayers and Smith (1982) in the area of the corporate demand for insurance, scholars such as Stulz (1984), Smith and Stulz (1985) and Shapiro and Titman (1998) have examined why large, well-diversified firms actively engage in hedging activities. The authors demonstrated several theories of hedging which overcome the irrelevancy arguments of modern portfolio and corporate finance theory. Positive theories of risk management, as a lever for shareholder value creation, argue that firm value is a concave objective function because of capital market imperfections.

The first theory suggests that, by reducing the volatility of cash flows, firms can decrease costs of financial distress (Mayers and Smith, 1982; Myers, 1984; Stulz, 1985; Smith and Stulz, 1985; Shapiro and Titman, 1998). In the MM world, financial distress is assumed to be costless. Hence, altering the probability of financial distress does not affect firm value. If financial distress is costly, firms have incentives to reduce its probability, and hedging is one method by which a firm can reduce the volatility of its earnings. By reducing the variance of a firm's cash flows or accounting profits, hedging decreases the probability, and thus the expected costs, of financial distress. Additionally, Smith and Stulz (1985) have argued that, while the reduction of financial distress costs increases firm value, it augments shareholder value even further by simultaneously raising the firm's potential to carry debt. Corporate risk management lowers the cost of financial distress, which leads to a higher optimal debt ratio and the tax shields of the additional debt capital further increases the value of the firm. This theory has been empirically proven by, among others, Campbell and Kracaw, 1987; Bessembinder 1991; Dolde, 1995; Mian, 1996 and Haushalter 2000.

The second hedging rationale suggests that, by reducing the volatility of cash flows, firms can decrease agency costs (see Jensen and Meckling, 1976). According to Dobson and Soenen (1993) there are three sound reasons based on agency costs why management should hedge corporate risk. First, hedging reduces uncertainty by smoothing the cash flow stream thereby lowering the firm's cost of debt. Since the agency cost is borne by management, assuming informational asymmetry between management and bondholders, hedging will increase the value of the firm. Therefore, management will rationally choose to hedge. Second, given the existence of debt financing, cash flow smoothing through risk hedging will tend to reduce the risk-shifting as well as the underinvestment problems. Finally, hedging reduces the probability of financial distress and thereby increases duration of contractual relations between stakeholders. By fostering corporate reputation, hedging contributes directly to the amelioration of the moral-hazard agency problem. Results of MacMinn and Han (1990), Bessembinder (1991), Nance, Smith and Smithson (1993), Minton and Schrand (1999) and Haushalter, Randall and Lie (2002) supports this hedging rationale.

Third hedging theory argues that cash flow volatility reduction can improve the probability of having sufficient internal funds for planned investments eliminating the need either to cut profitable projects or bear the transaction costs of obtaining expensive external funding. The main hypothesis is that, if access to external financing (debt and/or equity) is costly, firms with investment projects requiring funding will hedge their cash flows to avoid a shortfall in their funds and costly visit to the capital markets. An interesting empirical insight based on this rationale is that firms which have substantial growth opportunities and face high costs when raising funds under financial distress will have an incentive to manage corporate risks in comparison to the average firm. This rationale has been explored by numerous scholars, among others by Smith and Stulz (1985), Stulz (1990), Hoshi, Kashyap and Scharfstein (1991), Froot, Scharfstein and Stein (1993), Getzy, Minton and Schrand (1997), Gay and Nam (1998), Minton and Schrand (1999), Haushalter (2000), Allayannis and Ofek (2001) and Haushalter, Randall and Lie (2002), Miloš Sprčić and Šević (2012),.

3. CORPORATE RISK MANAGEMENT RATIONALES IN CROATIAN COMPANIES

3.1 Methodology and Data Collection

In order to test analysed determinants of corporate risk management decisions, empirical research was conducted on the largest Croatian non-financial companies. Companies needed to meet two out of three conditions required by the Croatian Accounting Law[2] related to large companies to be included in the sample.[3] A list of the largest 400 Croatian companies[4] has been used and 157 companies that have met the required criteria were selected in the sample. Financial firms were excluded from the sample because most of them are also market makers, hence their motivation in using derivatives may be different from the motivations of non-financial firms. Data were collected from two sources: from annual reports and notes to the financial statements and through the survey. Managers of 49 companies answered to the questionnaire creating a response rate of 31 per cent, what is considered as satisfactory for statistical generalisation (e.g. the response rate of the 1998 Wharton survey of derivate usage, as reported in Bodnar et.al. (1998) was 21 per cent). However, it is important to mention that the inability to compare the survey results to the data of non-responding companies should be treated as a limitation of this research.

Survey data were analysed by using multivariate analysis. Binominal logistic regression was estimated to distinguish between the possible explanations for the decision to hedge corporate risk. Binomial (or binary) logistic regression has been selected because it is a form of regression that is used when the dependent variable is a dichotomy (limited, discrete and not continuous) and the independents are of any type. Besides the fact that the dependent variable in this research is discrete and not continuous, logistic regression has been chosen because it enables the researcher to overcome many of the restrictive assumptions of OLS regression. E.g. Unlike OLS regression, logistic regression does not assume linearity of relationship between the independent variables and the dependent, does not require normally distributed variables, does not assume homoscedasticity, normally distributed error terms are not assumed, does not require that the independents be interval or unbounded, and in general has less stringent requirements.

Based on the arguments that arise from the presented literature survey, several hypotheses have been proposed in this paper. We argue that hedging can increase the value of the firm by reducing the costs associated with financial distress, the agency costs of debt, expected taxes and capital market imperfections. These premises are known as the shareholder maximisation hypothesis and are tested in the following assumptions. The argument of reducing the costs of financial distress implies that the benefits of hedging should be greater the larger the fraction of fixed claims in the firm's capital structure (Myers, 1984; Stulz, 1984; Smith and Stulz, 1985; Campbell and Kracaw, 1987; Bessembinder, 1991; Dobson and Soenen, 1993; Dolde, 1995; Shapiro and Titman, 1998; Mian, 1996; Haushalter 2000). The agency cost of debt argument implies that the benefits of hedging should be greater the higher the firm's leverage and asymmetric information problem (Mayers and Smith, 1982; 1987; MacMinn and Han, 1990;

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[2] In Croatian: Zakon o računovodstvu, *Narodne novine* 146/05

[3] Criteria related to large Croatian companies: a value of total assets higher than 108 million kuna, (2) income in the last 12 months higher than 216 million kuna, and/or (3) annual number of employees higher than 250.

[4] The list has been published by the special edition of Privredni vjesnik

Bessembinder, 1991; Dobson and Soenen, 1993; Minton and Schrand, 1999; Haushalter et. al., 2002). The argument of costly external financing implies that the benefits of hedging should be greater the more growth options are in the firm's investment opportunity set (Froot, et. al., 1993; Getzy et. al., 1997; Gay and Nam, 1998; Minton and Schrand, 1999; Allayannis and Ofek, 2001; Haushalter et. al., 2002). The tax hypothesis suggests that the benefits of hedging should be greater the greater is the value of the firm's tax loss carry-forwards, investment tax credits and other provisions of the tax code (Froot et. al., 1993; Nance et. al., 1993; Mian, 1996)Therefore, a positive relation between decision to hedge and a company's leverage, asymmetric information problem, investment (growth) opportunities and expected taxes has been predicted.

3.2 Research Hypotheses and Research Variables

A dependent variable has been designed in the form of a binary (dichotomous) measure and was coded as *"1"* for those firms that hedge corporate risks and *"0"* for those firms that do not hedge corporate risks. In the group of companies named "hedgers" we included not only companies that use derivatives instruments as an instrument of corporate risk management, but also companies that use other types of hedging strategies like operational hedging, natural hedging, diversification of business etc.

To examine the hypothesis regarding the reduction of the financial distress cost, the firm's leverage have been employed. Leverage was used as a proxy for the impact of fixed claims on the decision to hedge. Numerous previous studies have used long-term debt to the book value of assets (Tufano, 1996; Nance et. al., 1993; Mian, 1996; Geczy et. al., 1997; Allayannis and Ofek, 2001) as a measure for company indebtedness. We took into consideration specific characteristics of Croatian companies and have modified this variable by including short-term debt into the analysis. In this way, we measured company's leverage by its total indebtedness, not only long-term one. The reason behind this way of thinking lies in the fact that listed Croatian companies very often use short-term debt and prolong it to the medium-term debt. E.g. Companies use commercial papers issued in several tranches, revolving short-term bank loans and/or trade credits given by suppliers which, due to the long-term contract with them, becomes constant source of financing. To conclude, we tested both long-term debt to the book value of assets and total debt to the book value of assets. The coefficients on both variables were predicted to be positive to the decision to hedge corporate risks.

The percentage of firm's stocks owned by institutional investors was a proxy for the asymmetric information and agency problem. DeMarzo and Duffie (1995), Tufano (1996) and Geczy et. al. (1997) have predicted that a greater share of institutional investors' ownership is positively related to the availability of information, and thus negatively related to the probability of hedging as it is proven that firms with greater informational asymmetry benefit greatly from risk management activity. The coefficient on this variable was predicted to be negative.

Investment (growth) opportunities were measured as the ratio of investment expenditures to the book value of assets (Haushalter, 2000; Froot et. al., 1993; DeMarzo and Duffie, 1991; Geczy et. al., 1997; Smith and Stulz, 1985). The coefficients on this variable was predicted to be positive. To examine the tax hypothesis, we have used total value of the tax loss carry-forwards plus tax loss carry-backs (Smith and Stulz, 1985; Geczy et. al., 1997; Tufano, 1996). The coefficient on this variable was predicted to be positive.

3.3 Research Results

Binominal logistic regression was estimated to distinguish among the possible explanations for the decision to hedge. In the logistic model we have tested whether the decision to hedge or not is a function of the four factors – the financial distress costs, agency costs, investment opportunities and taxes.

$$Hedge = f\,(FC, AC, IO, T) \qquad (1)$$

where:

- *Hedge* - binary variable which takes on a value of 1 if the firm hedges and 0 if the firm does not hedge
- *FC* - firm's probability of financial distress or bankruptcy
- *AC* – agency costs of debt facing the firm
- *IO* – investment opportunities
- *T* – tax provisions

Table 1 reports multivariate analysis results relating the decision to hedge to the determinants of hedging for the analysed Croatian companies. The predetermined independent variables include total debt to the book value of assets as a proxy for financial costs, debt rating as a proxy for agency cost of debt, investment expenditures to assets as a proxy for costly external financing, total value of tax loss carry-forwards and tax loss carry-backs as a proxy for tax incentives. We excluded long-term debt to the book value of assets as a measure of leverage as it has not shown statistically significant in the model.

The multivariate regression model for the Croatian companies has revealed that the corporate decision to hedge is related to the company's leverage and investment opportunities and not related to taxes and informational asymmetry and the agency cost of debt.

In corporate hedging research, the relationship between hedging and leverage is of a particular interest since theoretical considerations suggest that both affect expected costs of financial distress and agency costs - greater leverage exacerbates those costs, but greater hedging ameliorates them, suggesting a positive linkage. Therefore, our research results confirm this theoretical relation in practice of Croatian companies and show a statistically significant positive relation between the decision to hedge and total debt to the book value of assets.

The investment expenditures to assets ratio, which controls for company's investment (growth) opportunities, tests our prediction that hedgers are more likely to have larger investment opportunities. The main hypothesis is that, if access to external financing (debt and/or equity) is costly, firms with investment projects requiring funding will hedge their cash flows to avoid a shortfall in their funds, which could precipitate a costly visit to the capital markets. The results of our logistic model support this prediction and show a statistically significant positive relation between the decision to hedge and investment expenditures to assets ratio.

Table 1: Multivariate results

Number of selected cases: 49
Number rejected because of missing data: 1
Number of cases included in the analysis: 48

Independent variables:

FINCOST	Total debt to the book value of assets
AGCOST	Percentage of institutional investors
CEF	Investment expenditures to assets ratio
TAX	Total value of tax loss carry-forward and carry backs

Estimation terminated at iteration number 9 because
Log Likelihood decreased by less than .01 percent.

-2 Log Likelihood	18.572
Goodness of Fit	14.936
Cox & Snell - R^2	.428
Nagelkerke - R^2	.683

	Chi-Square	df	Significance
Model	24.575	6	.0010
Block	24.575	6	.0010
Step	24.575	6	.0010

——— Hosmer and Lemeshow Goodness-of-Fit Test———

	Chi-Square	df	Significance
Goodness-of-fit test	3.4025	8	.7838

———— Variables in the Equation ————

Variable	B	S.E.	Wald	df	Sig
FINCOST	**85.670**	**39.033**	**48.172**	1	**.0382**
AGCOST	1.1796	1.5441	.8701	1	.2832
CEF	**373.821**	**227.182**	**44.575**	1	**.0348**
TAX	-3,31E-04	4,31E-02	.0105	1	.9184
Constant	-2.3670	1.2890	1.7434	1	.4296

No outliers found.

4. RISK ADJUSTED VALUE

In this section, corporate value will be disassembled to its key factors in order to present an analysis of how corporate risk management can influence these value drivers. Company's value is a function of four fundamental variables (Damodaran; 2008):

– Cash flows from existing investments;
– Expected growth rate that determines the value of the future cash flows;
– Return on capital from new investment;
– Weighted average cost of capital.

Analysis of the impact of risk and risk management to enterprise value will begin by analysing activities that management should take if they want to increase the value of the company. Corporate value can be increased by one, or a combination of the following activities: by increasing expected cash flows; by increasing the rate of return on existing assets; by increasing the rate of return on new investments; by increasing the expected growth rate of the company while assuming that the return on invested capital is higher than the weighted average cost of capital; by reducing the weighted average cost of capital. Above activities are creators of enterprise value; however they are also means of destroying value if their interrelationships are not properly managed. Therefore, it is important to analyse the risks that affect the formation of these determinants and to take those actions that will minimize the negative impact of risk, and leave room for positive changes in the corporate value at the same time.

The expected rate of growth as well as the rate of return on invested capital (relative to the overall cost of capital) to a large extent determines the value of the expected free cash flow, and consequently the overall value of the company. The logic is sharp-cut - a company that achieves a higher rate of return on capital invested in the business is worth more than companies whose rate of return on invested capital is lower. Analogously, the company that achieves higher growth rates will be worth more than a company that is growing more slowly, regardless to the same rate of return on invested capital (Copeland, Koller and Murrin; 2000).

Increased value of the expected cash flows is associated with the achievement of higher yields on the capital invested in existing assets. If the existing property is more efficiently managed, it generates a higher value of the cash flows. In the short term, the company may increase the growth rate and return on invested capital through better management of existing assets. Enhancement of the rate of return on existing investments is achieved through an increase in operating profit as well as through higher turnover of invested capital and its reinvestment in the company's business. Risk hedging activities can contribute to the rate of return enhancement on several ways. For example concluding forward contracts with key suppliers can reduce the cost of raw materials and ancillary services. Forward contracts with customers can provide stabilisation of revenues and market share. Additionally, thoughtful risk taking activities like entering a new market will provide new market opportunities, deals with new customers and increase in sales volume, etc.

However, it should be noted that the long-term growth is associated with new profitable investments that increase the expected cash flows of the company. It is important to evaluate the risk-profit characteristics of new investments in order to objectify the expected cash flows of the project. The expected rate of growth of the company is determined as the earnings retention rate multiplied by the expected rate of return on invested capital, which is computed as the ratio of net operating profit after tax to the total operating capital invested.

$$g = R_{OIC} \times z$$

z = earnings retention rate

R_{OIC} = expected rate of return on invested capital

$$R_{OIC} = \frac{NOPAT}{Operating\_capital}$$

In other words, the expected growth rate is a function of retained earnings and rate of return on invested capital. The expected growth rate can be increased by increasing the share of retained earnings in relation to the part of earnings paid to the owners, which is justified from the owner's point of view only if the return on invested capital is higher in comparison to the cost of capital. The expected growth rate also increases by increasing the rate of return on invested capital, which will be achieved through more efficient investments, what would lead to the increase in expected operating profit.

It should be emphasised that the management of corporate risks increases the corporate value through effective co-ordination of financial and investment decisions. Cash flows' volatility reduction increases the probability of having sufficient internal funds to finance planned investment opportunities. This reduces the need for withdrawal of profitable projects and solves the underinvestment problem. Profitable investments increase the return on invested capital and expected growth rate. In addition, risk management reduces the transaction costs related to the expensive capital raised on capital markets, which also increases the value of the company.

Last analysed variable that can affect the value of a company is the total cost of capital. According to absolute valuation models, cost of capital decrease will increase the value of the company. The cost of capital is the discount rate in the valuation model that reflects the current risk level of the enterprise, the risk of its future investment and the capital structure risk. The cost of capital is an indicator of the business and financial risk of the company. Consequently, it can be concluded that, by reducing or adequately managing different types of corporate risk, it is possible to reduce the cost of capital and thus increase the value of the company. Companies that actively manage risks and reduce the likelihood of insolvency and financial difficulties will be rewarded by its investors through a lower required return on capital. By efficiently managing risks, the company gets a better credit rating as it becomes less risky investments, which helps reduce the cost of debt, and consequently, reduce the total cost of capital. Enterprise value is further increased by increasing its credit capacity. Managing corporate risk reduces the probability of bankruptcy, which leads to the optimal mix of debt and equity formed at a higher level of indebtedness. Taking advantage of the increased credit capacity increases the present value of the tax shelter, what increases the overall value of the company.

5. CONCLUSION

For a long time it was believed that corporate risk management is irrelevant to the value of the firm and the arguments in favour of the irrelevance were based on the Capital Asset Pricing Model and the Modigliani-Miller theorem. However, it is apparent that managers are constantly engaged in hedging activities that are directed at the reduction of unsystematic risk. As an explanation for this clash between theory and practice, imperfections in the capital market are used to argue for the relevance of corporate risk management function. If corporate hedging decisions are capable of increasing firm values, they can do so by reducing the volatility of cash flows. Reduced volatility of cash flows results in decreased costs of financial distress. Additionally, it reduces the costs associated with information "asymmetries" by signalling management's view of the company's prospects to investors, it reduces agency problems, including distortions of management's incentives to undertake all value-adding investments. In addition, reducing cash flow volatility can improve the probability of having sufficient internal funds for planned investments eliminating the need either to cut profitable projects or bear the transaction costs of obtaining external funding.

We tested these relations on the sample of large Croatian non-financial companies. The evidence based on the multivariate empirical relations between the decision to hedge in analysed companies and financial distress costs, agency costs, costly external financing, and taxes supports tested hypotheses related to the investment expenditures-to-assets ratio and total debt to assets ratio. Therefore, it can be concluded that Croatian companies that are more leveraged and have more investment opportunities have more incentives to manage corporate risk. Additionally, in the last section of this paper, by using Risk adjusted value approach, we have shown that efficient risk management can influence company value drivers and positively affect overall enterprise value.

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CRISIS MANAGEMENT DILEMMAS: DIFFERENCES IN ATTITUDES TOWARDS REACTIVE CRISIS COMMUNICATION STRATEGIES AMONG FUTURE BUSINESS PROFESSIONALS IN CROATIA

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Abstract

For a corporation, a crisis is a circumstance in which it cannot function properly, which affects the organizational ability to function, prevents the achievement of goals, as well as the very survival of the organization. In this paper we analyze the process of crisis communication, characteristics of known reactive crisis communications strategies and examine if there are differences in attitudes towards reactive communication strategies among future business professional. In order to so, we use two samples of undergraduate seniors at the University of Zagreb: business school students and public relations students. Namely, in the future, business students will assume management positions in organizations of different types, while their colleagues studying public relations will be in a position to lead the communication of these organizations, with both groups mutually cooperating. To test the differences in tendencies towards certain reactive strategies we used a survey methodology where students were presented with hypothetical situations. By conduction a comparative analysis of their responses and tendencies to use specific strategies, our research results show that there are significant differences between the two groups. Students of public relations have a greater tendency to use active strategies compared to their counterparts studying business economics, who in turn display greater caution and passivity in their approaches. Based of our findings it can be concluded that both groups require further training and acquisition of practical experience to be able, at the highest level, to face, handle and successfully resolve crisis communication situations that were presented to them during the research.

Key words: *crisis communication, crisis management, communication strategies, public relations, business professionals*

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1. CRISIS AND CRISIS MANAGEMENT

There is no single universally accepted definition of a crisis, although there is a general consensus that a crisis is an event that can harm and even destroy an entire organization (Mitroff, Pearson, Harrington, 1996, p. 7). A crisis is a disrupt, a transient difficult state in every natural, social and thought process, where lying at the very essence of a crisis is the realization that a decision on something that has yet to be decided has to be made. That is, a crisis is a decision on a state in which the old and the new are confronted; it is a decisive, or more precisely a tipping point. Crises are events that inherently carry potential damage and catastrophic effects and result in a negative public perception (Crandall, Parnell, Spillan, 2010). From a company's perspective a crisis is an unforeseen and undesired process which can substantially threaten or completely disable development capabilities of a company (Krystek, 1982, p. 14). Therefore, a crisis represents a real or a potential threat to the company, to its industry and to its stakeholders. For a corporation, a crisis is a circumstance which affects its organizational ability to functi-

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on, prevents the achievement of goals, as well as the very survival of the organization. Even a crisis, which, at first glance does not appear of dramatic magnitude, can have a negative impact on the image of the organization that can become so large that it threatens the company's long-term survival. (cf. Skoko, 2006, p. 244). Therefore, the main task of management is to minimize threats and provide guidance for successful crisis management (Coombs, 1999, p. 3), where factors of complexity and intensity of the environment imply different reactions from management.

Crisis management is a relatively new field of management that involves identifying the nature of a crisis, interventions in order to minimize the damage and taking actions to recover from the crisis aftermath, all with a pronounced focus on protecting its image and creating a visible impression for stakeholders that recovery is underway. Crucial areas of crisis management are: identifying a crisis, isolating the impact of a crisis, crisis communication, controlling damage caused by a crisis, preparing an assessment of recovery options, preparing a contingency plan, selecting a crisis strategy, crisis intervention, and assuming responsibility for the outcome.

Mitroff (2004, p. 10) distinguishes a key difference between crisis management and crisis leadership. Crisis management is most often reactive and recognizes a crisis once it has happened, as opposed to crisis leadership which is proactive, which attempts to identify a crisis and prepare the company for its consequences before the crisis even arises. In any case, managing communication during a crisis has become one of the most important processes of communication management. Coombs (2007, p. 3) considers appropriate crisis communication management as one of the key elements of crisis management, adding that a crisis situation is often of a perceptual nature.

Existing research show that no company is immune to crisis (Coombs 2007, p. 48), no matter how financially successful, powerful or reputable it is (Regester and Larkin 2005, p. 142). Dilenschneider (2000, p. 121) claims that no two crisis situations are identical, and emphasizes that every crisis situation has its specific causal factors, ramifications, duration, rhythm and uncertainties. This approach is supported by Kunczik (2006, p. 177), who point out that it is impossible to develop a scenario that applies equally to all corporations and crisis situations they encounter with. He emphasizes that this would presume universal knowledge of organizational and communication structures of the organization in question, as well as local and regional conditions in which they operate. Kunczik concludes that it is only possible to prepare general instructions on how to act in crisis situations, which can serve as a framework for a communication strategy focused on consensus, which must be adapted according to individual viewpoints.

Tomić (2008, p. 363) states that causes of crisis situations can be divided into internal and external. *External causes,* as the name itself suggests, appear outside of the organization, and it is considered that the corporation does not have a significant influence over them. External causes include natural disasters and accidents, political and social changes, economic crises, recessions, market changes, security environment, etc. On the other hand, *internal causes* often imply crisis situations that are not visible outside of corporations. Internal causes include poor work organization, strained interpersonal relationships, incompetence and immorality of management, corruption, negative rivalry, lack of corporate culture, poor working conditions, unrealistic union goals, lack of communication, etc. Luecke (2005, p. 24) summarizes the causes of a crisis, stressing that the possible causes of a crisis can be described in the following five categories: *accidents and natural disasters*, *crises related to health and the environment*, *technological incidents, economic and market forces* , and *out of control employees.* Cutlip et al (2003, p. 389) point out that, in addition to the cause, it is extremely important to recognize the type of a crisis, in order to prepare an adequate response, which depends on the type and duration of possible scenarios.

Seymour and Moore (2000, p. 10) provide a very vivid classification of crisis situation types, who compare crisis situations with snakes. A *cobra crisis* is a disaster that happens to a corporation suddenly, it catches it off guard, leading to a crisis with very little time to react. On the other hand, a *python crisis* implies a crisis driven by a slower burning issue, i.e. a crisis that represents a set of problems that paralyze a corporation one after another, slowly destroying it to pieces.

2. MANAGEMENT ASPECTS OF COMMUNICATION IN CRISIS CONDITIONS

There are various definitions of crisis communication. Fearn-Banks (2001, p. 480) defines crisis communication management as a strategic planning process whose goal is to anticipate crisis situations and to react properly during a crisis situation, or in a situation of negative events, a process that eliminates part of the risk and uncertainty and allows the organization to effectively manage its destiny at the same time.

Analyzing the life cycle of a crisis situation, Fearn-Banks (2001) distinguishes five phases of development of a crisis situation. The first is *detection* in which a corporation notes the warning signs, the second is *preparation or prevention* in which the warning signs are noted and proactive and reactive plans are prepared to deal with the situation, the third is *containment* , i.e. taking steps to limit the duration of the crisis or its effects, the fourth is *recovery* where the corporation attempts to return to "business as usual" state, and the fifth phase is *learning* in which the organization considers what happened and assesses the negative or positive effects for the future (Langford, 2009, p. 434).

Many authors stress out a need for a systematic approach to crisis situations by preparing contingency plans to prepare the organization's leadership for the challenges that will arise when a crisis occurs. Sam Black (2009) points to several elements that should be incorporated into a possible crisis plan. An *analysis of possible crisis causes* prescribes that it is necessary to anticipate possible difficulties, whether they are of an external or internal nature. Often it is impossible to predict every possible crisis. *Preparing a communications plan* should include planning communication before the crisis, communication during the crisis and crisis communication after the crisis. *Selection of staff* means identifying individuals who would be available at the time when the crisis emerges. *Communication capacity* implies the technical elements of communication, in order to prevent a communication blockage in the middle of a crisis. *Training* means educating individuals who will be involved in the crisis situation, in order to make sure that they are familiar with their obligations when a crisis breaks out. Finally, *simulating a crisis situation* is the last element of crisis planning that should be tried out prior to an actual use, which will provide an answer on how staff will respond in a crisis situation.

Of significant importance for the outcome of a crisis situation is the manner in which the corporation communicates with the media. As a communication channel towards the vast majority of stakeholders, it is necessarily that the media is approached carefully, respecting all their idiosyncrasies. The media, therefore, in crisis situations must be provided with timely information, because the corporation will, by doing so, provide the right image to the public and remain credible. Also, it is necessary to designate a person which will be responsible for the communication with journalists, providing them information, thus providing a uniform transmission of information. And in the event of a large-scale crisis, when a much greater availability of information is required, it is necessary to establish a communications center. Namely, a crisis attracts the media because it is perceived by journalists as a "good story" and if timely information is not provided, it is highly likely that they will be led by gossip, rumors, and partial information. For many corporations and the managers leading them, especially when they find themselves in a crisis situation for the first time, the attention of the media and the public that they are exposed to creates extensive pressure, which they are not capable of handling well. Crises always come when they are least expected and corporations almost always, without exception, await them insufficiently prepared.

3. REACTIVE CRISIS COMMUNICATION STRATEGIES

In cases when a corporation is already facing certain allegations or critiques, or in cases when problems are already present, managers are put into a position to act reactively. Situations like these, corporations tend to achieve public's understanding, keep and restore a positive image, and to rebuild trust and support (Smith, 2009, 115). Smith also points out three approaches relevant for drafting communications responses in negative situations. *Apologia* is a formal defense through which an organization explains its actions and positions in a negative situation.

Jugo (2012, p. 186) quotes Smith who notes that it is important not to confuse *apologia* with apology which is an expression of fault and remorse. An apologia could include an apology, but it is much more than that. *Theory of accounts* refers to the use of communication to manage relationships in the wake of rebuke or strong criticism. The third approach is the *image restoration theory* that is based on the presumption that, in the face of criticism, both people and organizations seek to maintain or rebuild a positive reputation.

Looking in general, Smith (2009, p. 117) differentiates seven different groups of reactive communication strategies. *Pre-emptive actions* are taken before the opposition launches its first charge against the organization. *Offensive response strategies* are based on a premise that the organization is operating from a position of strength in face of the opposition. This group incorporates four different strategies: (a) *attack* strategy that claims that an accusation of wrongdoing is an attempt to impugn the organization's reputation by an accuser who is negligent or malicious, (b) *embarrassment* in which an organization tries to lessen an opponent's influence by using shame, humiliation or other incriminating information, (c) *shock* as a deliberate agitation of the mind or emotions, particular through use of surprise, disgust, or some other strong and unexpected stimulus and (d) *threat* that involves the promise that harm will come to the accuser or the purveyor of bad news. Hereby, Heath (2001, p. 505) quotes Benoit who states that corporations, to use this group of strategies, have to be perfectly clear of any responsibility related to opposition's allegations or problem they are in.

Defensive response is a group of strategies describes by Smith (2009, p. 119) as less aggressive response to opposition's critique. It contains three different approaches: (a) *denial* where no blame is accepted claiming that the reputed problem doesn't exist or didn't occur, (b) *excuse* in which an organization tries to minimize its responsibility for the harm of wrongdoing, (c) *justification* which admits the organization did the deed but did so for a good reason. Related to this group of strategies, Heath (2001, p. 505) quotes Bradford and Garrett who state that using these strategies doesn't come without problems stating that individuals will not believe organization's statements without proof presented by a third, independent party.

Diversionary response strategies are four reactive strategies whose intention is to shift the gaze of the public from the problem associated with the organization: (a) *concession* when an organization tries to rebuild its relationship with its public by giving the public something it wants, (b) *ingratiation* as a strategy of rather questionable ethical standing when an organization tries to manage the negative situation by charming its publics giving them something of relatively little significance although it is presented as something of crucial importance , (c) *disassociation* which attempts to distance an organization from the wrongdoing associated with it and (d) *relabeling* when an organization refers to a problem with a new name which is more acceptable in the public than real, negative label (Smith, 2009, p. 123).

Vocal commiseration strategies are a family of four strategies that Smith (2009, p. 124) describes as ones in which the organization expresses empathy and understanding about the misfortune suffered by its publics: (a) *concern* through which the organization expresses that it is not indifferent to a problem, without admitting guilt, (b) *condolence* in which the organization expresses grief over someone's loss or misfortune, again without admitting guilt, (c) *regret* which involves admitting sorrow and remorse for a situation with a wish that an event had not happened, and finally (d) *apology* which involves publicly accepting full responsibility and asking forgiveness.

In this respect, Heath (2001, p. 507) quotes Tavuchis who points out a difference between corporate apologies and apologies given by individuals. Corporate apologies do not remove attention from the incident and the incident is most likely not forgotten as the case is with individual's apology. On the contrary, when a corporation issues an apology, it puts additional accent on that particular incident.

Rectifying behavior strategies are five strategies in which, according to Smith (2009, p. 130) an organization does something to repair the damage done to its publics: (a) *investigation* when an organization promises to examine the situation and then to act as the facts warrant, (b) *corrective action* which involves taking steps to contain a problem, repair the damage, and/or prevent its recurrence, (c) *restitution* which involves making amends by compensating victims or restoring a situation to its earlier condition and finally (d) *repentance* which involves both a change of heart and change in action. Heath (2001, p. 505) adds that corrective strategies are best to combine with apologia strategies and quotes Benoit (1995) and Hearit (1995) who state that this combination is the best if the corporation is to convince their customers that a possibility of specific problem happening again is limited to a minimum.

The last group of reactive strategies according to Smith (2009, p. 131) is *deliberate inaction.* This is a group of two strategies that both include not to comment the situation or the problem: (a) *strategic silence* that implies patience and composure which can shorten the life cycle of unpleasant situation, but it is not to be confused with the "no comment" statement that is immediately perceived as guilt accepting answer and (b) *strategic ambiguity,* the organization's refusal to be pinned down to a one particular response.

4. EXAMINATION OF TENCENCIES TOWARDS THE USE OF REACTIVE STRATEGIES AMONG FUTURE BUSINESS PROFESSIONALS IN CROATIA

In order to examine the perception and position towards reactive communication strategies, and to test for differences in the attitudes towards the named strategies among future business professional, we conducted a qualitative research among the undergraduate seniors (students in their final year of undergraduate studies) at the University of Zagreb. We selected two populations of undergraduate students: business school students and public relations students. The reason the selection of the these two groups is that, in the future, business students will assume management positions in organizations of different types, while their colleagues studying public relations will be in a position to lead the communication of these organizations, with both groups mutually cooperating.

The research was done by survey methodology which resulted in 165 respondents, out of which 129 are business school students from the Faculty of Economics and Business and 36 are public relations students from the Faculty of Political Science

The survey questionnaire consisted of a total of seven questions, each of which represented one group of reactive strategies, presented through the simulation of a crisis situation, and for which the students were asked to select one of the strategies among the offered answers that they would undertake if faced with such a situation. The difference in answers between the business school students and public relations students was tested using the z-test for differences in proportions in two independent samples.

Table 1: Differences in tendency to select strategies from the *pre-emptive actions* group among business students and students of public relations

	Public relations students (n=36)		*Business students (n=129)*		*z-test*
	Total	%	Total	%	
Denial and legal reaction	5	13,9	66	51,2	3,9939***
Completely ignore problem	2	5,5	3	2,4	-0,9996
Pre-emptive response	29	80,6	51	39,5	-4,3544***
Admittance and self-punishment	0	0	9	6,9	1,6299
Total	36	100	129	100	

*p<0,1; **p<0,05; ***p<0,01

Analyzing the *pre-emptive actions* strategies that imply the moment immediately before the other side has begun an attack on the organization, students were presented with the following hypothetical situation: "*Media following your corporation have learned of your CEO's extramarital affair. A reporter has made you aware of this information, and has mentioned that the news will be released in three days".* When deciding on the strategy that will be used, there is a visible difference between business students and students of public relations. Namely, 51.2% of business students chose the passive option, where they would wait for the publication of negative information and then utilize all legislative and legal options available to them; placing denials and initiating available legal measures. On the other hand, this strategy would be chosen by only 13.9% of public relations students. This difference in preference for selecting a strategy of denial and legal reaction between business students and students of public relations is also statistically significant ($z=3{,}9939$; $p<0{,}01$). On the other hand, an astounding 80.6% of public relations students selected the strategy of *pre-emptive response,* the most active in the group of strategies that implies placing public justification for a certain procedure before the other side has even made their opinion public, while 39.5% of business students chose this strategy. The observed difference between the two groups of students is significant ($z=-4{,}3544$; $p<0{,}01$). The remaining two possibilities in this scenario, completely ignoring the problem and admitting and self-punishment, was selected by a considerably smaller number of respondents.

Examining the tendency to use strategies from the second, *offensive responses*, group, which are undertaken so that the organization could await an attack from a much stronger position, the respondents were described the following hypothetical situation: *"Your company has come into the spotlight after the media reported that your biggest client is the State (90% of revenues come from the State), and that the company is favored compared to other companies in the same sector".* In selecting the individual strategies to undertake in this situation, there is also a noticeable difference in the preferences of the two groups of students. In this situation, 39.5% of business students have selected the most passive of available strategies, *threaten opponents*, while the same strategy was chosen by half as many of their peers studying public relations, only 22.2% of them, and this difference is statistically significant at a 10% level ($z=1{,}9163$; $p<0{,}1$). On the other hand, 36.1% of public relations students selected the *embarrassment* strategy*,* i.e. the strategy by which they would try to reduce an opponent's influence by making public incriminating information about it. As a comparison, this strategy would be selected by only 17.1% of business students, which shows that public relations students are more inclined to a more active approach in resolving communications problems compared to business students, and the stated difference in the tendency to select this strategy among the two groups of students is statistically significant ($z=-2{,}4731$; $p<0{,}05$). The second choice for students of public relations is the *shock* strategy, selected by 30.6% of them, which once again confirms that public relations students are more inclined to select more active and dynamic strategies.

Table 2: Differences in tendency to select strategies from the *offensive responses* group between business students and students of public relations.

	Public relations students (n=36)		*Business students (n=129)*		*z-test*
	Total	%	Total	%	
Attack on opponent	4	11,1	27	20,9	1,3336
Embarrassing the opponent	13	36,1	22	17,1	-2,4731**
Shocking the opponent	11	30,6	29	22,5	-0,9996
Threat to all opponents	8	22,2	51	39,5	1,9163*
Total	36	100	129	100	

*p<0,1; **p<0,05; ***p<0,01

When analyzing the third group of strategies, *defensive responses*, which imply a less aggressive response to external criticism, respondents were presented with the following hypothetical situation: *"Your company is a food producer and is in the spotlight because of a finding by inspectors that one of your products contains more than 1% of allowed GMO ingredients. All the media have reported this information and have been brutally attacking the company for three consecutive days".* Expounding on the strategies that they would use in this situation, both business students (74.4%) and students of public relations (77.8%) dominantly decided on the *excuse* strategy, by which, on behalf of the organization, they tried to minimize responsibility for the harm or wrongdoing. By choosing this strategy, students would, on behalf of the organization, significantly shorten the duration of the crisis situation, thereby reducing potential long-term negative impacts due to media coverage of the organization in an obviously negative context. The second most preferred strategy for both groups was the *justification* strategy, by which the organization recognized fault for the event, however, emphasizing that there was a valid and legitimate reason. Opting for *justification* was a total of 20.9% of business students, and 22.2% of students of public relations, while only a negligible number of respondents opted for the remaining two options, *denial* and complete *ignoring* of the situation. Analyzing the responses to this question and the hypothetical situation, we did not find a statistically significant difference in the tendency to select specific strategies from the defense response group between business students and students of public relations.

Table 3: Differences in tendency to select strategies from the *defensive response* group between business students and students of public relations.

	Public relations students (n=36)		*Business students (n=129)*		*z-test*
	Total	%	Total	%	
Denial	0	0	4	3,1	1,0696
Justification	8	22,2	27	20,9	-0,1677
Excuse	28	77,8	96	74,5	-0,4124
Ignoring	0	0	2	1,5	0,7517
Total	36	100	129	100	

*p<0,1; **p<0,05; ***p<0,01

The group of strategies called *diversionary response strategies*, whose goal is to divert attention from the connection of the company to the stated problem was tested on respondents with the following scenario: *"You work in a large national television company, and a regular commentator has offended one of the underprivileged social groups with an inappropriate comment in the television program. All media, non-governmental organizations and institutions are publicly criticizing you"*. Stating their opinions on this strategy, both groups once again answered very similarly, and in all of given strategies we did not find statistically significant differences among the two student groups. More than half of business students, 69.8% of them, as well as students of public relations, 61.1% of them, selected the *disassociation* strategy, where organizations attempt to distance themselves from negative aspects they are being linked to, especially in cases when the accident occurs due to a failure to comply to the organization's policies and regular patterns of behavior. This strategy too, as well as the one predominantly selected in the previous question, was chosen to significantly shorten the lifespan of the crisis situation, which shows a tendency in both groups of students to seek the quickest way to resolve the problem in the public, which would in all likelihood continue to occur within the organization's system. The second preferred strategy, also for both groups, in this case was the strategy of *relabeling,* by which a problem that would appear would be named something differently, that is, much more acceptable to the target audiences than the real problem. The remaining two strategies, *concessions* and *ingratiations*, were chosen by less than 10% of respondents in both groups.

Table 3: Differences in tendency to select strategies from the *diversionary response* group between business students and students of public relations

	Public relations students (n=36)		*Business students (n=129)*		*z-test*
	Total	%	Total	%	
Concession	4	11,1	7	5,4	-1,2090
Ingratiation	3	8,4	8	6,2	-0,4534
Disassociation	22	61,1	90	69,8	0,9835
Relabeling	7	19,4	24	16,6	-0,1141
Total	36	100	129	100	

*p<0,1; **p<0,05; ***p<0,01

Researching the use of strategies from the *rectifying behavior* group, respondents were presented with the following hypothetical situation: "*Your company, a large mobile telecommunications operator owned by the State, due to a mistake in its own system, has left customers for three days without a mobile signal, which was finally reestablished after media criticism and pressure from angry customers. The company has already suffered obvious damage".* Analyzing the answers of the respondents, we determined significant differences in the tendency to certain strategies from this group of reactive strategies between business students and students of public relations. 94.4% of public relations students chose the *restitution* strategy, which involves making amends by compensating victims or restoring a situation to its earlier condition. By selecting this strategy, students would, prior to a likely investigation and its possible negative consequences, beforehand reduce the damage to the organization. On the other hand, only a little over half of business students, 62.7% of them, opted for the *restitution,* strategy. The observed difference between the two groups of students is statistically significant ($z=-3{,}6541$; $p<0{,}01$). Furthermore, there is a significant difference ($z=2{,}5914$; $p<0{,}01$) in the tendency to select the *corrective action* strategy, which was not selected by any of public relations students, as opposed to 16.3% of business students, and the tendency to select the strategy of *repentance* ($z=2{,}1868$; $p<0{,}05$), which was selected by 17.1% of business students, and only 2,7% of public relations students.

Table 5: Differences in tendency to select strategies from the *rectifying behavior* group between business students and students of public relations

	Public relations students (n=36)		*Business students (n=129)*		*z-test*
	Total	%	Total	%	
Investigation	1	2,7	5	3,9	0,3112
Corrective action	0	0	21	16,3	2,5914***
Restitution	34	94,4	81	62,7	-3,6541***
Repentance	1	2,7	22	17,1	2,1868**
Total	36	100	129	100	

*p<0,1; **p<0,05; ***p<0,01

The tendency to use reactive strategies from the *vocal commiseration* group, in which organizations express empathy and understanding for the misfortune that their target audiences have experienced, was analyzed by presenting respondents with the following hypothetical situation: "*A group of children that was celebrating a birthday in one of your fast food restaurants ended up in the hospital due to food poisoning. Although it has not been confirmed that the food poisoning was caused by your food, the media are largely indirectly creating an image that it is your company that is responsible for the situation. At that moment, it is still unknown whether or not you are really responsible, while the guilty party will be known only in about 10 days when the results of the toxicological analysis of the food in your restaurant are known".* A large number of students of public relations (66.7%) selected the *regret* strategy, which involves admitting sorrow and remorse for a situation, with a wish that an event had not happened, while 45% of business students choose for this strategy. The greater tendency of public relations students to the regret strategy compared to business students is statistically significant ($z= -2{,}3031$; $p<0{,}05$). Regret does not imply recognition of one's own guilt, in fact, sometimes it can emphasize the refusal to accept guilt. When looking at the remaining strategies offered in this group, *apology* by which acceptance of responsibility is admitted, and *condolence,* a somewhat more formal strategy, but without accepting guilt of the organization itself, we have not found statistically significant differences between business students and students of public relations. The least number from both groups of respondents selected the most passive option, the strategy of *expressing concern.*

Table 6: Differences in tendency to select strategies from the *vocal commiseration* group between business students and students of public relations

	Public relations students (n=36)		*Business students (n=129)*		*z-test*
	Total	%	Total	%	
Concern	2	5,6	18	14,0	1,3651
Condolence	5	13,9	25	19,4	0,75528
Regret	24	66,7	58	45,0	-2,3031**
Apology	5	13,9	28	21,7	1,0367
Total	36	100	129	100	

*p<0,1; **p<0,05; ***p<0,01

Considering the tendency towards using the last group of reactive strategies of crisis communication, *deliberate inaction*, by which organizations do not provide significant comments to criticism or attacks aimed at them, respondents were faced with the following hypothetical situation: *"You are managing a sports team that has just beaten its greatest rival in a crucial game. A questionable decision by the referee that went in your favor occurred during the game, and it was not caught by the official camera. Your opponent is applying media pressure in order to justify the poor result, announcing a press conference for the next day that will generate a great deal of media interest that is unfavorable for you. You, nevertheless, find your own video recording of the situation under question, which proves that you are right".* Students of public relations, an astounding 77.8%, dominantly selected *strategic silence* as the approach suitable for resolving this situation. This strategy implies not responding to criticism, which shortens its "lifespan" and, after some time, closing the story with your own arguments by which you completely refute the other side's arguments. On the other hand, only 43.4% of business students opted for this strategy, and the stated difference in the tendency to select this strategy between the two groups is statistically significant (z= -3,6471; p<0,01). There is also a statistically significant difference in the tendency to choose the strategy of *completely ignoring* this situation (z=2,2987; p<0,05): only 5.6% of public relations students selected the stated strategy as opposed to 22.5% of business students. A statistical difference has been determined also in the tendency to select the *strategic ambiguity* (z=1,9426, p<0,1) strategy, which was selected by only 2.7% of public relations students compared to 14.7% of business students. A significant difference was not determined concerning the selection of *direct confrontation*.

Table 7: Differences in tendency to select strategies from the *deliberate inaction* group among business students and students of public relations

	Public relations students (n=36)		*Business students (n=129)*		*z-test*
	Total	%	Total	%	
Direct confrontation	5	13,9	25	19,4	0,7553
Completely ignore	2	5,6	29	22,5	2,2987**
Strategic silence	28	77,8	56	43,4	-3,6471***
Strategic ambiguity	1	2,7	19	14,7	1,9426*
Total	36	100	129	100	

*p<0,1; **p<0,05; ***p<0,01

5. CONCLUSION

Crisis communication management and the use of reactive crisis communication strategies certainly represent one of the most challenging segments of public relations in organizations. Communicating during a crisis carries a great deal of stress and insecurity which, with insufficient experience in facing such situations, brings a whole range of challenges in terms of communication and management. In addition to the principles of crisis communication, in this paper we sought to encompass and analyze available reactive crisis communications strategies that the organizations and the professionals managing communications have at their disposal.

In this study we analyzed the attitudes toward different reactive communication strategies of future business professionals. Business students will likely be in a position to manage entire systems and organizations and will be faced with crisis situations during their working lives. On the other hand, public relations students will likely during their careers manage communications in large systems, organizations and corporations. Both groups of future business professionals will find themselves in situations where they must mutually cooperate to resolve crisis situations. Generally, it is possible to conclude that, in a situation when they are presented with the imperative of making decisions on procedures in a crisis situation there are significant differences in the approach among the two groups of students when choosing strategies for dealing with crisis situations. Business students, to a greater extent, chose more passive strategies and also strategies that are less risky compared to students of public relations. On the other hand, students of public relations in general mostly opted for strategies that carry proactive features and additional risk, not waiting for certain negative information to become publicly available, in order to then set out to resolve the situation. A significant difference was also noticed in the situation when the organization is being criticized for being favored, in which business students again, almost twice as many compared to their public relations peers, selected the most passive of the proposed strategies, while the public relations student swere in turn much more inclined to select a significantly more active approach by which the opponent would be embarrassed or the public shocked.

The least difference between the two groups of students was observed in situations where the organization was faced with a crisis due to an error in its own system for which it was forced to divert attention from its own problems and when it is unquestionably responsible for the resulting situation. The highest preference in this situation, shown by both groups of students, was toward approaches that would minimize the responsibility for the situation and thus to a greater extent as possible try to reduce the duration of the problematic situation. However, in situations when the organization is threatened with long and arduous litigation, students of public relations reported significantly greater preference for the selection of a "middle ground" strategy that would solve the problem before litigation, recognizing responsibility for failure and compensation for damages to all injured parties. On the other hand, business students would choose this approach to a much lesser extent, and unlike their counterparts from the public relations study program, would significantly earlier decide for the other two extreme possibilities, that of a full recognition of responsibility and rectifying behaviors to a much lesser extent than the other options. Finally, in situations where they must choose one of the strategies when the organization is suffering criticism that is unjustified, public relations students have opted for the most risky, but the approach with the greatest potential benefit for the organization, while this approach is chosen much less by business students. On the other hand, as opposed to public relations students, they decided on the least risky strategy of ignoring the situation, which would, however, not bring any positive effects to the organization itself.

When analyzing the results of the research, it is necessary to take into account that both groups of respondents who participated in this study do not have significant practical experience and that this test can serve as a roadmap for their further education and training in the field of crisis management. In order for participants in the study to be able to face, in the best way possible and according to good business practices, real crisis situations similar to those that were presented to them in this study, their further education and gaining of practical experience is essential.

With this research and the obtained results we hope that they will serve as a quality foundation for adjusting and improving the curricula in business schools and political science as well as related disciplines, and also that the findings of this paper will help motivate future business professionals for further training in this area.

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THE IMPORTANCE OF THE INSTITUTIONAL FRAMEWORK IN REGULATING CORPORATE SOCIAL RESPONSIBILITY

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Abstract

Process of globalization conditions the business to acknowledge a factor that go beyond the boundaries of classical economic theory. Effective management of the company entails building of mutual rational relationships and constructive communication with all the stakeholders in business processes. Analysis of the activities of modern companies entails the acknowledgement of their positive and negative impacts on the society and natural environment. Corporate social responsibility (CSR) is becoming an increasingly important research phenomenon, but also an institution, which serves as an indicator of civilization and sustainable development.

The aim of this paper is to demonstrate the importance of the institutional frameworks in regulating the CSR, to analyze some key aspects and issues related to the observed phenomenon and define its contemporary position. It starts from the hypothesis that a) CSR gradually changes, but its position is on the line between rhetorical illusion, voluntary possibility of implementation and the need for forced (institutional) commitment, and b) that institutional pluralism is a precondition for overcoming of the institutional vacuum and monist quasi-institutionalization of neo-liberal type. The conclusion is that it is necessary to institutionally define the achievement of balance between the economical, environmental and social imperatives.

Keywords: *Corporate Social Responsibility (CSR), Sustainable Development, Corporate Governance, Institutions, Institutional Framework.*

JEL Classification: G34; M14; O17;
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1. INTRODUCTION

The subject of our analysis in this paper is the issue of corporate governance (c. g.) in the context of its CSR. The activities of creation and development of institutional support of mentioned phenomenon can not be seen only as a reaction to the major conflicts of interest, affairs and corruption scandals spawned by corporate governance in market economy countries. On the contrary, through the prism of sustainable development it must be constantly worked on overcoming the gap between the legislation and its application in daily practice.

Acceptable approach to CSR involves the integration of three basic concepts: the concept of profit, which assumes that the primary responsibility of management and managers is business and profit maximization, stakeholder concept, which advocates that the management should take care of the impacts of the activities of the company to its stakeholders and recognize their interests in decision-making and social power / social responsibility concept, which assumes that the company and the business must have a certain social responsibility for the possession of power.

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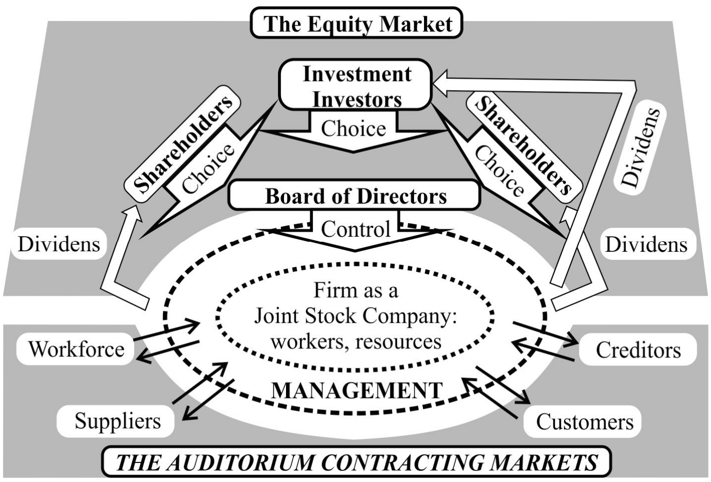
2. LITERATURE REVIEW

Institutional aspects are emphasized in the beginning of the introduction of corporate governance and the formation of the modern corporation. In fact, from the moment of which the owners were no longer be personally responsible for the obligations or for any other obligation that a company can create (limited legal responsibility), i.e. occurrence of the separation of the ownership function from the function of administering the firm's resources. Above phenomenon are identified by A. Berle and G. Means (1932) as one of the most important in economic history. In this way, the modern corporation is formed as an intermediate institutional management mechanism, which has a duty to diversify risk and reduce the cost of capital, although it creates a natural conflict between those who bear the risk (shareholders) and those who run it (managers).

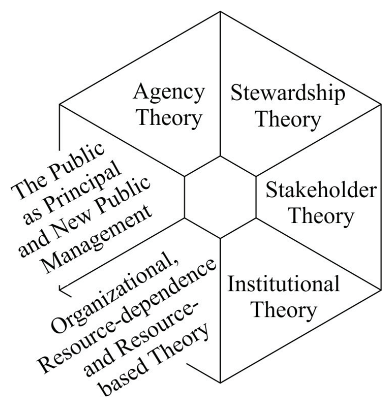
Figure 1: The structure of corrected of the Berle and Means modern corporation



Source: M. Drašković, and A. A. Lojpur, 2013.

Analysis of various theoretical models (ownership theory, stakeholder theory, agency theory, stewardship theory, institutional theory, and others) of modern corporation and corporate governance clearly indicates the dominant role of institutional factors in their formation and development.

Figure 2: Corporate Governance: Important Theories

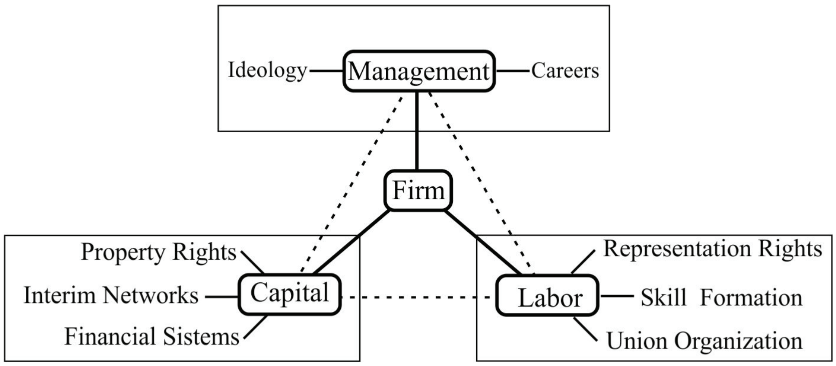


Source: Ibid.

For institutionalists, corporate governance concerns „*the structure of rights and responsibilities among the parties with a stake in the firm*" (Aoki, 2000, p. 11). From the viewpoint of comparative institutional analysis employing game theory, corporate governance is seen as „*self-enforcing mechanisms that govern (such) strategic interactions among the players*" and is defined as „*a set of self-enforceable rules (formal or informal) that regulates the contingent action choices of the stakeholders (investors, workers, and managers) in the corporate organization domain*" (Aoki 2001, p. 281).

An approach Aguilera and Jackson (2003) which emerged from institutional theory is „actor-centered institutionalism", which explains firm-level corporate governance practices in terms of institutional factors that shape how actors' interests are defined and represented. They describe corporate governance and the institutional domains shaping it as having three dimensions - management, capital and labor (Figure 3).

Figure 3: Institutional Domains Shaping Corporate Governance



Source: Aguilera & Jackson, 2003.

The stronger movement for socially responsible corporate governance has started in the late 20th and early 21st century which includes the protection of the interests of all institutional actors and all institutional levels of corporate governance.

In the introductory part of the *Principles of Corporate Governance* (OECD, 2004, p 9), the emphasis is put on the importance of the legal, institutional and regulatory framework for corporate governance: „*It provides guidance and suggestions for stock markets, investors, corporations and other stakeholders in the process of developing good c. g.*" ... The pluralistic economic institutional framework it is impossible to make corporate management become the „*synergy between macroeconomic and structural policies in achieving basic objectives of development policy ... and a key element in improving economic efficiency and growth as well as increasing of confidence of investors ... and the level of trust necessary for proper functioning of the market economy*".

New Institutional Economics (NIE) it is a multilevel concept, which means that institutions can be defined at the level of macro-conditions, markets, at the firms. NIE is concerned with the choice of a governance structure of economic actors under a given institutional environment, as well as with the effects that various institutional environments have on economic performance and development, and the change of these environments over time (Draskovic, and Stjepcevic, 2012, p. 28).

The NIE of studying organizations has been informed by themes of control and coordination that fall within the domain of corporate governance, which broad definition is exploring the implicit and explicit relationships between the corporation and its constituents. The NIE of North and Williamson have offered frameworks regarding the role of institutions in c. g. that are rooted in a rational actor model of the corporation. North argues that a national system of c. g. may be seen as an institutional matrix that provides both the roles to the players and the goals to be pursued by the corporation. Williamson acknowledges the embeddedness of c. g. arrangements in larger, society-wide systems of institutions (according to: Fiss, 2008, pp. 389-390).

Institutions, whether formal and/or informal, create a governance structure at different levels of interaction within an economy. One important level of interaction is the corporate. Discussions about the nature of the institutional setting at the corporate level, have recently received much attention in both academic and policy making circles. According to many authors, specific institutional frameworks should be in place in order to be able to support a strong c. g. framework.

Zingales (1997, p. 3) defines c. g. as "the complex set of constraints that shape the ex-post bargaining over the quasi-rents generated in the course of a relationship". These constraints are largely determined by the institutional setting, which may influence contracting relationships between various parties (Postma, Hermes, 2002, p. 3). Dixit (2009, p. 5) considers that the economics institutions are conducive to good c. g. In opinion V. Nee (2003, p. 26) the institutional environment presents the formal regulatory rules monitored and enforced by the state that govern property rights, markets and firms. It imposes constraints on firms through market mechanisms and state regulation, thus shaping the incentives structure.

3. THE INSTITUTIONAL FRAMEWORK OF CORPORATE GOVERNANCE AND CRS

It is not disputable that the power of corporations grew out of the exploitation of social resources. In economic jargon, this means that the Pareto optimum is not being respected, as the private interest is being forced to the detriment of the public interest. The former is possible only in conditions of fiasco of social and economic institutions. The establishment of an institutional framework and its appliance is a prerequisite for CSR. Because many „morbid“ disorders of corporations are evident, relating to

a) indifference to the feelings of others,
b) inability to maintain stable and enduring social relationships,
c) indifference regarding the safety of others and
d) dishonesty (repeated lies and deception of consumers, the society etc.).

Whether CSR category may be more a necessity or is it the result of consciousness and notions of responsibility and ethics, or be subject to strict institutional changes (orders)? It seems that for the salvation of the planet and of humanity, the third variant must be imperative for the sustainable development. In the part relating to the principles of CSR, in addition to general views, seven principles have been set out in detail: accountability, transparency, ethical behavior, respect for stakeholder interests, and respect for the rule of law, respect for international norms of behavior and respect for human rights. These principles are not a substitute for legal obligations arising from the „*rule of law*". They serve as „helpers" to give responsibility a moral component in addition to legal.

With this very statement, one enters the institutional zone, which generates the behavior of all participants of economic activities and their relationships. Because they are implemented within the constraints, which are conditioned by the institutional structure of society and which narrow the field of individual and corporate choices. Effective institutional environment is able to reduce the negative consequences of opportunistic behavior of corporations, because its basic element - the norm, is understood as a rule of conduct and / or an obligation, generating the penalties for non-compliance. The norm is based on the principle of obligingness and as such represents a complete opposite of the voluntary principle, which characterizes CSR.

C. g. is the set of processes, customs, policies, laws and institutions affecting the way in which a corporation is directed, administered or controlled (Tchouassi, Nosseyamba, 2011, p. 198). C. g. institutions are those that determine the playing field of internal and external stakeholders in the firm. Corporate governance can be considered as a form of institutional design. These institutions are mainly path-dependent (historically determined) and mostly determined by the institutional context. C. g. contains both internal and external control relationships. Relationships between the internal and external control mechanisms reflect the interplay between internal institutions and external forces (notably policy, legal, regulatory, and market forces).

Next to the above mentioned control relationships, which are generally more formal in character, there may be informal institutions that play a role in c. g. They may be firm specific norms and values, management ethos and codes of conduct in business, as well as more general norms and values existing in society at large, self-regulation within a certain industry, and the reputation of a firm in its relations with its competitors, suppliers and customers. C. g. institutions are aimed at supplementing formal contracts between different stakeholders.

Table 1: Internal and external corporate governance institutions

Institutions	*Internal control*	*External control*
Formal	Supervisory board; Management team; Shareholders; Workers council; Guidelines and authority relations.	Competition authorities; Laws on, *e.g.,* property rights, bankruptcy and insolvency procedures, and rules regulating enforcement; Exchange rules (stock exchange); Accounting standards, and auditing and disclosure principles; Reputational agents (financial analysts, accountants, and the like); Institutional organizations like Central Banks, OECD, World Bank, EBRD.
Informal	Firm specific norms and values; Managerial ethos; Codes of conduct	Self-regulation in a sector; Reputation (trust); Societal norms and values.

Source: Postma, Hermes, 2002, p. 5

4. TRANSITIONAL BRAKES OF CORPORATE GOVERNANCE

According to the WEF's *Global Competitiveness Index* 2011-2012, which covers 142 economies of the world, all members of the former Yugoslavia take fairly low places(from 57-100). According to selected institutional indicators, related to c.g., the situation is also unfavorable. Basically they have in common the following problems: unstable and non-transparent institutional framework, insufficient knowledge, a high degree of ownership concentration, the possibility of expropriation of small shareholders, underdeveloped capital markets, short business practice, the agency problem between the majority owners (shareholders) and minority owners (shareholders), unprofessional management and the gap between formal regulations and substantive practical application of regulations and institutional arrangements.

In most transition economies, there was no „creative destruction“ in are of economic institutions, but there was the inconsistent, non-transparent, interest-motivated quasi-monist improvisation. It has caused a lot of confusion and negative consequences. Some interest-oriented alibi-economists (alibi-reformers) rhetorically substitute institutions by quasi-institutions, replacing the thesis. Therefore, the retrograde transition processes and corporate governance deficit is blamed by „*populists and nostalgics of the previous system*.“ Searching for the causes of the crisis and the transition of corporate governance out of institutional area does not make sense. Some individuals ignore clear distinction between some real economic institutions and their quasi-substitutes (eg market and distorted market structure, competition and monopoly privileges, conditions for mass entrepreneurship and individual pseudo-entrepreneurship, mass unemployment and individual overwork, regular business and non-market wealth, freedom and captivity, and full-blooded market, corporate governance and management of informal groups, etc).

The alleged commitment of some economists- reformer of (neo) liberalism, is not in compliance with their non-market monopolistic preferences, anti-institutional arrangements and non-market acquired wealth. Transparent sheath this sort of individualism is highly interest-oriented and limited to a narrow layer of privileged individuals. Reduction of the individual basis of social development has become a permanent and negative sign on the way into the present and future crisis. Institutionalized individualism of all (and not just the privileged) means freedom of choice for all. Only it can be a basis for the healthy entrepreneurship development, corporate governance and ownership efficiency.

Practice has proved that the annuity oriented behavior, the gray economy, „good players“ and their „relationship“ simply substitute the institutional and corporate behavior. It has been the way that shareholders lose their shares and dividends instead of corporate governance. Inconsistent and destructive institutional imitation and improvisation are directly affected on equality of conditions in the acquisition of private property, competition, distribution of wealth, etc.

Specific institutional braking mechanism can be described as a quasi-institutional monism. Market regulation (generated in neo-institutional economic policy) actually does not work even close to the real capacity, but in reduced various forms of substitution and deformed structures, which are under the direct influence of informal and alternative institutions. In such a reducing macroeconomic conditions is not possible to establish a favorable environment for microeconomic effects of corporate governance. Quasi-institutional have blocked principles proclaimed monism market (competition, efficient owners, private business as a mass categories, etc.) as well as innovation processes, knowledge, economic restructuring, etc. The result is *guild capitalism* (Berglöf and E. von Thadden, 1999) in which the usual private firms are favored by political figures.

This eliminates the possibility of the formation of corporate governance. Subjective regulators ignore the institutional norms of behavior. Perverted and reduced individualism arises as a civilization and a social norm. All real institutional concepts are blocked and modified by various political decisions and by interests of the *„reform creators*.“ In this way they block corporate governance, the creation of competitive practices and competencies, economic growth and development.

Quasi-neoliberal economics has shown that ignoring corporate governance, through the creation and operation of strong linkages between firms, banks and state-party authority, to giving selectively loans on very favorable terms and to privileged companies, giving a number of projects to the same individuals, expands business based on asymmetric information, the artificial devaluation of property, inflationary credit, market monopoly and corruption.

C. g. in most countries of the former Yugoslavia began to form in parallel with the privatization process, which allowed the increase of property. All attempts to improve the business environment for the improvement of c. g. have not led to satisfactory results. They have not followed the modernization of company legislature aimed at strengthening the rights of shareholders. Why? Because in the real institutional framework, numerous forms of quasi-institutional, alternative and informal substitutes existed and functioned, which objectively significantly affected the compliance with the strict rules of the game and constrained the development of c. g. It is in observed transition countries should be based on four basic principles: fairness, transparency, management responsibility to the owners and responsibility of the company before the surroundings. However, already at the first step, the ownership transformation led to the breach of mentioned principles. Privatization does not only stand for the transfer of property rights from the state to private investors, but also a change of control and management in enterprises, protection and specification of property rights, increase of enterprise efficiency etc. Obviously, the consistent application of the principles of c. g. requires a long process, in which the legislation will be changed, as well as business practices, business standards and ethics, etiquette, etc.

The main problems of c. g. in the considered countries are: abuse of shareholders' rights, non-transparent ownership structures, direct connection between control and property, inadequate and inexperienced corporate bodies and minimizing the value of the shares of minority shareholders.

5. CONCLUSION

Specifics of particular models of c. g. and appropriate CSR are predominantly conditioned by the character of relations between the two environments - corporate (voluntary, based on market laws) and institutional (binding, based on the regulations and standards). It can be assumed that in the future all models of CSR that prefer sustainable development will be increasingly leaving the first zone and accept the rules of another environment.

Our analysis has confirmed the initial hypothesis that CSR gradually changes, but its position is still at the relation between rhetoric and willingness, it is far from institutional obligation. In order to move CSR from zone of voluntarism to the zone of obligation, it is necessary to institutionally define and achieve a balance between economic, environmental and social imperatives. If this really happens, then Toffler's „adaptive corporations" will indeed have to change and adapt, in the interest of sustainable development.

Too many institutional factors (ownership, control, institutional investors, laws, standards, instruments of economic policy, etc.) are involved in the activities of the corporations for a such important and propulsive area such as institutional conditions, which constitute the institutional environment, to be left to the principle of voluntarism. Since the escalation of environmental and economic problems is increasingly emphasizing the issue of sustainable development, it is clear that the output is to be sought in the application of mandatory limiters which are called the institutions.

A new model of economic growth and sustainable development, in addition to forcing intellectual (high-tech and innovation) and environmental (clean technology, new energy sources) components must be based on institutional pluralism as a general development framework and advanced corporate governance, which includes a networked partnership cooperation and consistent application of all its fundamental principles in business. The synergy of these components is a rational response to the challenges of the crisis.

C. g. as a way of managing the corporations has not yet been affirmed in many transition economies. In underdeveloped and / or insufficiently developed institutional environment that exists in most of the transition countries the significant development of c. g. as an important element of building the microeconomic environment is not possible. In conditions of institutional protection of business and knowledge, the protection of shareholders and investors, which should be provided by c. g., is not possible.

The basic institutional foundations of c. g. (state, market and ownership regulation) in observed transition states were unstable. They broke under the weight of numerous social – pathological changes. Fixing these foundations is a prerequisite for the development of effective c. g., and sustainable economic and social development.

The market model of corporate governance per se is exposed to different institutional and corporate influence factors. In the future, we must find an appropriate model to satisfy the terms of a conflict of interest and corporate and institutional factors, as a condition for sustainable development.

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IMPACT OF CORPORATE GOVERNANCE ON PERFORMANCE OF COMPANIES

IGOR TODOROVIĆ[1]

Abstract

Corporate governance is system by which companies are directed and controlled, but also the relationship between companies and interest groups which determines its strategic direction and performance. Through appropriate application of the principles of corporate governance a company increases profitability and returns, improves its competitiveness, credibility and reputation and improves relations with key stakeholders such as investors, business partners, employees, customers, etc. Companies that insist on the highest standards of governance reduce many risks that arise from daily operations. Such companies are able, by better performance and returns, to attract investors whose investments could help finance further growth and development. The study will assess the level of implementation of corporate governance and level of performance in companies from the Republic of Srpska. Results of implementation of the corporate governance in companies will be presented using Scorecard analysis for evaluation of the implementation of practices and principles of corporate governance on a sample of 19 companies which are listed on the Official market of the Banja Luka Stock Exchange. Level of performance will be assessed by determining the net profit margin and earnings per share for the same sample of companies. Results will be compared with results obtained by a similar analysis conducted for companies listed on the Vienna Stock Exchange to determine the impact of corporate governance on performance of companies.

Key Words: *Corporate Governance, Firm Performance, Net Profit Margin, Earnings per Share, Scorecard Analysis, the Republic of Srpska.*

JEL Classification: G30, G34, G39

Preliminary communication

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1. INTRODUCTION

Corporate governance is a key element for improvement of investors' confidence, increase of competitiveness and improvement of economic growth. Corporate governance is on the top of agenda for international development as stated by James Wolfensohn that "the governance of the corporation is now as important in the world economy as the government of countries" (Wolfensohn, 1998).

Good corporate governance can help to prevent corporate scandals, fraud, and potential civil and criminal liability of companies. Good corporate governance enhances image and reputation of a company and makes it more attractive to investors, suppliers, customers and other stakeholders of the company. There is evidence from many researches that good corporate governance produces direct economic benefit to the company, making it more profitable and competitive.

For investors one of the most important aspects when making an investment decision is level of implementation of corporate governance principles (public disclosure of information, protection of shareholder rights and equal treatment of shareholders) and profitability, which ensures return on their investment.

Research problem of this paper is based on determining the impact of level of implementation of corporate governance on performance of companies. Level of performance will be as-

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sessed by determining the net profit margin (NPM) and earnings per share (EPS), while level of implementation of the principles of corporate governance in companies will be assessed using Scorecard analysis for evaluation of the implementation of (good) practices and principles of corporate governance. Research will be done on a sample of 19 companies from the Republic of Srpska, which are listed on the Official market of the Banja Luka Stock Exchange. Results will be compared with results obtained by a similar analysis conducted for companies from Austria, which are listed on the Prime market of the Vienna Stock Exchange.

2. THEORETICAL ASPECTS OF CORPORATE GOVERNANCE

Discussion on corporate governance started in early 80's during which American managers had neglected interests of shareholders which coursed fall of share price.

Work on corporate governance has been done for many years, but mostly by the Organization for Economic Co-operation and Development (OECD). Governments of OECD member countries have interest to work in best interest of their citizens, to ensure good practice of corporate governance as a vital element in promotion of prosperity and economic growth. The OECD has published Principles for corporate governance in 1999, which are first international code of good corporate governance approved by governments. The OECD Principles focus on publicly traded companies, both financial and non-financial, and have a goal to help governments in their efforts to evaluate and improve the legal, institutional and regulatory framework for corporate governance. They also provide guidance and suggestions for stock exchanges, investors, corporations, and other parties that have a role in the process of developing good corporate governance.

Arrangements, implications and responsible institutions for corporate governance vary from country to country, and experience from developed and transition countries shows that there is no universal framework for all markets. Therefore the Principles are non-binding or obligatory, but voluntary in form of recommendations, so every country can adapt and implement them in accordance with specific circumstances of individual countries and regions, that is to individual tradition and market conditions.

In last few years corporate governance has become subject of the large interest in theory, as well as in practice. Parker stated that "corporate governance has commanded the highest levels of attention and debate among legislators, regulators, professions, business bodies, media and in the general community" (Parker, 2007). Despite existence of many different approaches and definition of corporate governance, it can be broadly defined as "basically the system by which companies are directed and controlled" (Cadbury, 1992). More accurately, it is the framework by which interest of various stakeholders are balanced, or as stated by the International Financial Organization (IFC) it „concerns the relationships among the management, Board of Directors, controlling shareholders, minority shareholders and other stakeholders" (IFC, 2005). The Organization for Economic Co-operation and Development (OECD) also defines corporate governance in its Principles of corporate governance „corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined" (OECD, 2004).

Structure of corporate governance determines distribution of rights and responsibilities between various actors in company, such as boards, managers, shareholders and other stakeholders, and lays rules and procedures for making corporate decisions. This way, it provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined (OECD, 2004).

Good corporate governance plays a key role in enhancing integrity and efficiency of companies, as well as financial markets in which company operates. Poor corporate governance weakens company's potential and in worst care can open the way for financial difficulties and frauds. Companies which follow the best practice of corporate governance usually raise capital easier and by lower price and in long term are more profitable and competitive than companies that have poor corporate governance. Companies that insist on the highest standards of governance reduce many risks that arise from daily operations. Such companies are able, by better performance and returns, to attract investors whose investments could help finance further growth and development.

Recent research in this field shows that investors have a tendency to invest more in companies which have better governance systems. Bushee, Carter and Gerakos (2007), as well as Leuz, Lins and Warnock (2007) support this claim that investors exhibit preference for well-governed firms.

Merton (1987) argues that investors are more likely to invest in those companies that they know about. Results of studies of Brennan and Cao, (1997); Kang and Stulz, (1997); Covrig, Lau and Ng, (2006); and Choe, Kho and Stulz, (2005) indicate that foreign investors tend to invest primarily in those companies associated with less information asymmetry.

3. METHODOLOGY OF RESEARCH AND RESEARCH HYPOTHESES

To determine the impact of level of implementation of corporate governance on performance of companies, Scorecard analysis for corporate governance, net profit margin (NPM) and earnings per share (EPS) were used.

Data for analysis was gathered from databases of the Banja Luka Stock Exchange and Vienna Stock Exchange, Reuters Observer station, companies' web pages and interviews with companies' top managers.

Level of implementation of the principles of corporate governance in companies from the Republic of Srpska was assessed using Scorecard analysis for evaluation of the implementation of (good) practices and principles of corporate governance, while level of performance was assessed by determining the net profit margin (NPM) and earnings per share (EPS).

Research was done on a sample of 19 companies which were listed on the Official market of the Banja Luka Stock Exchange.

To determine the impact of level of implementation of corporate governance on performance of companies, gathered results for companies listed on the official market of the Banja Luka Stock Exchange was compared with results obtained by a similar analysis conducted for companies listed on Prime market of the Vienna Stock Exchange.

The Scorecard for the Standards of governance of Joint Stock Companies was developed by the Banja Luka Stock Exchange with the assistance of the International Finance Corporation (IFC) based on the model of the Scorecard for German corporate governance (The Banja Luka Stock Exchange, 2009).

The structure of the Scorecard analysis contains the main criteria which are included in the standards and recommendation of best practice of corporate governance, with the relevant set of questions for each area.

The structure of the Scorecard analysis consists of seven areas: commitment to corporate governance principles, rights of shareholders, equal treatment of shareholders, role of stakeholders in governance of joint stock companies, publishing and transparency of information, role and responsibility of the boards and audit and internal control system.

Conceptually, the evaluation of the implementation of the principles of corporate governance should have the score between 65% - 75%, which is possible by the implementation of mandatory principles of corporate governance defined in the Standards of Governance of Joint Stock Companies. Achieving the total score of 100% should be an incentive for companies to implement higher principles of corporate governance (Strenger, 2002).

To offer useful answers to the research problem and realize the study objectives, the following hypotheses were tested.

H0: Level of implementation of corporate governance has a positive impact on performance of companies.

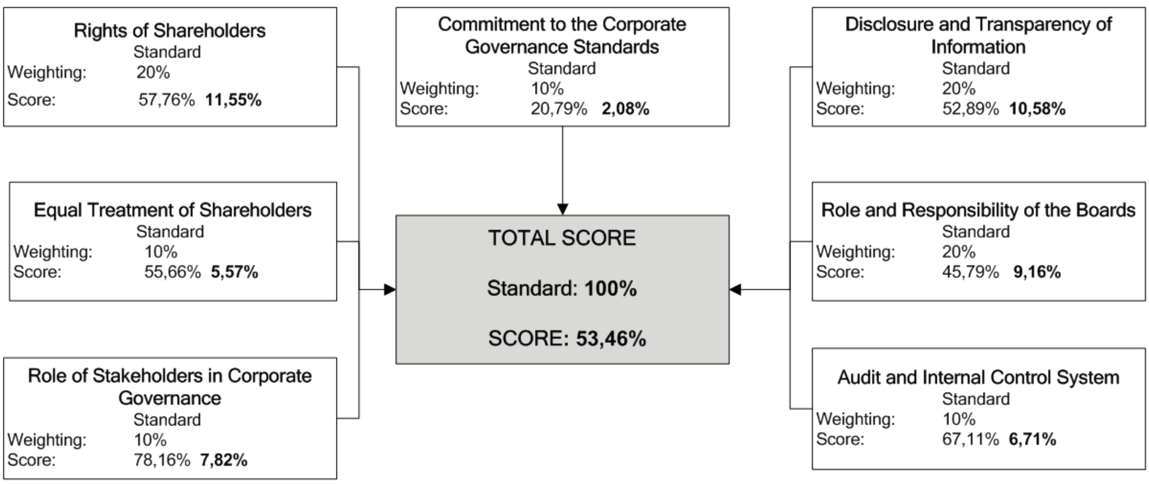
H1: Companies with higher level of implementation of corporate governance have higher earnings per share (EPS).

H2: Companies with higher level of implementation of corporate governance have higher net profit margin (NPM).

4. AN ANALYSIS OF INFLUENCE OF CORPORATE GOVERNANCE ON PERFORMANCE OF COMPANIES

Shleifer and Vishny define corporate governance as "the ways in which suppliers of finance to corporations assure themselves of getting a return of investment" (Shleifer and Vishny, 1997:2). Therefore, it is important to find out whether the level of implementation of corporate governance is correlated with performance of companies. If it is so, companies should follow the best practice of corporate governance to attract investors and raise finance at lower price. To determine this, results of level of corporate governance, net profit margin and earnings per share for companies from the Republic of Srpska will be analyzed and compared to findings for companies from Austria.

Figure 1: Results of Scorecard analysis for evaluation of the implementation of practices and principles of corporate governance for companies form the Republic of Srpska



Source: The author's research

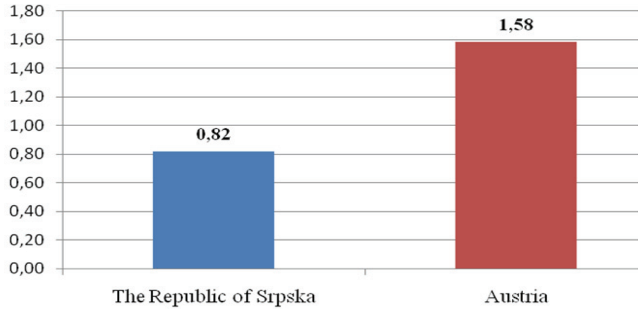
As shown in Figure 1 total score of the implementation of practices and principles of corporate governance for companies from the Republic of Srpska is 53,46% which shows that implementation of principles of corporate governance in these companies are not on satisfactory level, taking into account that companies that apply basic principles of corporate governance should have the score between 65% - 75%. Particularly low level is showed in commitment to the corporate governance standards, role and responsibility of boards, disclosure and transparency of information and rights and treatment of shareholders.

Net profit margin (NPM) for companies from the Republic of Srpska is negative, showing at -7,11%, while earnings per share (EPS) for companies from the Republic of Srpska is 0,82 EUR.

These results indicate that companies from the Republic of Srpska have low level of implementation of principles of corporate governance and low performance shown by Scorecard analysis score and net profit margin.

To show impact of corporate governance on the performance of companies these results will be compared to the results obtained by a similar analysis conducted for companies listed on the Vienna Stock Exchange.

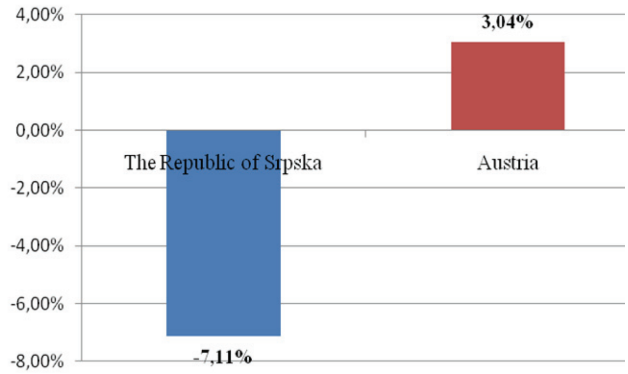
Figure 2: Results of earning per share (EPS) for companies from the Republic of Srpska and Austria



Source: The author's research

Earnings per share (EPS) for companies from Austria is 1,58 EUR which indicates that on average these companies are more profitable and generate more earnings that can be converted to dividends, showing better returns to investors and higher value on stock market than companies from the Republic of Srpska.

Figure 3: Results of net profit margin (NPM) for companies from the Republic of Srpska and Austria



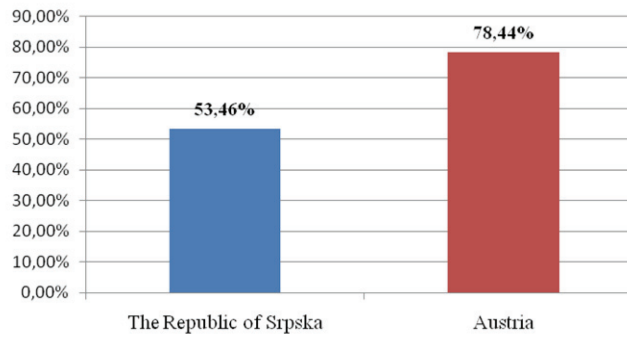
Source: The author's research

Net profit margin (NPM) for companies from Austria is 3,04% which indicates that on average these companies are more profitable, more effective at converting revenue into actual profit and have better control over its costs compared to companies from the Republic of Srpska. This shows that companies from the Republic of Srpska have lower margin of safety and high risk for investors due to losses and negative margin.

Total score of the implementation of practices and principles of corporate governance for companies from Austria is 78,44% which is based on the Corporate governance index (Kaufmann, 2004:101). Also according to the prime market rules of the Vienna Stock Exchange compliance with the Code of Corporate Governance is mandatory for all companies listed on the prime market. Companies from the Republic of Srpska have total score of the implementation of practices and principles of corporate governance of 53,46%.

This shows that companies from Austria have higher level of implementation and are more committed to principles of corporate governance than companies from the Republic of Srpska.

Figure 4: Results of corporate governance score for companies from the Republic of Srpska and Austria



Source: The author's research

5. DISCUSSION

Results from Figure 2, 3 and 4 shows that companies from the Republic of Srpska have lower level of implementation of principles of corporate governance, lower net profit margin, and lower earnings per share compared to the companies from Austria.

These results show that companies with higher level of implementation of corporate governance principles have higher net profit margin and earnings per share. While companies that have lower level of implementation of corporate governance principles have lower or negative net profit margin and lower earnings per share. This indicates that companies with higher level of implementation of principles of corporate governance and better practice of corporate governance are more profitable and have better performance. As a result, implementation and compliance with principles and good practice of corporate governance has an impact on performance of companies.

Therefore, companies with lower level of implementation of corporate governance principles (companies from the Republic of Srpska) should implement and should comply with corporate governance principles and standards, increase disclosure of information, and increase protection of shareholders, if they are to survive in global market, become more competitive, profitable, attract investors and raise capital at lower price.

6. CONCLUSION

Results of the analysis indicate that there is an obvious correlation and impact of implementation of principles of corporate governance on performance of companies.

Companies from the Republic of Srpska which are listed on the official market of the Banja Luka Stock Exchange have lower level of implementation and compliance with principles of corporate governance, lower net profit margin and earnings per share than companies from Austria which are listed on prime market of Vienna Stock Exchange. This indicates that companies with higher level of implementation of principles of corporate governance and better practice of corporate governance are more profitable and have better performance.

Therefore, if companies want to increase their performance, survive in global market, become more competitive, profitable, attract investors, customers and raise capital at lower price, they must implement corporate governance principles and standards in their strategy and decision making process.

One of the main barriers for implementation of principles of corporate governance by companies is seeing corporate governance as a good will and not as an essential part of responsible business practice. They view corporate governance only through cost of implementation. Moreover, companies do not understand positive influences which corporate governance can have on company's performance, especially on relations with investors. Therefore, responsible institution of capital market should draw attention of companies to potential benefits and advantages of implementation and compliance of corporate governance, as well as give them support for implementation of corporate governance.

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PROTECTION OF MINORITY SHAREHOLDERS IN B&H, CROATIA, MACEDONIA, MONTENEGRO AND SERBIA

DARKO TIPURIĆ[1], VELJKO TRIVUN[2], MIA MRGUD[3], and MAJA ŠUKLEVA[4]

Abstract

Earlier studies indicate that Bosnia and Herzegovina, Croatia, Macedonia, Montenegro and Serbia, as well as other countries in transition, are characterized by a relatively high ownership concentration, which points to the presence of conflict of interest between majority and minority shareholders and possibility of abuse of minorities' rights. Accordingly, the paper aims to analyze and compare the legal measures of protection of minority shareholders in these countries, which will allow making conclusions on the current level of legal protection of minority shareholders and determining the necessary courses of action for its improvement. It has been widely accepted that company law and regulation of capital markets play a significant role in the development of financial markets, corporate governance and corporate finance and that by means of improving the legal environment it is possible to restrict the possibilities for expropriation of minority shareholders. In the paper we analyze and compare the relevant provisions of company laws in the observed countries. Unlike previous research on the quality of corporate governance in these countries that focused mainly on implementation of the OECD Principles, we focus on the pre-defined key mechanisms to protect minority shareholders with no aspirations to cover all aspects of the protection and seek to identify weaknesses in legislation. The results point to a relatively high level of protection of minority shareholders "on paper" in the analysed countries, but also to some weaknesses which vary from country to country.

Keywords: *corporate governance, legal protection, minority shareholders, transition countries.*

JEL Classification: K22;

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1. INTRODUCTION

Earlier studies indicate that Bosnia and Herzegovina, Croatia, Macedonia, Montenegro and Serbia, as well as other countries in transition, are characterized by a relatively high level of ownership concentration. Although there is no accurate data on the ownership structure of joint stock companies (JSC) in Bosnia and Herzegovina (hereinafter: B&H), it can be assumed that there is a majority shareholder in most of the companies (ROSC, 2006). According to the results of research conducted in the Federation of Bosnia and Herzegovina (hereinafter: FB&H) in 2009, 78% of joint stock companies are characterized by majority or dominant ownership (Karić, 2009). The results of a research conducted in the Republic of Srpska (hereinafter: RS) in 2008 also point to the concentrated ownership, and according to it there is a majority shareholder or shareholder who owns more than 50% of the shares in 54% of the companies (Jeftić, 2008).

Studies conducted in the Republic of Croatia for the years 2004 and 2006 on a sample of public joint stock companies and in 2010 on a sample of non-financial joint stock companies show a high concentration of ownership in Croatian companies and its gradual increase in the past decade. An increase in the share of companies with dominant shareholder that owns 70% or more in the ownership structure is particularly being emphasized. According to data for the year

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2006, share of the largest shareholder in company's equity is 51.52% in average, and of the second-largest shareholder 12.37%, which in total represents a share of 63.9% in the hands of the two largest shareholders. In a relatively small number of companies (17.3%), the largest shareholder has a share in the capital of less than 20%, while more than 20% of companies have a dominant shareholder with a share of over 80%, and 52.8% of companies have a shareholder with a share of over 50% of the capital (Tipurić et al., 2008; Tipurić et al., 2011).

Studies conducted in the Republic of Serbia in 2006 also point to a high concentration of ownership, according to which in approximately 50% of the surveyed joint stock companies in real sector over 2/3 of the shares are held by one shareholder (Đulić, 2008).

Ownership concentration is an important internal mechanism of corporate governance, thanks to the active participation of large shareholders in management (Tipurić et al., 2008). However, large shareholders often represent their own interests in companies at the minority's expense. Corporate law has a difficult task in this case, since it needs to protect minority shareholders, but also try to keep the benefits associated with the presence of a controlling shareholder (Dammann, 2008). Vutt (2009) considers the protection of minorities to be a central problem of company law, and it is particularly important in the context of transition economies (Avilov et al., 1999).

It has been widely accepted that company law and regulation of capital markets play a significant role in the development of financial markets, corporate governance and corporate finance (La Porta et al. 1997, 1998, 1999; Pagano and Volpin 2005). By means of improving the legal environment it is possible to restrict the possibilities for expropriation of minority shareholders and reduce the agency conflict between majority and minority shareholders. Accordingly, there is evidence of a growing similarity in the systems of corporate governance regarding the level of legal protection of ownership positions and interests of minority shareholders, the role of boards in overseeing management and transparency (Tipurić, 2011).

The analysis and comparison of legal measures to protect minority shareholders which follow include provisions of company laws in Bosnia and Herzegovina, i.e. its entities FB&H and RS, Croatia, Macedonia, Montenegro and Serbia concerning the open joint stock companies of general type that are listed on the stock exchanges. Financial institutions and joint sotck companies in majority state ownership are exempt since they are generally subject to regulation by specific laws. The provisions relating to the open joint stock companies listed on a stock exchange will be discussed, as the corporate governance standards apply to them (IFC, 2009), and only such companies have an incentive to take actions to solve the problem of protection of minority shareholders (Loderer and Waelchli, 2010).

Unlike previous research on the quality of corporate governance in these countries that focused mainly on implementation of the OECD Principles, the analysis that follows focuses on the pre-defined key mechanisms to protect minority shareholders with no aspirations to cover all aspects of the protection of shareholders' rights and seeks to identify the weaknesses in the legislation. Based on the analysis, the conclusions about the current level of legal protection of minority shareholders that the laws in these countries provide "on paper" and the necessary courses of action to improve their legal protection are being derived in order to improve their legal protection. When it comes to B&H, the analysis is carried out on the entity level due to the significant differences between the entity company laws, which include different board structures and mechanisms of shareholder protection (Mrgud, 2011).

2. LEGAL FRAMEWORK AND METHODOLOGY

In the last few years there has been a series of changes i.e. introducing new regulations in the area of corporate governance and investor protection in all of the five countries. Similar to the other transition economies, some of the changes come too late and their expected efficiency is lower than in case they were adopted at the beginning of the reforms (Mrgud, 2011). All the observed countries are subject to harmonization with the EU law. However, the scope of the mandatory provisions of the EU company law that the future member states must adopt in order to harmonize its legislation with the *acquis communautaire* is relatively narrow, and several important aspects of corporate governance, company and securities law remains intact with the harmonization requirements, which means that many important issues in this respect are left to the member states' discretion (Soltysinski, 2004).

National laws recognize a series of measures aimed to prevent abuse of the principle of majority and to protect the minority. The rules for the protection of minority are broadly defined in the legal literature and it is not easy to set aside rules that are considered as rules designed to protect the minority. According to the *Methodology for Assessing the Implementation of the OECD Principles on Corporate Governance*, the *ex ante* and *ex post* mechanisms to protect minority shareholders are being distinguished (OECD, 2006). Similarly, Vasiljević (2007) lists two groups of measures that derive from the literature as preventive (out of court) and the judicial and administrative measures to protect minority shareholders, while the preventive measures consist in using the powers of minority shareholders at the shareholders' meeting and powers with respect to various forms of internal and external institutional control.

Ex ante provisions designed to protect minority shareholders which are considered as important include preemptive right to buy shares of new issues and qualified majority required for making certain decisions, including the approval of the majority of minority for transactions with related parties. The right of minority shareholders to convene a shareholders' meeting, cumulative voting when electing board members and the possibility that minority shareholders elect a certain number of members of the supervisory / management board, audit committee or similar body are also considered as potentially important mechanisms. If controlling shareholders decide to remove the company from the stock exchange listing, provisions that require or allow them to pay out the remaining shareholders at a price of shares determined by an independent assessment may be of a particular importance. However, provisions on disclosure and clearly defined obligation of loyalty of board members to the company and all its shareholders are referred to as being crucial for minority shareholders protection (IOSCO, 2009). Ex post rights provide redress in case of violation of ex ante rights and include individual, derivative and class actions, and enforcement and investigation by the regulator.

In the past decade, more indices that seek to measure and compare the level of protection of minority shareholders in various countries and regions in the world have been constructed, and they can serve as a starting point in the analysis and comparison of company laws in observed countries. In the Doing Business reports values of four indices constructed according to Djankov et al. (2008), which measure the protection of minority shareholders against self-dealing in transactions with related parties i.e. misuse of corporate assets by directors for achieving personal gain, are being published. Although the reports take into account regulations relevant to the life cycle of small to medium-sized companies, and indices are constructed on the basis of standardized scenarios with specific assumptions and, accordingly, do not include all aspects of regulation in the area of interest (in this case, all aspects of the protection of minority shareholders), the values shown may be useful for the initial analysis and comparison as they are based on the laws and regulations.

Table 1 shows values of the indices of investor protection for all the observed countries, including regional and OECD high income countries averages. Strenght of investor protection index is calculated as the average value of three indices: extent of disclosure index, extent of director liability index and ease of shareholder suits index which cover the approval and transparency of related party transactions, liability of board members for self-dealing and possibility of shareholders to obtain corporate documents before and during the trial, respectively (DB 2013). Higher values of the indices indicate that national regulations provide better protection of investors against self-dealing. According to the strenght of investor protection index, Macedonia is ranked as 19th, Montenegro 32nd, Serbia 82nd, B&H 100th and Croatia 139th out of 185 countries covered by the report (DB EECA 2013). In comparison to 2005, region of Eastern Europe and Central Asia has progressed in this area the most, approaching the OECD high income countries, which is also evident from the values of indices in the last report (DB 2013).

Table 1: Investor Protection in B&H, Croatia, Macedonia, Montenegro and Serbia

Country / Region	*Extent of disclosure index (0-10)**	*Extent of director liability index (0-10)**	*Ease of shareholder suits index (0-10)**	*Strenght of investor protection index (0-10)**	*Rank DB/ 185* (GCR/1 44)***	*Protection of minority shareholders interes***	*Rank GCR/ 144***
Bosnia and Herzegovina	3	6	6	5,0	100 (80)	3,1	138
Croatia	1	5	6	4,0	139 (110)	3,6	120
Macedonia; FYR	9	7	5	7,0	19 (17)	3,5	123
Montenegro	5	8	6	6,3	32 (29)	4,2	65
Serbia	7	6	3	5,3	82 (65)	2,6	143
Eastern Europe and Central Asia	7	5	6	5,9	62		
OECD high income	6	5	7	6,1	61		

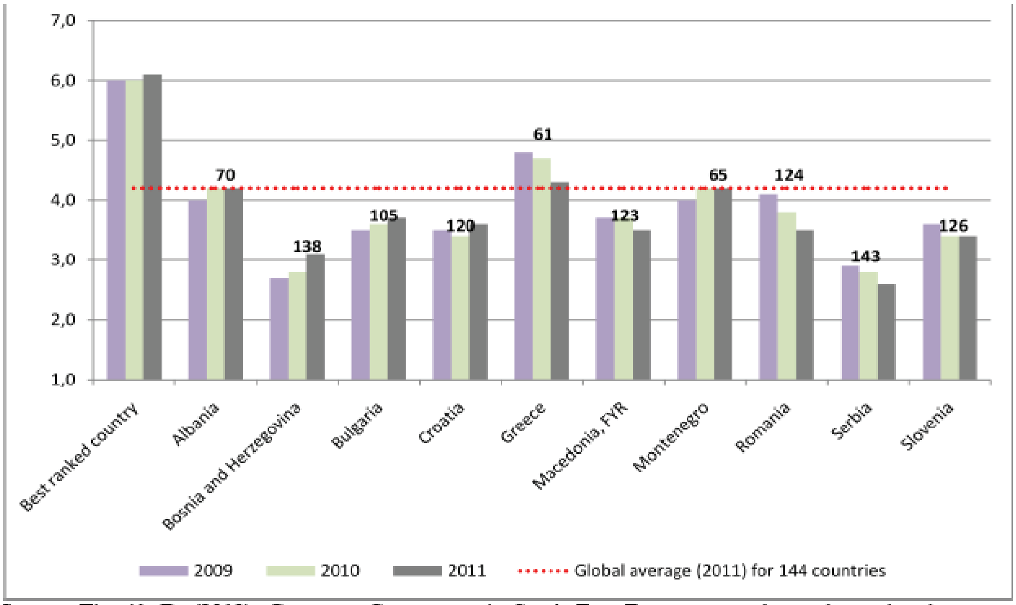
*Sources: *http://www.doingbusiness.org/data/exploretopics/protecting-investors;*
***WEF (2012) Global Competitiveness Report 2012-2013*

According to Doing Business, with the reforms in 2009, Macedonia has increased investor protection by regulating the approval of transactions between related parties, increasing disclosure requirements in the annual report and making it easier to bring a lawsuit against directors in cases of harmful transactions between related parties (DB EECA 2013). On the other hand, there is no change in value of the strenght of investor protection index for Serbia after introduction of the new Law on Companies in 2012, and neither the last changes in Croatian Law on Companies did affect the value of this index for Croatia. The fact that no information is provided on the method of calculating index value for the B&H, which is characterized by different entity regulations, puts somewhat into question credibility of presented values.

Although competitiveness reports of the World Economic Forum publish data collected for the Doing Business reports in terms of the level of investor protection (DB 2013; GCR 2012-2013), they also publish values of their own indicator of protection of minority shareholders interests as well as ranking of countries in that respect (see Table 2.1. and Graph 2.1.). The indicator of protection of minority shareholders interests by WEF is based on responses to the question of the extent to which the interests of minority shareholders are protected by the legal system in certain country (1 = not at all protected, 7 = fully protected) which is a part of the annual survey of business leaders' opinions (Executive Opinion Survey) conducted by the WEF (GCR 2013).

What immediately becomes obvious is the extremely good ranking of Macedonia according to the DB 2013 and relatively poor ranking according to the GCR 2012-2013, while Montenegro is relatively well ranked in both cases. Unlike Macedonia and Montenegro which rank well above the regional average in the DB 2013, B&H, Croatia and Serbia rank significantly below based on the same report. Position of B&H can not be interpreted in terms of the DB with respect to a completely different entity regulations in this area and the lack of information on how this issue was resolved in calculation of the index, while 138th position out of 144 countries in the GCR indicates very little protection of the minority interest according to the opinion of business community. Croatia is unexpectedly low ranked according to both reports, and the DB clearly indicates a problem in the segment related to disclosure of related party transactions. Bearing in mind its modern legislation, Serbia is unexpectedly penultimate ranked by the GCR and has relatively poor ranking according to the DB report which points to problems in terms of the types of evidence that can be collected before and during the trial.

Graf 1: Protection of minority shareholders' interests



Source: Tipurić, D. (2012): Corporate Governance in South East Europe: towards good practice, key note speech, 2nd International Conference ECONOMIC SYSTEM OF THE EUROPEAN UNION AND ACCESSION OF BOSNIA & HERZEGOVINA, Vitez; Source of data: The Global Competitiveness Report World Economic Forum

Since the issues of regulating disclosure of related party transactions and ease of shareholder suits, are, in addition to corporate law, subject to other regulations, the analysis and comparison that follows will not allow a full insight into the reasons for this ranking. The analysis and comparison will include the provisions of company laws in five countries concerning the mechanisms of protection of minority shareholders identified as significant by the OECD and in the legal literature.

3. MEASURES OF MINORITY SHAREHOLDERS PROTECTION

3.1 The pre-emption right

In all the observed countries, the existing shareholders' pre-emption right, i.e. the right to acquire new shares in order to maintain their share in equity is defined by the law and can be excluded or limited by a general meeting decision (in Serbia only in a case of the offer that does not require publishing prospectus). In Croatia and Serbia, making such a decision requires at least ¾ of the votes of represented equity with special conditions for its validity (disclosure and a report on the reason in Croatia, reasons and justification of price in Macedonia and Serbia), in Macedonia and Montenegro 2/3 of the votes, and in FB&H – majority vote of the total number of voting shares. The law in RS does not provide for a special majority, but (along with the LoC in Montenegro) requires a statement of reasons and a rationale for the proposed issue price. In Croatia and the RS there is a possibility that the management (board) decides on the limitation or exclusion of pre-emptive rights pursuant to the law, which in Croatia requires the approval of the supervisory board (Art. 233, 308, 324-325, 341 LoC C; Art. 251, 253, 262, 278, 288 LoC S; Art. 213-215, 223 LoC FB&H; Art. 203, 208 LoC RS; Art. 31, 35, 53, 56 LoC MN; Art. 422, 425 CL M).

Legal provisions on pre-emption rights in Croatia and Serbia are in an appropriate way also applied when acquiring and disposing with the own shares, which is a recommendation of the General principles (1999). In B&H, Croatia, Montenegro and Serbia, these provisions are also applied to convertible bonds.

In FB&H, the decision by general meeting on the limitation or exclusion of pre-emption right will be considered a significant change in the company or shareholders' rights, which activates provisions of the LoC on minority protection in decision-taking. Interestingly, in Croatia there is a possibility to determine that exercising a share-based right depends on whether the shareholder has held the share for a given time period (Art. 229 LoC C) and, as an example Gorenc (2004) describes a possibility for the statute to determine that the "pre-emption right is granted to shareholders who held shares over no less than two years". There are no data on using this possibility in practice.

It is important to ensure a simple procedure for exercising the pre-emption rights, with that the ultimate efficiency of this mechanism depends on the financial possibilities of the right holder. Rules pertaining to the way and timeframe of exercising the pre-emption rights differ greatly between the countries. Only the LoC FB&H explicitly prohibits the transfer of pre-emption right to a third party, while the LoC MN is not explicit but forbids its transfer to the buyer in the event of a sale of shares. In Serbia and RS the laws set conditions with respect to the selling price at issuance with a view to exercising the pre-emption right. In Serbia and RS shares of a new issue are sold at market value (at least) as determined by the law i.e. relevant regulations (Art. 53 LOC MN; Art. 259-260 LoC S; Art. 207, 235 LoC RS). A significant means for shareholder protection in new issues includes the request for issuing shares at a price that is not lower than their market value with the precise definition of the concept.

3.2 The rights of minority shareholders in respect of convening and holding of the general meeting and cumulative voting

Unlike the LoC FB&H which contains far fewer provisions in this regard, Croatian LoC contains detailed provisions on convening and holding of the annual general meeting and exercising shareholders' rights, which Gorenc (2004) interprets as the legislator's intention to protect the justified minority's interests by making it impossible for the majority to prevent attendance and decision-making at the meetings, as well as by preventing the obstruction of general meetings by minority. The time-limit for delivering i.e. publishing notification on convening the general meeting in Croatia, Montenegro and Serbia is at least 30 days and in FB&H only 20 days before the meeting, which is below the minimal requirement set forth by the Shareholders' Rights Directive (Art. 279 LoC C; Art. 36 LOC MN; Art. 365 LoC S; Art. 242 LoC FB&H). In none of the observed countries are shares blocked prior to the shareholders' general meeting.

Convening of the general meeting in FB&H may be requested by shareholder(s) with more than 10% of the total number of voting shares, in Macedonia and RS by shareholders with no less than 10% of voting shares (in RS on an issue proposed for the extraordinary meeting), and in Croatia, Montenegro and Serbia by shareholders who together have no less than 5% of the equity (a smaller share can be determined by the company statute). In practice, the 10% minimum may be too high a threshold, which will depend on the ownership structure of an actual company. In the event that the general meeting is not convened by the authorized convener upon request, in FB&H the one who submits the request is authorized to convene it directly. In Serbia and RS, the board is entitled to reject the request for convening an extraordinary general meeting, though only in cases provided for by the law. In Croatia, Montenegro, Serbia and RS shareholders who are authorized to request the convocation of general meeting are also entitled to request the inclusion of a new item to the agenda, while in FB&H, the right to change and amend the agenda is granted to shareholders with at least 5% of voting shares. In Macedonia every shareholder has that right before convening of the meeting, but when the assembly has already been convoked the right belongs only to shareholders who jointly possess one fifth of the total number of shares with a right to vote (Art. 278 LoC C; Art. 337, 372 LoC S; Art. 243-244 LoC FB&H; Art. 36-37, 40 LoC MN; Art. 385 CL M; Art. 268, 275 LoC RS).

The laws in all the observed countries require a qualified majority for making certain crucial decisions at the general meeting. In Croatia and Serbia and in one case Montenegro (Art. 24 LOC MN), the law requires a majority of at least ¾ of the represented equity, wherein in cases provided for by the law, the statute may require even higher majority and/or fulfilling additional requirements, while in B&H, Macedonia and Montenegro it is necessary to have a 2/3 majority of the represented voting shares. Legal solutions in FB&H require a qualified majority for a considerably smaller number of crucial decisions. Interestingly, according to the Law in Macedonia changes in the statute are adopted unanimously. The unanimous consent protects minority shareholders, i.e. it gives them a right to veto, but in practice may cause other kind of problems. With respect to Croatia, provisions on the necessary qualified majority for decision-making should be viewed in context of the fact of leaving the determination of quorum to the statute, which in practice can be relatively small (Mrgud, 2011).

Joint-stock companies in B&H, Macedonia and Serbia are subject to the mandatory rule "one common share, one vote". In Croatia, it is prohibited to issue shares which, for the same amount of equity pertaining to them, grant different voting right at the general meeting i.e. plural voting is prohibited. In Montenegro the company's statute may provide that certain classes of shares do not provide voting rights, while in Macedonia that is allowed only for preferred shares (Art. 169, 208, 477 i 511 ZTD: Art. 251 LOC S; Art. 199 ZPD FBiH; Art. 198, 203 i 285 LOC RS; Art. 32, 54 LOC MN; Art. 280 CL M).

With respect to companies whose shares are traded in an organized securities market, there is no possibility for limiting the number i.e. the percentage of individual shareholder's vote in any of the countries. In Croatia, however, special limitations of exercising the right to vote apply to companies with mutual shares of 25% to 50% of the equity, which cannot make use of rights from the part of the share that exceeds 25%.

In Macedonia, Montenegro and Serbia shareholders are entitled to vote in writing without attending the meeting, and in Croatia if contemplated by the statute. With the exception of FB&H, it is possible to give power of attorney to vote by electronic communication, and there is a possibility (obligation in Montenegro) that the statute provides for voting by electronic communication whithout attending the meeting. The legislator in Montenegro goes a step further, and in case of interferences in electronic communication it requires the session to be interrupted by the chairman and continued after eliminating the interferences. It should also be noted that LoC C includes detailed provisions on exercising voting rights through financial institutions and shareholders' associations, and in Serbia on voting through proxy including banks, with a view of preventing possible abuses (Art. 274, 277, 291-292 LoC C; Art. 36, 39, 39b LOC MN; Art. 400, 400a LC M; Art. 335, 340-341, 344 LoC S).

In FB&H, voting in absence is allowed only for the open JSCs, under the conditions and in the manner provided for by the company statute in accordance with Securities Commission's regulations. Since there are still no Securities Commission's regulations on this issue, it should be considered that such a way of voting is not possible. Voting could only be achieved by means of filled-in and signed voting ballots submitted to the company by mail, fax or e-mail prior to the date of general meeting (Art. 249-252 LoC FB&H). In RS it is not allowed to vote by mail. Giving proxy electronically under the condition of ensuring the statement authenticity could only be allowed by the memorandum of association or company statute (Art. 278 LoC RS).

In Croatia, RS and Serbia it is allowed to grant special rights and benefits to founders (in Croatia to individual shareholders) or to third persons, which has to be indicated in the memorandum of association or in the company statute (Art. 175, 256 LoC C; Art. 267 LoC S; Art. 183 LoC RS). Pursuant to the LoC C, the benefits may also include special rights in the company control, such as the right of delegating supervisory board members (Gorenc et al., 2004). In Montenegro the Law allows and regulates shareholders agreements on voting (Art. 39a LOC MN).

In B&H and Montenegro members of open JSCs' boards are appointed at the general meeting by means of cumulative voting. Cumulative voting will be used in Macedonia and Serbia if provided by the statute. In Croatia general meeting decides upon the appointment of supervisory/management board members by the majority of votes, and there is no institutionalized protection of minority with respect to the appointment of supervisory board members (Barbić, 2006). The legal solution can be changed by the statute. However, in Serbia and RS a vacant position in the board is filled in by co-opting. On the contrary, in Montenegro the Law explicitely requires election of a new board of directors in the event of a resignation or termination of performing the functions of a member. The Croatian law provides for the possibility of appointing supervisory board members by the court (Art. 256-257, 272.c-272.d, 275 LoC C; Art. 344 CL M; Art. 42 LOC MN; Art. 384, 386, 436 LOC S; Art. 262 LoC FB&H; Art. 300-302 LOC RS).

The effectiveness of cumulative voting as a mechanism that allows minority shareholders to elect their "representative" into the board will depend on the board size i.e. on the number of members being elected and the number of voting shares that the minority holds (IFC, 2009, p 96). According to the data from 2006, the average number of supervisory board members in Croatian JSCs is 5 (Tipurić et al., 2008). In more than a half of JSCs covered by the research in FB&H from 2008, the number of supervisory board members is 3, and only in 3 companies it is 7 or more (Karić, 2008). When the above-described is viewed in the context of the fact of high ownership concentration, the conclusion of small practical significance of this mechanism is inevitable.

The solutions present in some jurisdictions under which minority shareholders with a given percentage of share in equity have the right to directly elect their representative in the board, or which limit representation of the controlling or significant shareholder in the board (e.g. majority of independent board members requirements) seem more acceptable in the given circumstances, particularly in the context of conclusions on the need to strengthen the role of board by increasing the number of independent members (Tipurić et al., 2011).

As a rule, minority shareholders have the right to propose candidates for election to the board. In FB&H and Montenegro, the right to propose candidates for membership in the supervisory board is granted to shareholder(s) with no less than 5% of voting shares. In Serbia and RS, candidates for the election of board members are proposed by the existing board, shareholders (with 5% share in Serbia) or the appointment committee. In Croatia, supervisory/management board members the election of whom is decided upon by the general meeting are proposed by the existing supervisory/management board, which was criticized in literature, since it leads to a closed system where majority shareholders elect majority of board members, who will subsequently propose new board members, etc. (Gorenc et al., 2004). In order to protect minority, all shareholders in Croatia are entitled to submit their proposals on the election of supervisory/management board members, which have to be decided upon prior to taking the decision on the supervisory/management board's proposal, if they are supported by shareholders with no less than 10% equity represented on the general meeting (Art. 280 LoC C; Art. 261 LoC FB&H; Art. 42 LOC MN; Art. 384, 434 LoC S; Art. 300-301, 308 LoC RS).

In B&H, for the possibility to submit a request for the appointment of a special committee i.e. an audit commissioner a share of no less i.e. over 20% in the equity is required, in Serbia 10% for the special or extraordinary audit, and in Montenegro only 5% share in equity for the appointment of representatives which will examine company's operations and accounting. The costs of such examination in Montenegro go to shareholders who demanded it, except when the results indicate that there is a good reason for the costs to be borne by the company. Additionally, a shareholder in FB&H with at least 10% of voting shares can request an audit of the semi-annual and annual statement and of the JSC's financial operations. The FB&H solution differs greatly in that in the event that the general meeting rejects the proposal for appointing an external auditor for this purpose, the auditor will be appointed by the SC (Art. 32 LOC MN; Art. 455-456 LOC S).

3.3 Other rights intended for *ex ante* minority protection

Company laws in all the observed countries include provisions on the sequence of distribution of profit, way and limitations in paying dividends, whereby there is no obligation to pay minimum dividend. Decisions on paying dividends are typically taken by the general meeting. In Serbia and RS, management board can be authorized to do so. The decision on using the profit in Croatia is taken by the management and supervisory board (executive directors and management board), and the Law strives to protect minority shareholders' right to dividend in potential attempts by majority to overfill the company's reserves (Barbić et al., 2006). In FB&H, as a prerequisite for making a decision on payment, conditions in terms of the ability of fulfilling obligations from operations and minimum market value of assets are set, which raise a number of questions regarding the value determination and interpretation of certain terms (Vilogorac and

Dizdar, 2000). Less than 10% of companies covered by a recent research in FB&H paid dividends over the past 3 years (Karić, 2009).

In B&H, Croatia, Montenegro and Serbia there are cases provided for by the law when minority shareholders can request the buyout of shares from the company. In FB&H the shareholders' right exists for general meeting decisions that result in significant changes in the company or shareholders' rights, and which encompass new issues of shares, bonds convertible to company shares or with pre-emption right to company shares, limitations or exclusions of pre-emption rights and changes in form, company split, merger with or acquisition of another company or vice versa. However, cases of restructuring or reorganization of companies with majority state capital are excluded (Art. 255 LoC FB&H).

In Montenegro, RS and Serbia, a shareholder has this right in cases of changes in the statute i.e. memorandum of association (and potentially other decisions in RS and Serbia) that affect his rights, company reorganization (in Montenegro limited to cases of disproportionate allocation of shares with regard to the ownership structure and dissatisfaction with the exchange ratio of shares and compensation in cash) and disposal with high-value assets. Similar to the FB&H, shareholder in Montenegro also has this right in case the general meeting limited or excluded preemptive right to shares or convertible bonds by its decision. In Croatia, this right is limited only to some cases of splitting and re-shaping the company into a limited liability company or public company, and signing a contract on running the company business or transfer of profit with affiliated companies. (Art. 492, 550.j-k, 562, 575 LoC C; Art. 22v, 22g, 32a LOC MN; Art. 474-475 LoC S; Art. 330, 435-436 LoC RS).

There are certain conditions for exercising buyout rights. In Montenegro voting against the decision is required, in the RS and Serbia voting against the decision or refraining from voting and a shareholder who has this right cannot challenge the company decision on which he bases it. However, in Serbia the right belongs to a shareholder who did not attend the meeting as well. In Montenegro and RS prior notification of the company on the intention to exercise the right is required, in FB&H a statement on the opposition entered into minutes before the voting starts, while in Serbia the request may also be submitted after the meeting. Similarly, in Croatia the right to severance pay in case of split is conditioned by a statement of opposition to the decision entered into minutes, and the right is also granted to a shareholder who did not attend the general meeting if he was prevented unlawfully, if the general meeting has not been convened properly or if the subject of decision-taking was not properly disclosed (Art. 32a LOC MN).

In FB&H, buyout of shares is performed at the fair market value for the period starting from the day of announcement to the day of general meeting, whereby the important issue of the way of determining the fair market value of shares in this relatively short period of time has not been regulated. In Montenegro and RS, companies are required to buy out shares at the market value, which is calculated on the day of passing the decision, ignoring any expected increase or decrease in value as its consequence. However, unlike the Montenegrin Law that insists on the average market value at that specific date, the Law in RS determines the market value as an average price regularly published on the stock exchange or another regulated market in the period immediately preceding the day for which it is determined, and which is not shorter than 3 nor longer than 6 months. In the event that shares are not traded regularly, or that there is no regulated market, the market value in RS is determined based on the estimated value of company assets using appropriate methods. In Serbia, the buyout is made by the highest of the precisely defined values: accounting, market or estimated (Art. 255 LoC FB&H; Art. 32a LOC MN; Art. 51, 259, 475 LoC S).

Deadlines for making the payment vary, and the longest is the one in FB&H (3 months). Besides, a company in FB&H may be allowed to fulfill the obligation from the request only partly within the described timeframe, with a further period of 6 months to pay the rest in case determined by the law (Art. 255 LoC FB&H; Art. 32a LOC MN; Art. 51, 259, 475 LoC S).

Generally, in all the observed countries requirements regarding disclosure and transparency are considered as relatively high. However, it seems that there is a need for "deep transformation in the attitude of all participants to the very idea of transparency" (Đulić, 2008) i.e. companies need to recognize their own interests in it, but there also must be a greater demand for information by investors.

As for the conflict of interest rules, in FB&H the obligation of reporting a conflict of interest to the supervisory board exists for its members and members of the management with the exclusion from the decision making in the first case and the written consent of the supervisory board as a condition for participation in such a business relationship in the second (Art. 270, 279 LoC FB&H). The LoC in Montenegro requires from the board members to adhere to the principles of good faith and to act with the due dilligence applying the rules of profession, and also to use their powers only for the benefit of the company which includes avoiding conflicts of interest between them and the company. Board members in Montenegro are obliged to report to the shareholders' meeting any benefit or privilege that they have in the company, besides the compensation for their work (Art. 44 LOC MN).

In Serbia and RS it is precisely determined what will be considered a personal interest. Conclusion of the legal transactions in cases of conflicting interests is allowed if they are approved, in good faith and with the knowledge of all the material facts related, by a majority vote of board members who have no interest in that business, and in case there is no such majority, by a majority vote of shareholders who do not have personal interest in it. The general meeting is informed on the approval of the board and the legal transaction. It is important to mention that in RS a shareholder, among other things, cannot vote at the shareholders' meeting when deciding on the approval of transactions which involve conflict of interest between him and/or related parties and the company, and on the exclusion of the pre-emption right for the shares being issued in a private offering in which he and/or a related party is a pre-known buyer (Art. 61-71, 362 LOC S; Art. 33-39 LOC RS).

Unlike the others, Croatia is one of the few countries in the Eastern Europe and Central Asia region which still allows voting of the board members who are in a conflict of interest, and one of the few countries in the world that does not require any disclosure of transactions with related parties (DB, 2011).

3.4 *Ex post* mechanisms of minority protection

The LoC FB&H does not recognize the possibility of a direct and/or derivative lawsuit by an individual shareholder or a minority group in case of opposing the decisions of the management and supervisory board. Notwithstanding, there is a possibility of applying for a compensation on behalf of the subsidiary by a shareholder representing at least 10% of the equity or less if provided by the statute (Art. 50.a LoC FB&H).

Croatian LoC provides a possibility for the shareholders holding at least 10% of the equity to require from the company to submit a request for compensation against its founders, members of the organs and individuals who have used their influence in the company i.e. benefited from the harmful acts. At the suggestion of the same qualified minority i.e. a shareholder with a share of at least HRK 8,000,000.00 there is a possibility of appointing special company representatives by the court, whereby the costs are covered by the company. In order to protect the minority, the company has no right to waive claims for damages or to settle for a period of 3 years. Additionally, in the case of company not submitting the request, while the facts determined by the law being present, the court on the qualified minority (at least 5% of the equity or HRK 4,000,000.00) proposal appoints special representatives who are required to submit a request on behalf of the company if they consider that there are chances for success in the dispute (Art. 252, 272, 272.k-l, 273, 273.a, 494, 501-502 LOC C).

In addition, shareholders in Croatia are "authorized to submit a claim for the damages they suffered if different from the damages caused to the company", whereby “damage caused to the company due to the reduction in share value, which also harms a shareholder, does not entitle the shareholder to demand a compensation” (Gorenc et al., 2004).

However, the significance of the solutions described is greatly reduced by the provisions that set the obligation for shareholders that requested submitting the claim from the company to solidary compensate the company for the costs in excess of what is obtained in the dispute, i.e. to compensate the company for all of the costs arising from the dispute in case of the rejection of claim, if the company fails in its claim for damages or succeeds only partially. This generally has a discouraging effect on the minority shareholders posing such a request. Special protection is provided to shareholders in case of a group of companies (Art. 252, 272, 272.k-l, 273, 273.a, 494, 501-502 LOC C).

Company laws of RS and Serbia recognize individual and derivative shareholder suits, and specify persons who have duties to a JSC: controlling shareholders, company representatives, directors and board members, internal auditors, and persons with a contracted authority to manage the company affairs. In Serbia and RS each shareholder has the right to bring an individual suit on their own or on behalf of more persons acting together, while shareholders who hold shares representing at least 5% of the equity have the right to file a derivative lawsuit on behalf of the company against any person with duties to the company for damages caused by their violation (Art. 61-71, 77-80 LoC S; Art. 31-42 LoC RS).

The LoC MN also recognizes both individual and derivative shareholder lawsuit. Each shareholder in Montenegro, regardless of their share in equity, has a right to sue in his name and on behalf of the company the responsible person in the company that is liable for irregularities in management or company operations. Understandably, if obtained the compensation in this case belongs to the company, and the shareholder is entitled to reimbursement of costs (Art. 30 LOC MN). The preconditions for filing a derivative lawsuit in Montenegro, RS and Serbia are capacity of a shareholder and company's refusal of the request for filing a lawsuit or failure to comply with the request within 30 days (Art. 30 LOC MN; Art. 61-71, 77-80 LOC S; Art. 31-42 LOC RS).

Also, each shareholder (or its successor) in Montenegro has a right to file a lawsuit at the Commercial Court in cases determined by the Law: unlawful act of the company or act outside its authority; majority shareholders discriminate against minorities; violated shareholders' rights; minority shareholders deceived by persons who control the company (board of directors or controlling shareholders). Also, the right to initiate proceedings exists if there is evidence that the company's operations are run or the board of directors uses its authorities in a way that threatens the rights of that or the other shareholders, not respecting his or their interests as shareholders, although such operations are done in good faith. In that case, a shareholder represents the interests of all the similarly threatened shareholders. The court in case of a founded complaint can remove imperfections, make a decision on compensation to shareholders, and in the enumerated cases may order the purchase of shares by other shareholders or the company itself, at a price which shares would have if there had not been irregular operations (Art. 30 LOC MN).

In the event that members of the management body fail to remedy the irregularities in cases determined by the Law, shareholders in Macedonia are entitled to request compensation for damages from the members of the management body (Art. 362, 408-414 LC M).

Shareholders in B&H, Montenegro and Serbia have a right of submitting a claim in the court in case of company not fulfilling the obligation of share buyout, and in Montenegro, RS and Serbia a right to lodge a request for an assessment of share value by the court. When it comes to the LoC MN, it should not be forgoten that the purchase price is determined as the average market value of shares on the day of making decision, and in case of inability for that price to be established due to the absence of trade, the Law leaves the possibility of starting a dispute. In Croatia, there is a possibility of court determining the severance in a squeezeout at the request of minority shareholder. In the case of the value/severance being determined by the court, the decision applies to all the disagreeing or minority shareholders (in Montenegro is only if that value is greater). Additionally, company laws of Serbia and RS include provisions on the company termination and other court measures at the request of minority shareholders who own at least 20% of the company equity (Art. 32a LOC MN; Art. 469, 476 LoC S; Art. 31-33, 39-42, 319, 337 LoC RS).

Croatian LoC contains detailed provisions on the reasons, authorizations, claims and effects of challenging and voiding of the general meeting decisions. A general meeting decision may be challenged by filing a suit against the company in cases specified by the Law, among other things, in case a shareholder tried to provide for himself or someone else benefits at the expense of the company or other shareholders by means of voting at the meeting. The authorization for bringing a lawsuit in that case has every shareholder. Otherwise, it belongs to a shareholder who participated at the general meeting and declared their opposition in the minutes, and to the other shareholders only in cases prescribed by the Law (Art. 280, 308, 355-366.a, 532, 550.k, 562 LoC C).

Gorenc (2004) considers this option as insignificant due to the multiple conditionalities, narrow scope of application and difficulties in interpretation of terms. Conditions being set here are usually not met in practice because the shareholders, especially minority, do not participate in the general meeting or are represented by financial institutions that do not have a practice of stating the opposition to the minutes. The law determines the cases when the decision of the general meeting can not be disputed, and among them is a violation of the right to use electronic communications in voting due to a technical fault with the exception of cases of gross negligence or intent, and violations of certain provisions related to disclosure and providing statements. In the context of good reasons, Gorenc (2004) points out that violations of procedures designed to protect minority shareholders are the absolute reason for contesting the general meeting decision. The right to file a lawsuit against the company in order to nullify the general meeting decision belongs to every shareholder.

Additionally, shareholders in Croatia holding at least 5% of the equity (or HRK 4,000,000.00) can file a suit to challenge a decision on profit distribution if it decides not to distribute profit to shareholders although reasonable business judgment with respect to the circumstances tells otherwise. The decision to increase the equity may be challenged by the each shareholder if preemption rights are excluded in whole or partly, and the (minimum) price determined is inappropriately low.

Similarly, in B&H and Serbia, the right to challenge and annul the general meeting decisions with the court is regulated by the laws, including conditions which are mainly voting against the decision or lack of presence due to irregularities in convocation. The laws of Serbia and RS also contain special provisions for contesting and voiding of the decisions in certain cases (Art. 256, 285 LoC FB&H; Art. 376-381 LoC S; Art. 293-297 LoC RS).

In Montenegro a shareholder who voted against or did not attend the shareholders' meeting which adopted a merger agreement, a decision on division or on separation with the establishment of one or more new companies has a right to demand from the court to cancel the contract or decision if the essential provisions of the restructuring procedure were not followed (Art. 22a, 22v, 22g LoC MN). Shareholders in Montenegro are entitled to file a suit for annulment of decisions of the meeting of shareholders in the following cases: non inclusion of the issue on which the decision was taken in the agenda in accordance with the Law; non registering acts or decisions for which there is such obligation; non respecting the legal provisions on convening and holding of the shareholders' meeting; decision non compliance with the LoC, statute and other regulations. Shareholders in Montenegro have a right to initiate proceedings for the annulment of a decision on voluntary liquidation in short proceedings before the court (Art. 24a, 41 LOC MN).

Shareholders in Macedonia also have the right to contest decision of the general meeting before the court. According to the Law, the decision may be contested by a shareholder who attended the meeting and declared his objection in the minutes; a shareholder who did not participate at the meeting because he was not allowed contrary to the law and/or the statute (meeting not properly called, issue not properly announced); and any shareholder, if the resolution was adopted with the intention for shareholders who voted for to gain benefit for themselves and/or for a third party, at the expense of the company and/or other shareholders (Art. 362, 413 CL M).

When it comes to judicial protection in non-contentious proceedings, in Croatia, Montenegro, RS and Serbia there is a possibility of making recourse to the court in case requests of minority for convening the general meeting are not met, and, with the exception of Montenegro, when requests for including of new issues in the agenda are not met and for the appointment of special auditors. In addition, in Montenegro, RS and Serbia one can go to court if the general meeting is not held within the prescribed period, in Croatia one can require the recall of members of supervisory board if an important reason exists, and in Serbia the court may order the company delivering answers to questions posed in the assembly and appointing of a temporary company representative.

For the appointment of auditors by the court in Serbia and RS it is enough to make it likely a violation of the law or the memorandum in contrast to the conditions set by the Croatian legislator concerning the existence of a reasonable suspicion of irregularities or gross violation of the law or statute. Given the simultaneous existence of provisions designed to protect the interests of the company, it seems that there is no need to set the last condition (Art. 278, 298, 300, 305.a, 500 LoC C; (Art. 40 LOC MN; Art. 338-339, 343, 397, 456-457 LoC S; Art. 269, 275, 325-327 LOC RS).

4. CONCLUSION

The analysis of legal measures to protect minority shareholders points to a relatively high level of protection of minority shareholders "on paper" in the analysed countries, but also to some weaknesses which vary from country to country. Generally, mechanisms of protection exist, but the actual protection depends on their proper functionality which is, in one part, determined by the whole subset of rules that make one mechanism functionable.

The legislation in FB&H somewhat laggs behind and abounds with ambiguities. Only in FB&H and Montenegro pre-emption right is not freely transferable. In FB&H cases of restructuring or reorganization of companies with majority state capital are excluded from the provisions on shares buyout including filing a complaint with the competent court to the disadvantage of minority shareholders in these companies. Concerning the buyout, the Law in Montenegro insists on the average market value at the day of making the decision. In FB&H and Croatia there is no possibility of filing derivative lawsuits. Croatia is one of the few countries in the region which still allows voting of the board members who are in a conflict of interest.

Even though pre-emption rights are recognized by all the five legislations, only in Serbia and RS the laws set conditions with respect to the selling price at issuance with a view to exercising these rights which is considered important in protecting minorities. In terms of the right to ask for convening of the general meeting or adding issues to the agenda, all the legislations set certain thresholds which in some cases may be too high. In practice, it will depend on the ownership structure of an actual company. Generally, we conclude that set thresholds for the realization of the rights of qualified minorities are often not adapted to conditions of a very concentrated ownership.

We also conclude on the small practical significance of cumulative voting as a mechanism that allows minority shareholders to elect their "representatives" to the board, since its effectiveness depends on the size of the board and, again, the number of shares in the hands of minority. The solutions present in some jurisdictions under which minority shareholders with a given percentage of share in the equity have a right to directly elect their representative in the board, or which limit representation of the controlling or significant shareholder in the board seem more acceptable in the given circumstances.

And, in the end, for the exercise of shareholders' buyout rights and the right to challenge the decision of the assembly, conditions in the form of voting against the decision or refraining from voting and stating the opposition in the minutes of the assembly are usually set and also not usually met in practice.

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TOWARDS A RELATIONAL VIEW OF CORPORATE GOVERNANCE

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Abstract

The ongoing transformation of corporate governance dominant focus from its traditional toward an integrated multidimensional level denotes actually that the new paradigm is emerging, the one that highlights a holistic governing approach and an augmented, overall corporate responsibility as well as long term corporate success and sustained competitiveness. Within such kind of an extended discipline's domain the conceptualization of more flexible governance models is needed, supported with the continuous improvement of the corporate governance practice. Consequently, a development of new mechanisms able to provide and maintain corporate fitness in contemporary fast changing business reality and an upgraded approach to governance processes design are required. The paper deals with the idea of conceptualizing the relational corporate governance framework suitable for an integrative, corporate governance system self-regulation, therefore assuring corporate fitness.

The theoretical part is based on a literature analysis in corporate governance, corporate reputation, strategic management and organizational studies research. The conceptual relational corporate governance framework is designed, grounded on dynamic capability view and stakeholder orientation, sustained by the social system theory. The outcome of the paper contributes to the underlying conceptual work for corporate governance and strategic management. In details, a theoretical relational based corporate governance concept aimed for managing ecosystem's corporate fitness as well as the underlying corporate and board capabilities are developed and proposed.

Keywords: *corporate governance, dynamic capabilities, corporate reputation.*

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1. INTRODUCTION

Corporate governance as a field recently became a topic of top academics and practitioners' interest, and moreover of regulators' and institutions' as well, due to the global occurrence of economic crisis and its unwanted consequences that have revealed many governance failures. As a result, there is an ongoing change of corporate governance practices, supported by OECD issue of *Key Findings and Main Messages* (OECD, 2009). In parallel, another movement is happening: in a contemporary business vision the firm is seen as an institution of modern society and as a sovereign social actor (King *et al*., 2010). An understanding of a company as a nexus of relationships (Wu and Eweje, 2008, p.7) instead of a nexus of contracts (Jones, 1995, p. 407; Jensen and Meckling, 1976) highlights its interconnectedness with and embeddedness into surrounding and global ecosystem.

The ongoing transformation of corporate governance practice denotes actually that the new paradigm is emerging, the one that highlights a holistic governing approach and an augmented, overall corporate responsibility as well as long term corporate success and sustained competitiveness. Within the newly shaped context, the scope of the field has to move beyond the classical meaning of the term "governance" as it is usually applied to contractual relations in and between organizations and their constituents (Lindberg, 2003), toward more of relational contracting. Thus, the relational assets of the corporation come to the focus. Among them especially sali-

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ent is corporate reputation since it can be understood as a kind of label for the corporate behavior as well as an interacting risk indicator. Indeed, companies interact while performing, and as the key outcomes of an overall corporate performance an operating result followed by the corporate reputation emerge.

Within this article, corporate governance is viewed as an integrative system of stakeholders' relations as well as a form of meta-management that joins legal, financial, ethical and organizational issues of the firm performance. On the other side, corporate reputation is regarded as a multidimensional phenomena and unique strategic relational resource, able to provide assistance in achieving various corporate goals, as well as in shaping the preferable kind of relations with its numerous stakeholder groups. The aim of the paper is revealing the powerful role of relational assets and particularly corporate reputation in the corporate governance processes, and thus shaping a new perspective of corporate governance based on relations. Moreover, within this article proposed relational corporate governance view (RCGV) actually imports a new dynamic perspective in corporate governance field by shaping bidirectional, two ways relational links between company and its stakeholders, moving from managing relationships toward building collaborative relationships suitable for the privileged exchange of ideas, knowledge and information, all necessary for generating and sustaining ecosystem's corporate fitness.

Such a framework has not been constructed up till now. The challenge of this article is to propose ecosystem's corporate fitness as an ultimate goal of a good corporate governance practice, grounded on a similar set of capabilities. RCGV allows for a shaping of corporate fitness capability and the corporate reputation to be used as a newly inaugurated self-regulating integrated corporate governance mechanism, designed as a driver of the firm's market and non-market based competitiveness and suitable for auditing quality of the firm governance system, as well. Starting with the ontological and epistemological changes of the corporate governance and related fields, the paper continues with the relational assets and dynamic capability overview, followed by relational governance framework conceptualization sustained by corporate reputation and its functionalities and concludes with some potentially useful managerial implications.

2. THEORETICAL BACKGROUND

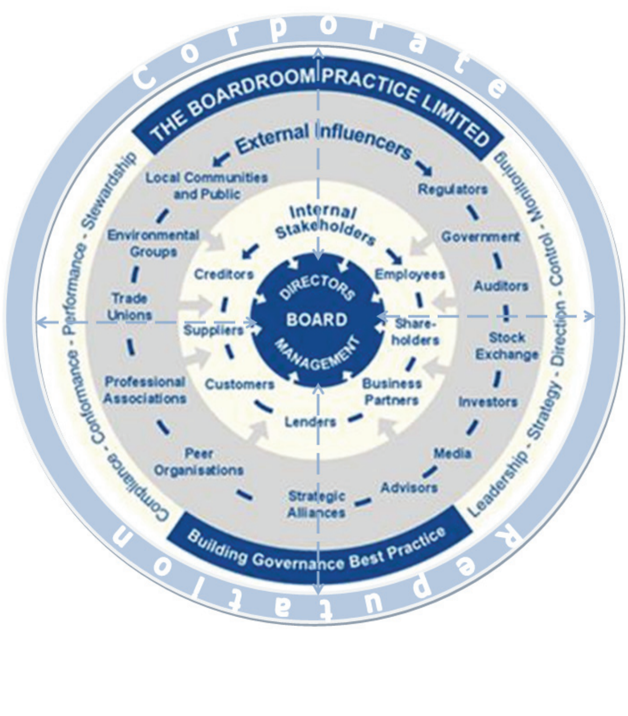
According to OECD, corporate governance (CG) involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performances are determined (OECD, 2004). Corporate governance can thus be defined as a kind of management of the management or meta-management. Good corporate governance depends on the balance of relations between internal and external mechanisms which ensure the efficiency of governing and help in the resolution of natural problems, as well as the possible conflicts that may occur within a corporate structure (Tipurić, ed., 2011). Effective governance requires leveraging of multilevel processes with respect to corporate institutional framework, stakeholders' interactions and managerial autonomy and accountability. Overarching important determinants of the quality of corporate governance are effective and efficient boards and their capabilities for provision of effective and efficient decision-making.

The essence of CG lies in the crafting and continuously refining of codes, laws, regulations, and processes that govern companies' operations, ensuring that shareholder rights are safeguarded and stakeholder and manager interests are reconciled. The control aspect of CG encompasses the notions of compliance, accountability and transparency (MacMillan *et al.,* 2004), and how managers exert their functions through compliance with the existing laws, regulations and codes of conduct (Cadbury, 2000). The direction aspect of CG includes corporate goals and related strategic choices, i.e. leadership and strategy aspects, which implies broader, organizational frame of governance, that involves: defining of roles and responsibilities; orienting management toward a long-term vision of corporate performance; setting proper resource allocation plans, contributing know-how, expertise, and external information; performing various watchdog functions; and leading the firm's stakeholders in the desired direction (MacMillan *et al.*, 2004; Cadbury, 2000;). The leadership and control aspects of CG both define the attention and the extent of power accorded to various stakeholders, including executives, managers, employees, and, to a lesser extent, external constituencies and actors.

The complexity of the issue has been recognized and shaped into three basic theoretic approaches: agency, stakeholder and stewardship theory. All three theories ponder the questions of the position and supervision of managers, but their responsibility, behavior and the manner of achievement corporate goals diverge. Despite of agency theory's longevity and still salient assumptions (Jensen and Meckling, 1976), the stakeholder and the stewardship theories of corporate governance offer more comprehensive approach to contemporary acceptable mode of governing the corporation. Born within strategic management field, the former has fundamentally shook up regulatory and contractual agency postulates. The later has emerged within the field of corporate governance as an alternative to agency theory. Stakeholder theory begins with the assumption that values are necessarily and explicitly a part of doing business, and rejects the separation thesis (Freeman, 1984), whilst the fundamental postulate of stewardship theory is that managers always act in such a way to maximize the interests of a company, while the contemporary business environment is forcing management towards ethically responsible, innovative, but profitable businesses (Davis *et al.*, 1997.)

Three mentioned theories may be considered as a partial dominant logic. Evaluated separately, each one offers good solutions to corporate governance problems that Sir Cadbury has defined as "the system by which companies are directed and controlled", more than two decades ago (Cadbury, 2000, p.8, Cadbury report, 1992). A narrow view of CG portrays it as an enforced system of laws and financial accounting. There is, however, a broader CG conceptualization, emphasizing every business' responsibilities toward the different stakeholders that provide it with the necessary resources for its survival, competitiveness and success (MacMillan *et al.*, 2004). Such an approach highlights the relational aspect of the field, dealing with the relations of governance structures within corporations determining the components of the governance system and the supervision of the corporation (Cadbury report, 1992). In this vein, governance could be seen as concerned with the mechanism by which business' relationships are directed and controlled (MacMillan *et al.*, 2004, p.15). The snapshot of the corporation's stakeholder relations perspective, encompassing the direct and indirect relations simplified depicts the figure 1.

Figure 1: Corporation's stakeholder relations perspective



As the figure 1. shows, corporate reputation and board have the salient role within relational perspective. Due to its specific position in the corporate structure, as a link between shareholders and top management, and being a provider for stakeholders' alignment, the supervisory board work assumes three roles: (1) control role, (2) strategic role and (3) service or resource provision role. The service or resource provision role of the supervisory board is primarily concerned with maintaining the formal and informal relationships with firm's stakeholders. The supervisory board can help the firm connect with the relevant segments and environmental constituencies and in securing important resources, while at the same time is expected to take into account the relevant interests of other stakeholders, especially employees, creditors, customers, suppliers and the local community, and in performing its duties should apply essential social standards and environmental protection principles. A supervisory board with a strong service or resource provision role can help better articulate the interests and overcome the inherent conflict between the various stakeholders. However, the strategic role of the board does not imply that the board engages in the strategy formulation, since it is the duty of the management board, but that it supports and leads the management in the realizing the firm's mission and its goals. The control role of the supervisory board implies monitoring and supervising the company's operations, current as well as preventive, i.e. the monitoring of business decisions and company's plans (Tipurić and Mešin, 2013).

Prior to proceed with the introduction of the RCGV in position as a new holistic approach to corporate governance that sustains corporate fitness, a genuine motivation for taking such a perspective as well as several notions, occurrences and attitudes need some attention to be properly introduced and explained, since they originate from a strategic management discipline and have not been regarded nor used within the corporate governance field so far.

3. THE ONGOING CHANGE OR A PARADIGMATIC SHIFT

The appearance of the broader view of corporate governance could be considered as a reaction to stakeholder-shareholder orientation rivalry. Nevertheless, it is a new global pattern of business and society integration that brings a shift in values and consequently, an emerging higher standard of corporate performance demand in terms of more corporate responsibility and increased requirements of performance. Companies are expected to conform while performing, or put differently, to do well and good to be acknowledged in today's business reality. Until recently predominant influential profit maximization business paradigm is fading away (Blair and Stout, 2007), due to the augmented accountability, as well as the transparency issues, while stakeholder value maximization and sustainable success concepts rob authority. All in turns motivate a movement for governance practice beyond its traditional bottom line towards an extended one.

The extension is headed for a holistic organizational level of governing the corporation that comprises regulative, social and environmental dimension, even political, beside economic. Within such kind of an extended discipline's domain the conceptualization of more flexible governance models is needed, supported with the continuous improvement of the corporate governance practice. Consequently, a development of new mechanisms able to provide and maintain corporate fitness in contemporary fast changing business reality and an upgraded approach to governance processes design are required.

Taking the attitude that the modern corporation is organization, an economic and social instantiation of the environment in which it is embedded, the notion ecosystem is used to explain the complexity of the business, social and institutional environment the corporation operates in. The comprehensive environment needs an equal perspective of CG domain and its existing practice upgrade, in order for the well governed company to possibly make advantage of its effective and efficient corporate governance system (Tipurić, ed., 2008, p.6). Following Teece, the business "ecosystem" stands for the community of organizations, institutions, and individuals that impact the enterprise and the enterprise's customers and supplies. The relevant community therefore includes complementors, suppliers, regulatory authorities, standard-setting bodies, the judiciary, and educational and research institutions (Teece, 2007, p.1325).

Such a complexity of environment should be taken as a new business reality. It indicates that corporations have to be or should become able to cope with obstacles to their sustainability by using opportunities and assets that are legitimately available. In such a framework, it is the duty of managers to make decisions that will increase value for shareholders and all relevant stakeholders' principals of the company, taking into account its competitiveness and efficiency, as well as its sustainable development (Tipurić, ed., 2008, p.vii). Steiner and Sterner has defined basic postulates of sustainable business as "be ethical, responsible, and profitable" (Stainer and Stainer, 1998, p.5). Each of the three postulates has its own issues, thus their integrated implementation requires the redesign of governing model orientation towards long-term economic, ecological and social performance that could provide for a corporation to achieve and sustain ecosystem's corporate fitness. Within this notion, the industrial, social and institutional dimension of business fitness is understood, all three considered as antecedents that support corporate sustainable success (Tomšić, 2013a, p. 849). The notion fitness is borrowed from population ecology literature and is brought to strategic management as a conceptual yardstick for measuring the performance of corporate dynamic capabilities (Helfat *et al*., 2007, p.7). The phenomenon of dynamic capabilities, as well as of the ecosystem corporate fitness will be explained in details in the subsequent chapter.

While witnessing actual corporate governance field debate, based mostly on the different approach to corporate responsibility and on the need for more managerial ethics and temperateness, but moreover on the highlighting the corporate embeddedness within the ecosystem it operates in, is seems that the very field nature is changing. The alliance of the business and society and all its growing interconnectedness have brought a need to (re)consider the corporate governance as a multidisciplinary field composed of organizational, financial, ethical, legal and strategy perspective as well, that should all be respected together when corporate goals set and decision making occurs. Thus, the kind of meta paradigm as a label for an integrated corporate governance perspective is needed.

CG discipline is not to be regarded separately from the other interfering fields. With respect to global ongoing changes and the nascent different business philosophy, related corporate governance disciplines are not speared of huge change magnitude either, a kind that is supporting the modification and stakeholder alignment of governance practices. Within the strategy field, there is a movement for integrating of economic rationality and so called "cold" cognitive mode with its, so far quite neglected "hot", emotional side and ethics, thus rebuilding a very foundation of the discipline, and transforming it into the one with more soul (Hodgkinson and Healey, 2011; Minoja, 2012). In conjunction with the traditional market based view and resource based view, an institutional based view is proposed by Peng *et al*. (2009) as a third leg of strategy.

Moreover, aside of the strategy discipline, the new institutionalism movement (Scott, 1995; DiMaggio and Powel, 1991) correctly points out the limits of a rational choice framework of economic decision making. However, by failing to explain the sources and avenues of modifications of those constraints, the new institutionalism alone is unable to provide a satisfactory explanation of change. Finally the capability approach, especially dynamic capability view (Teece *et al*., 1997; Helfat et al. 2007; Teece, 2007) has brought the need for ambidextrous kind of organizations (O'Reilly and Tushman, 2008) that respect duality at a corporate level which implies that the corporation has to manage competences and transactions simultaneously, or put differently, the mechanisms of the firm involve both economizing transaction costs for static efficiency and generating values through learning and innovation for dynamic efficiency.

Within the organizational studies, King's, Felin's and Whetten's (2010) meta theory of the organization as a social actor is proposed. Actually it suits as an good example of holistic meta paradigm. It highlights organizational intentionality and sovereignty, beside coherence and identity, as well as distinctive social actor status of the organization. That puts the corporation itself in the central position as acting subject, while its board and management plays an even more influential role in shaping overall corporate performance and related responsibilities (Minoja, 2012).

All mentioned implies that the special attention is to be dedicated to adequate corporate behavior as well as on creating the value for stakeholders and achieving the corporate sustained success, all in one.

It is on a discipline academics and practitioners to approve or disprove whether is just a context change happening or is the real paradigmatic shift going on, but following Kuhn, the later occurrence might be closer to the present reality. In his well-known treatise on how science progress, Kuhn (1962) stated that the fields develop through paradigm shifts, intermixed with periods of "normal science" during which the implications of the paradigm are explored. When a new paradigm emerges, it calls for the agreement on at least (new) basic ontological enquiry, hoping for an adequate epistemological sustain of the changed reality in form of new knowledge, meaning and understanding. Ontology is defined as the branch of metaphysics dealing with the nature of being (Oxford dictionary, 1992, p. 829). Thus, with respect to all tackled global business' nature change, as well as the incidences within the disciplines that CG as a field is naturally related to and shares an attitude of the corporate survival and sustained successful performance as an overarching goals, the reconsideration of CG practice is to be observed in parallel with the ongoing transformation within the related fields. Since, like Rumelt, Schendler and Teece have objected for the strategy management, it seems that the corporate governance as an intrinsically interdisciplinary field could not be regarded any more through an unifying, but rather as an integrated meta paradigm lenses (Rumelt *et al*, eds.,1994, p.1).

For articulation of the fundamental issues underlying the extended and arguably changed field domain, the meta theory of the organization as a social actor, as well as dynamic capability view that comprises three generic, behaviorally based higher order capabilities actually suit as a good starting point for shaping the new holistic CG frame, labeled here as RCGV. Such an approach might be helpful in resolving some of still under-explained, but fundamental questions in stakeholder orientation, i.e. to whom the company is responsible, whose expectations are to be respected, to what extent, when and how?

4. RELATIONAL ASSETS AND DYNAMIC CAPABILITIES VIEW

With respect to previously mentioned board's strategic as well as service or resource provision role, an extended CG view implies that both of the roles have an extended scope. Taking the view of corporation as a social actor as well as an organization, its assets may be classified as: financial, physical, relational, human, cultural, practices and routine assets, and intellectual property assets (Marr et al. 2004, p. 315). Using of the assets terminology that are usually grouped as tangible and intangible, of particular interest in fast changing hypercompetitive environment are intangible assets that are understood as a critical value drivers (Hall, 1992).

Intangible assets defined by Itami as invisible assets are information-based, which includes technology, consumer trust, brand image, corporate culture, as well as management skills. According to Itami they are the most important resources for long-term success because only invisible assets can be used simultaneously in several areas (Itami, 1987). Intangible assets are defined as those assets whose essence is an idea or knowledge, and whose nature can be defined and recorded in some way (Hall, 1992). The author splits them into intellectual property (those assets for which the organization has property rights) and information or knowledge assets (those assets for which the organization does not has property rights). Intangible assets drive capability differentials, which in turn drive sustainable competitive advantage, which is why organizations need to bring intangible resources and core competences into their strategic thinking (Hall, 1993).

Relationship assets rest and could be cultivated in the relationship between an organization and its internal and external stakeholders as well as in their interactions. Relationships can include official relationships such as partnering or distribution arrangements as well as non-formalized relationships. Itami (1987, p. 19) has first started to highlight the information or knowledge exchange between company and their external environment. Information flows from the company to the external environment include corporate reputation, brand image, corporate image, and influence over the distribution channel and its suppliers. Hall suggests that reputation is, along with human capital, the most valuable corporate intangible assets (Hall, 1992). Besides, it is the most reliable safeguard of corporate relational assets and especially stakeholder relations, both primary and secondary (Mahon, 2002).

Corporate reputation (CR) is the fundamental bond between company and its stakeholders, which by shaping the way of their behavior, can generate many favorable consequences to a company (Fombrun and Shanley, 1990, p.233), since it is a concept held in the minds or cognitions of stakeholders (Bromley, 2000). It is a reflection of social evaluation of the firm (Deephouse and Suchman, 2008), whose value steams from the positive collective perception of stakeholders (Pfarrer *et al.,* 2010). Corporate reputation is viewed through economic and social contexts, as intangible resource and as corporate liability, in parallel. Within the resource view, reputation is considered as strength and opportunity making construct (Fombrun, 1996), while within governance view, reputation is regarded as corporate behavior' restrictive effects generating and binding construct, due to fulfillment of stakeholder expectations (Mahon, 2002). While summarizes all what is known about the company (Schultz *et al.*, 2001), reputation may be considered as a mirror in which the company can accurately see its history, current market reflection and its internal situation (Dortok, 2006; Fombrun, 1996). Thus without an acceptable reputation, it is very difficult for a corporation to survive or to make progress.

Reputation entails two main components: p*erception* - how the company is perceived by all stakeholders; and *reality* - the truth about a company's policies, practices, procedures, systems and performance (Schultz and Werner, 2005). Consequently, due to its informational asymmetry power, it is a suitable corporate tool for influencing stakeholders' perception (Weigelt and Camerer, 1988). CR is formed directly through stakeholder's experience in relations with the company, or indirectly, through a recommendation of intermediates, media or participants of direct interaction (Fombrun in Hitt *et al.,* 2001, p.296). Companies can have reputations for different characteristics, behaviors or outcomes (MacMillan *et al*., 2005, p. 217), but whatever kind, reputation is fragile, easy to ruin, hard to recover, its safeguarding is employees and employers job, but its managing is board's duty. Since CR encompasses all of the company's explicit and implicit promises toward its stakeholders (Devine and Halpern, 2001), based on past actions in similar situation (Mahon, 2002, p.418), it reflects corporate conformance and performance, simultaneously.

The assistance of a good reputation in empowering company's relational skills within stakeholder network, for the company is important not only from the perspective of the influential groups for its survival and achievement, but also as an external source of new information, ideas and knowledge that could help boards in better decision making and direction of the company, in terms of sensing and seizing opportunities and deterring threats. To be able to, company has to have developed dynamic capabilities (Teece, 2007; Teece *et al.*, 1997). Capabilities refer to a firm's capacity to deploy resources, usually in combination, using organizational processes, to effect a desired end. They are information-based, tangible or intangible processes that are firm-specific and are developed over time through complex interactions among the firm's resources (Amit and Shoemaker, 1993, p.35).

Dynamic capability (DC) is the capacity of an organization to purposefully create, extend, or modify its resource base (Helfat *et al*., 2007, p.1), understood as a higher-order skills that help in creating, reconfiguring and balancing of organizational resources and capabilities (internal perspective), in identifying, knowing and realizing opportunities, and in timely detection, offsetting and managing threats (external perspective), linking the external and internal company's environment (Tomšić, 2013b). DC can be disaggregated into the capacity: to sense and shape opportunities and threats; to seize opportunities; and to maintain competitiveness through enhancing, combining, protecting, and, when necessary, reconfiguring the business enterprise's intangible and tangible assets (Teece, 2007, p.1319). For the purpose of RCGV, DC can be defined as collective, managerial and organizational capacity of corporation to purposefully revitalize and transform its resource base in order to achieve congruence with the changing ecosystem, ensuring an ecosystem's corporate fitness and thus corporate sustainable development (adjusted, based on Helfat *et al.*, 2007; Augier and Teece, 2009).

Relevant field research highlights the importance of dynamic managerial capabilities as the key mechanism to achieve congruence between the firm's competencies and changing environmental conditions. Adner and Helfat (2003, p. 1012) define dynamic managerial capabilities as the capabilities with which managers build, integrate, and reconfigure organizational resources and competencies. They insightfully identify the three attributes underpinning dynamic managerial capabilities as (1) managerial human capital, (2) managerial social capital, and (3) managerial cognition. Managerial human capital includes the skills and knowledge repertoire of managers, which are shaped by their education and personal and professional experiences. Managerial experiences in specific contexts allow managers to acquire and develop specialized knowledge and skills, while managerial social capital involves managers' ability to access resources through relationships and connections (Adler and Kwon, 2002). Managers' formal and informal network ties help acquire essential resources and provide them with critical information for decision making. Managers' human capital and social capital are linked because the information and knowledge that managers gain through various relationships can be crucial in building and renewing their human capital (Coleman, 1988).

Dynamic managerial capabilities are driven by managerial cognition, which consists of the belief systems and mental models that managers use for decision making. Managerial cognition is shaped by personal and professional experiences and managers' interactions in internal and external networks (Adner and Helfat, 2003). All three elements of dynamic managerial capabilities: human capital, social capital, and cognition are intertwined. But Kor and Mesko extended the perspective by arguing that the three elements of dynamic managerial capabilities are vitally linked to the notion of managerial dominant logic such that they are the key inputs in shaping this logic. Managers' dominant logic refers to the way in which managers conceptualize the business and make critical resource allocation decisions. (Kor and Mesko, 2013, p. 235). This logic represents management's view of the world, where the firm stands in its business environment, and what it ought to be doing. Dominant logic is an articulation of the fundamental strategic beliefs, assumptions, and intentions of the CEO and senior management (Lampel and Shamsie, 2000).

For the conceptualization of RCGV Kor and Mesko idea will be borrowed for developing of board specific dominant logic, enriched with, corporate reputation in the position of balancing corporate governance mechanism (Tomšić, 2013a), both aimed at cultivating corporate fitness, thus shaping a dynamic corporate governance model.

5. CONCEPTUALIZATION[2]

Many different kind of relationship has been conceptualized so far within and between firms, such as joint ventures, alliances and networks, highlighting their firm-specific role contributing to a better performance (eg. Dyer and Hatch, 2006; Helfat *et al*., 2007). But there is no limit to apply such logic to a corporate stakeholder network. Stakeholder relations are firm specific, customized web of corporate life and are equally suitable for internal and external exchange of intangible assets, such as information, knowledge or ideas. Relational advantage approach (Dyer and Singh, 1998) postulates that some unique assets of company's need outside of its boarders are reachable but only through a form of willingly exchanging, not through formal contractual relationship. It is up to corporation to learn how to use them as well as to develop specific mechanisms for the purpose. Such kind of capability could be developed at the corporate level, sustained by a mediating role of its boards, supervisory and management, since they represent a decision making authorities of the corporation as a whole. Within this article, the corporate level

[2] Conceptualization is an extraction of the forthcoming doctorial thesis theoretical and empirical research: Tomšić, D. (2013): The role of corporate reputation in building dynamic capabilities of firms. Zagreb: Faculty of economics and business.

of performance as the unit of analysis is regarded, with respect to all three basic board's role, but in particular strategic decision making and goal setting activities.

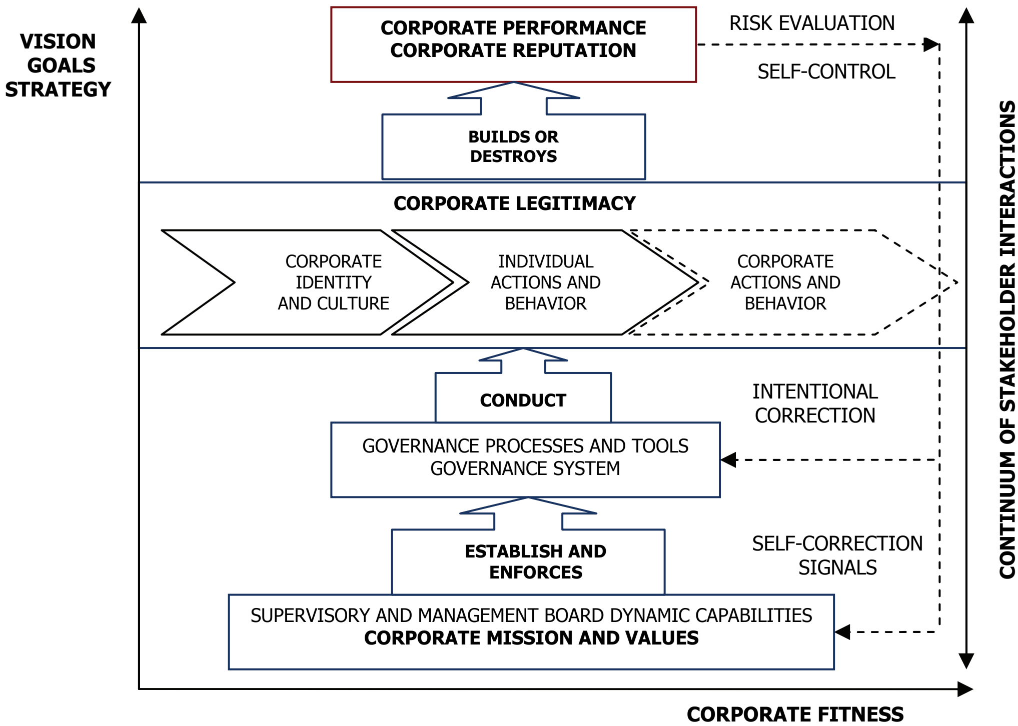
Bringing the capability notion within CG field actually means that the whole new perspective, aside of transactional contracting in taken, since the term governance is traditionally associated with lowering transactions costs between contracting parties and arranging incentives in such a way (Lindberg, 2003., p. 71). Transaction cost economics (Williamson, 1985) has strongly influenced understanding of governance so far, thus good cooperation is seen as a transaction with low transaction costs of contractual relations. But, on the other side, many scholars including transaction cost economists have observed that the governance of interorganizational exchanges involves more than formal contracting, since are typically embedded in social relationships. Dyer and Singh have proposed a relational view of a cooperative strategy as a source of interorganizational competitive advantage, thus starting the avalanche of research with respect to privileged interfirm exchange of routines and knowledge, suggest that a firm's critical resources may span firm boundaries and may be embedded in interfirm resources and routines. Relational capacity is defined as the ability and willingness of companies to the partnership through which can reach resources and capabilities beyond its borders (Dyer and Singh, 1998:672).

Besides, they have defined the relational rent notion as a supernormal profit jointly generated in an exchange relationship that cannot be generated by either firm in isolation and can only be created through the joint idiosyncratic contributions of the specific alliance partners (Dyer and Singh, 1998, p. 660). Relational contracts are defined as informal agreements sustained by the value of future relationships (Baker *et al.,* 2002). Relationally based governance emerges from the values and is agreed-upon processes found in social relationships which may minimize transaction costs as compared to formal contracts. For such relationally-governed exchanges, the enforcement of obligations, promises, and expectations occurs through social processes that promote norms of flexibility, solidarity, trust and information exchange (eg. Poppo and Zenger, 2002 for review).

The challenge of this article is to propose ecosystem's corporate fitness as an ultimate goal of a good corporate governance practice, and as a dominant board logic that should be grounded on a similar set of capabilities. The strategy management field literature is already familiar with the different forms of performance fitness. Helfat *et al.* (2007) contrasted evolutionary (dynamic, external) fitness with technical fitness. Technical fitness looks upon how effectively a capability is performed, while dynamic fitness, by which external fitness is meant regards whether the right activity is being performed. The latter is about making the right investments at the right time, and lining up the necessary complements (Augier and Teece, 2009, p. 412), but both are adaptive in nature. Thus, Teece has additionally proposed entrepreneurial kind of fitness, highlighting so the element of dynamic capabilities that involves shaping the environment capacity, which is entrepreneurial in nature.

Here proposed ecosystems' corporate fitness (ECF) stands for the context and performance integrated - industrial, social and institutional - dimensions of business fitness of a corporation. In particular, ECF is designed as a measure for the corporate capacity of self-regulated governance. To be able to practice fitness of a kind, grounded on a similar self-governance capacity, labeled here as ecosystem's corporate fitness capability (ECFC), corporation needs to develop and sustain its relational resources and routines and a favorable corporate reputation, due to the convenience of reputation's dynamic nature. In accordance with the definition of organizational capabilities, corporate fitness capability is composed of: (1) sensemaking ability for overarching supraindividual goals as a dominant logic; (2) ability to adopt, master and making use of dynamic capabilities sustained with favorable board-member reputation; and (3) the ability to understand stakeholders' attitudes and balance their expectations and demands through direct and indirect interaction.

Figure 2: The model of ecosystem' corporate fitness capability – ECFC within RCGV



Following Weick's call for explaining "more verbs instead of nouns" (Weick, 1995, p. 198), taking social actor lenses as corporate governance meta-theory, as well as dynamic capability and stakeholder orientation in term of boards and stakeholder engagement, the conceptualization of RCGV starts with the allocation and the recognition of roles. Following Kor and Mesko (2013) idea, the new dominant logic construction would be, as follows: (1) the company as a social nexus takes the principal role and becomes the acting subject; (2) board takes the member-agency role and become the performing predicate; (3) corporate goals, actions and a mode of behavior become the object in focus; and (4) corporate reputation become a new corporate governance mechanism as well as a self-regulated and directed tool for developing and sustaining ecosystem corporate fitness. Finally, as an overall outcome of the RCGV perspective, the flexible and dynamic model of corporate governance practice is shaped and depicted within figure 2. as the role model.

The framework reveals core corporate governance processes with respect to mission, identity and legitimacy as a constructive elements of corporate reputation, and paths of their linkage with corporate goals and chosen strategies in order to calibrate stakeholder alignment. Thus, boards have got both market and non market evaluating tool, suitable to audit corporate direction and control processes in form of achieved positive or negative reputational change. Moreover, direct and indirect relations between framework elements point to a dynamic process view of corporate governance that places reputation in a mediating position for the corporate goals setting and for the manner the performance is to be conduct in order to achieve and sustain corporate fitness. The role model corporation from a perspective of RCGV is in need of a good corporate reputation, since it is taken as a criterion for stakeholders' interaction entry decisions.

6. DISCUSSION AND FINDINGS

The challenge of this article is to propose ecosystem's corporate fitness as an ultimate goal of a good corporate governance practice and RCGV as flexible and dynamic corporate governing meta-model. In doing so, the basic step to be taken is to reorient overall board members mindset from short term and individually opportunistic toward supraindividual overarching goals to act appropriately (Lindenberg and Foss, 2011, p.504). Moreover, since board cognition mediate the relations between corporate context and the strategic responses to environmental change, to be able to cope with external and internal pressure and expectations of good performance and behavior board, equally as management are in need of dynamic capabilities, especially its sensing capacity, in order to achieve ecosystem's corporate fitness.

6.1 Sensemaking ability for overarching supraindividual goals and mindsets

By its very nature, sensemaking is an interpretive process that people use to place equivocal and ambiguous environmental stimuli into defined cognitive schemas, or mental frames that allow them to make sense of those stimuli. Organizational sensemaking allows organization members and groups to develop commonly shared meanings about key features, such as the organization's meaning, which issues it faces, and how to resolve these issues (Weick, 1995). Through organizational sensemaking, individuals and groups interactively create their social reality, which ultimately becomes the organizational reality. Sensemaking processes are important in organizational life and strategic decision making as they allow determining reference points and suggesting possible outcomes of organizational actions (Gioia and Chittipeddi, 1991).

At the board level, sensemaking processes involve as well activities such as environmental scanning and issue interpretation, which in turn influence decisions about corporate activities and goals setting. Board as a decision making authority of the corporation as a whole have to have a good understanding of a corporate mission and the values it sustains and revolves. Mission and values serves as a starting element of the corporate strategic goal framing through which the organizational and consequently corporate identity emerge. Aligning of corporate goals set with the corporate mission and identity oriented toward stakeholder value creation is assuring the mutual understanding of overarching supraindividual corporate goals. Overarching goals combine cognitive and motivational elements. When they are activated, such goals "frame" a situation by steering important cognitive processes in the service of the focal goal, a process in which motivation expresses itself though cognitions. Supraindividual mindset means to sustain collective orientation instead of individual opportunism. (Lindbenberg and Foss, 2011, pp.504-505).

Within the RCGV there are two goals of a kind that are valid for board decision making: the first is to act appropriately and fair and the second is to respect reputation effects and its risks consequences. They are here proposed as a new generic corporate dominant logic.

Stakeholder-oriented discourse emphasizes the communal aspects of reputation by reconstructing the business in a reciprocal relationship with its surrounding community (Lähdesmäki and Siltaoja, 2010, p. 213). According to Bosse *et al.,* (2009) people behave reciprocally by rewarding others whose actions they deem fair and willingly incurring costs to punish those they deem unfair. The underlined logic here goes for the corporation and its board behaving and acting. The idea that norm-based social control mechanisms - like reciprocity - commonly influence the behavior of parties to an incomplete contract is well established. Therefore, the level of contribution nonemployee stakeholders provide to the firm can also be expected to vary according to their perceptions of reciprocity. That is, variance in stakeholders' reciprocal behavior toward a firm hinges on the same thing that influences employees' reciprocal behavior—their perceptions of fairness (Bosse et *al.*, 2009, p.451). Thus, any stakeholder that perceive a firm as fair across all three types of justice, distributional, procedural and interactional will have an incentive to contribute more positive effort to the firm than those that perceive the firm is unfair on every or one of these dimensions.

Acting appropriately stands for the goal setting mode in the best interest of the corporation, with respect to its corporate mission, identity, legitimacy and reputation. This imaginary chain actually represents the internal and external perspective of corporate reputation building, which emerges as an outcome of firm interactions that spans all groups of corporate stakeholders. Bosse *et al.* (2009) have empirically tested how perceptions of fairness result in reciprocity extending toward all stakeholders of the firm, and thus positively affects firm performance. Thus, when board' decision-making is perceived as being appropriate and fair, stakeholders' reaction upon taken decisions is expected to be favorable as well, even though some decisions might not meet stakeholder expectations (Fassin, 2012). In the RCGV model, management board is considered also as a stakeholder group. Following overarching, supraindividual goals setting logic, the board should not have more doubt about goals' paradox expressed as the picking-achieving system of equations (Tomšić, 2013a, p.848).

Having in mind that corporate reputation is created both inside and outside of the company, it reflects the quality and the efficiency of the way the company is conduct. The quests of direction, control and responsibility could be well sustained by use of corporate reputation. Thus, CR is suggested as an integrated, internal and external corporate governance mechanism (Tomšić, 2013a). By using of social discourse, reputation could be portrayed as a control mechanism because it tells others about company's compliance with norms and even about how the business is conducted from the moral point of view. In this normative sense, the discourse is based on the kind of social control and is therefore understood as a mechanism to ensure compliance with norms (Lähdesmäki and Siltaoja, 2010, p. 214-215).

But moreover, the reputation role as the governance mechanism expands when is supported by reputational risk management approach. Building on Scadizzo, reputational risk can be seen as a function of the gap between stakeholder expectations and the company performance, with the former measured through regular attitude surveys and the latter through specialized audits (Scandizzo, 2011, p.50). Thus the management of reputational risk is as much a matter of governance, information gathering, accountability and controls as it is a by-product of a firm and its people's commitment to stay true to its mission and its values in their day-to-day work.

Corporate board decision making, in order to safeguards or to reshapes stakeholders' alignment and corporate reputation, has to be performed with a high awareness of reputational risks and its effects on companies control governance mechanisms. The board capable of and willing to perform in line with here proposed generic corporate dominant logic, essentially demonstrates distinguishing, corporate governance specific facet, suitable for sustaining corporate governance overall performance, and thus achieving and sustaining ecosystem's corporate fitness.

6.2 Ability to adopt, master and making use of dynamic capabilities sustained with favorable board-member reputation

Within RCGV board takes the member-agency role and becomes the performing predicate. Being in such position, board reputation affects overall corporate reputation. Besides, board reputation could be assessed through its members individual or collective perspective, thus it is important to create and sustain positive individual and collective favorable reputation of board members, since it is taken as a criterion for stakeholders' interaction entry decisions. Stakeholder support, on the other hand is needed for the strategy implementation as well as for the developing of beneficial relationships, to be of use for a company. Relationship to stakeholder group is to be assessed from descriptive, instrumental and normative view (Donaldson and Preston, 1995) of their salient expectations in order to calibrate overall corporate performance. As the descriptive perspective, within RCGV, the corporate dominant logic is understood.

RCGV anticipates that dynamic sensing, seizing and transforming capabilities, as they are introduced in organizational level form are the prerequisite of modern governance in ever-changing environment. A company that is excellent at making the wrong things will fail (Augier and Teece, 2009, p. 411). Arguably, corporation without the board, capable of sensing stakeholder expectations, expectations' gaps and the level of their satisfaction that is achieved so far by actual corporate behavior and performed CG practice, has a huge obstacle in its way to become ecosystem's fit. It especially matter when corporate goals are set and strategies approved. Moreover, board unable of seizing capability, in form of making strategic decisions as well as timely investment decisions, arguably harms corporate resource base and future potentials. The transforming capability within CG perspective actually refers to management board oriented actions with respect to its performance.

Board unable of transforming the management board timely, which implies the replacement of underperforming managers, rewarding of over-performing, and undertaking other necessary sensing, seizing and transformation oriented activities could be considered as the board with unsatisfying governance capacity, and as such a kind of threat and weakness for overall corporate performance, as well as its prospects for survival. Moreover, with respect to its control and strategic role, board that does not sense, act and intentionally correct all the corporate activities that endanger corporate performance or its reputation might be considered as failing in its both, monitoring and directing role, that will consequently weaken its services or resource providing role too.

Following Adner and Helfat (2003) concept of dynamic managerial capabilities can be helpful for explaining the differences in board members respond to changes in the external as well as internal corporate environment. The three attributes could be taken as underpinning indicators of their dynamic capacity on personal level, namely, board member human capital, social capital and cognition, and how they affect particular board member's ability to sustain corporation's fitness and overall performance within his or her assigned board member role and supervisory duty.

The board capable of mastering organizational and individual level dynamic capability, essentially demonstrates self-regulating capacity as the distinguishing, corporate governance specific facet, suitable for sustaining corporate governance overall performance, and thus achieving and sustaining ecosystem's corporate fitness.

6.3 Ability to understand stakeholders' attitudes and balance their expectations.

Corporate behavior as well as its reputation outline an overall corporate performance in terms of economic, financial, social, and environmental outcomes (Fombrun 1996, p. 399) since, while operating, companies interact. These interactions "take place both in the marketplace of goods and services (where strategy is focused) and in the marketplace of ideas (where corporate social performance and political strategy research are focused)" (Mahon, 2002, p. 417). As the consequence of company's interactions, its reputation emerges, encompassing; on the one hand, it's both market actions and behaviors that praise the corporation's competitiveness and conformance at the same time; on the other hand, the extent of stakeholder expectation fulfillment. By obeying to legal and regulatory institutional framework of the environment they operate within, corporations meet a minimum of requirements, in particular a necessary part of their legitimacy. But beside regulative terms, there are normative and cognitive ones (Wang, 2010, Deephouse and Carter, 2005) company should not disregard in order to assure the sustained development of its business activities and an acceptable reputation, as well. So, pursuing of corporate principles, practices and values represents the board-chosen path that deliberately shapes corporate behaving.

Companies that act and perform below stakeholder expectations are gaining unfavorable reputation, which restricts their prospects of long term successful performance (Scandizzo, 2011). As figure 2. depicts, CR is situated as corporate performance consequence, and as antecedent in a next business cycle, as well. By respecting reputational change, board actually has an indirect and direct stakeholder feedback response with regarding corporate direction and behavior, and is in position to deliberately adjust corporate processes. To meet the stakeholder expectation(s) regarding overall corporate performance without significant gap is a hard corporative goal to achieve, but could be calibrated better by delving into the mode of meaning(s) (re)construction to reputational dimensions change. Referring to the doctorial thesis empirical research performed in Croatia in 2012 on a simple of 1000 biggest companies (ranked by total annual income), results point out to emergence of the relational dimension of reputation. Thus, the functional, relational, affective and social dimensions are proposed as the newborn taxonomy of corporate reputation. Table 1. summarizes the empirical findings.

By following new, four-dimensional reputational taxonomy, the interpreting of changes in corporate reputation might be much more accurate than it presently is, if is evaluated through each of four proposed dimensions. Herewith, market performance could be matched with functional reputation, behavior with relational reputation, corporate social responsibility and citizenship with social reputation, and appearance with affective reputation. Besides, such a framework allows for matching, even mapping of relevant primary and secondary stakeholders' requirements toward a company, and thus achieving more calibrated decision making, regarding the targeted extent of stakeholder satisfaction.

Table 1: Corporate reputation generic four dimensional taxonomy

REPUTATION	*Functional*	*Social*	*Affective*	*Relational*
Reference	Objective world of the true Performance tags of functional system	Social world of the good Ethical standards Expectation gap	Subjective world of the beautiful Individual character Image	Experiential world of (direct and indirect) interactions Values, culture, behavior organizational identity,
Indicators	Competence Success	Integrity Responsibility	Attractiveness Uniqueness	Relationship mode Fairness
Appraisal style	Cognitive-rational	Ethical	Emotional	Behavioral
Sub dimensions	Performance Quality Capability	CSR Citizenship	Communication Emotions Character	Trust and credibility Commitment Reliability and responsibility Legitimacy

Izvor: Tomšić, D. (2013b). The role of corporate reputation in building dynamic capabilities of firms. The doctorial thesis in preparation. Zagreb: Faculty of economics and business. The model is built on the basis of Eisenegger and Imhof (2008, p.130).

Respecting previously stated theoretical and empirical research results of CG and CR fields, as well as proposed conceptualization insights, the governance control mechanisms and reputation dimensions relationship could be accessed through high-medium-low scale, a kind that is common at risks management practice. Thus, following proposed dominant logic, corporate board decision making, in order to safeguards or to reshapes stakeholders' alignment and corporate reputation, has to be performed with a high awareness of reputational risks and its effects on companies control governance mechanisms.

Besides, having in mind that stakeholder' relations could be regarded as the firm specific network reveals the hidden talent of corporate reputation: a company that posses positive reputation, and is perceived as behaving fairly within its complex network of internal and external relationships may use its reputational platform as a kind of privilege information and knowledge sharing space that Nonaka and its colleagues labeled as *Ba*: the shared context for knowledge creation (Nonaka *et al.*, 2000).

Corporate reputation, viewed in such an dynamic mode, actually means its transformation from one-directional (inside out) oriented emitting resource to bidirectional, two ways (inside out and outside in) operating flow, which capture is role as a resource and as a driver capability. Reputational capability is defined as the capacity of companies to make use of their reputational potential in order to create, develop, maintain and exploit interactions with stakeholders within the overall performance context for the purpose of knowing valuable and relevant information, ideas and knowledge, and for the effective balancing of the company's resource base. Since stakeholders in interaction with the company gain experience and feelings of it, directly or indirectly, that form their attitude, and moreover their behavior toward the company in focus, by making use of its reputation capacity a company may achieve better understanding of its arms length as well as embedded relationships, thus cutting the expectation gap (Tomšić, 2013b).

In line with previously stated propositions, the board able to understand stakeholders' attitudes and balance their expectations essentially demonstrates leveraging capacity and a dynamic flexibility of corporate governance practice, suitable for sustaining corporate governance overall performance, and thus achieving and sustaining ecosystem's corporate fitness.

7. CONCLUDING REMARKS

The challenge of this article was to propose ecosystem's corporate fitness as an ultimate goal of a good corporate governance practice and RCGV as flexible and dynamic corporate governing model. By orienting towards relational aspect of corporate governance, the missing link for a holistic perspective is highlighted and added, in particular, ecosystem stakeholders' interacting. Besides, the idea of the paper might help in resolving many ongoing debates within the field. Corporate reputation potential, along with dynamic capabilities, corporate and board', are surely surprising as being introduced to corporate governance field. However, in searching for improvements of effectiveness and efficacy of governance system, and in sensing and implementing corporate change and renewal in a manner that is highly regarded in market as well as in non market arena, they are more than desirable and robust concepts. Their significance is expected to increase in the future, as they form a constituting part of the business sustained success.

Social actor meta-theory seems like the promising avenue for resolving many under-explained questions within stakeholder orientation. Corporate fitness as well as the underlying capability that are in line with the contemporary strategy's state of art hopefully will served as the new path for developing of more efficient and effective corporate governance practice, possibly as the yardstick for corporate governance quality. The insights and propositions offered here need to be further empirically tested in order to gain the firm inference and explanatory power, which is considered as the major limitation of the article.

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CORPORATE CRISIS AND CRISIS STRATEGY IMPLEMENTATION

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Abstract

Crisis creates or can create undesirable outcome for corporations. Corporation's most often response to a crisis is implementation of a radical change, which represents management's reaction to a direct and for survival of the company dangerous threat. Management, that implements crisis strategies, must be able to manage change during crisis. Based on the estimation of the corporation's condition and desired outcome, strategies implemented during crisis can end up with two diametrically opposite effects – corporate survival or leaving the business. Business failure is not the only solution for a company in crisis. Successful turnaround and crisis solution are a possible option, but a possibility of an option doesn't guarantee that it is a most probable option. Successful turnaround and crisis solutions don't occur spontaneously; they are triggered by corporate management, its creativity and courage to implement radical change.

This research is based on investigating internal and external sources of corporate crisis and a role of major stakeholders in the process of corporate recovery. The research includes investigation of corporate response during crisis and this could broaden our basic understanding of strategy implementation role in the extremely delicate moment of company's life. Since corporate crisis negatively affects company's goals and can lead to corporate breakdown, this research is offering results of an empirical investigation that determines modes how companies in a crisis manage change and how managers choose and implement offensive and defensive strategies suitable to crisis conditions.

Key words: *corporate crisis, crisis management, radical change, crisis strategy, turnaround.*

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1. INTRODUCTION

Every company is developing under conditions of risk of crisis and during this process its environment is constantly creating new threats to its existence and its business operations. Only in very rare cases companies after long time period don't fall into crisis, which if it is not solved in time, can cause possible breakdown of the company. Every day we witness global big companies' bankruptcies and business failure for many other companies, especially those that didn't adjust their strategies to substantially different economic or political conditions fast enough.

There is no universally accepted definition of crisis, but majority of authors agree that a crisis in general is a very negative event that can damage or even destroy every organization (Mitroff, Pearson, Harrington, 1996). This leads to a conclusion that crises are events that have internal damage potential and disastrous effects (Crandall, Parnell, Spillan, 2010) and they result with negative public perception. Since corporate crisis is damaging corporate goals and can lead to its business breakdown, it is of great importance to determine ways how management leads change and how managers choose and implement strategies suitable to crisis conditions.

2. CORPORATE CRISIS AND CRISIS STRATEGIES IMPLEMENTATION

Corporate crisis represents unplanned and unwanted process that damages primary goals of a company and implies ambivalent outcome (Osmanagić-Bedenik, 2003). Crises are threats to

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company's business and they create or have potential to create negative and unwanted outcomes in terms of efficiency and effectiveness of the business. Increase in uncertainty and risk on a global level implies larger vulnerability of the companies. Regardless on different reasons causing business crises, they can be externally or internally generated.

Crisis is a decision in a state when corporate disease and corporate health are faced. Business crisis demands a radical change – the one that implies possibility of reaching highly desirable and positive outcome or the one that implies highly unwanted and negative outcome.

2.1 Corporate crisis - conceptual background

Majority of corporate crises occur due to incapability of management to anticipat changes in company's surrounding (Mitroff, Anagos, 2001). Companies in crisis face many different reasons for failure. Most common external reasons for corporate failure are changes in industry/market structure, decrease in market share and loss of main customers, loss or problems with main suppliers, problems with ensuring „fresh money“ due to the lack of creditor's confidence, changes in legislation etc. Internal reasons are usually connected to incapable and inefficient top management (DiNapoli, 1999). Most common mistakes of management of a corporation in crisis are bad decisions on credit loans (debt), overcapacity of production, low responsiveness to changes in business environment, loss of operational control – especcially over cash flow, costs and business performance – that leads to insolvency. Main symptoms of companies in crisis can be extracted from all of this – decrease in sales volume, decrease in capacity usage, decrease in profit margins, increase in costs, increase of indebtedness, impossibility of paying loans, impossibility of paying taxes, impossibility of paying suppliers, impossibility of paying employees, impossibility in setting new orders and taking future obligations (Sloma, 1999).

Crisis management is a relatively new field of management, which includes identification of the nature of a crisis, intervention to minimize damage and activities for crisis recovery, often with a strong focus on public relations to recover any damage to the company's public image and to assure stakeholders that recovery is underway. Critical fields of crisis management are identifying the crisis, isolating the crisis, crisis communication, controlling the damage, assembling a crisis management team, creating a crisis management plan, crisis intervention with crisis forecasting and taking responsibility for the outcome. When meeting previously listed tasks Mitroff (2004) makes an important distinction between crisis management and crisis leadership. Crisis management is mostly reactive and recognizes crisis after it happens, while crisis leadership is proactive and it is trying to identify the crisis and prepare the company for its consequences before the crisis actually happens.

Crucial concept on which effective top management can base corporate recovery is break-even analysis that gives information about is it possible to start with saving a corporation in a crisis. Profit, positive cash flow (that ensures solvency) and EBITDA are three goals based on which corporate recovery should be managed – if the assumption is that none of the goals can be met, company will not be able to survive (Platt, 1998). The EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) of a company gives an indication on the operational profitability of the business. A negative EBITDA indicates that a business has fundamental problems. A positive EBITDA, on the other hand, does not necessarily mean that the business generates cash. This is because EBITDA ignores changes in working capital, capital expenditures taxes and interest. Decrease (deficiency) in working capital is one of the consequences of financial breakdown of the company, increased level of indebtedness, impossibility of acquiring of bridge capital and all of this is pushing company toward insolvency and illiquidity. If a company is reports loss in business, especially if the loss is higher than the initial capital/ equity increased for undistributed profit and reserves, then the company reports losses that exceed equity (reported in the balance sheet assets) and this in combination with insolvency is creates a legal obligation for crisis management to submit proposal for starting the bankruptcy procedure at the court of competent jurisdiction. The reasons for bankruptcy are inability in payment and over indebtedness. Based on this, for a company in crisis it is essential that its management effectively recognizes signals of the crisis, creates crisis plan, implements one or (usually) more crisis strategies, maintains positive cash-flow, avoids longer blockades of companies account and prevents legal conditions for bankruptcy to occur (Kružić, Glamuzina, Lovrinčević, 2013).

Some of the significant problems manifested during the crisis are exerted and limited financial resources (usually accompanied with insolvency threats), loss of operational control (over budget, costs, performance, cash flow), demoralized management, employees worried for their working positions, unsatisfied suppliers and bankers (due to the delay in payment) and scared owners of the companies. All these issues must be resolved to create a turnover in company's performance towards stable and re-established growth. This is crisis management's main goal during corporate turnaround (crisis management is very often "new" management that replaced "old" top management on the incentive of shareholders/owners).

2.2 Radical change – corporate response to a crisis

When corporate crisis lasts for a longer period, the chances for a successful recovery and survival diminish – poor crisis management can, based on the research results conducted by Ucelly (2002), destroy company's reputation and bring to legal consequences, usually leading to bankruptcy. Goldman and Traverso (1997) offered analysis which implies a conclusion, that in a case of early detection of crisis and under assumption that a company has a good and successful management, improvement is possible and solving the crisis is relatively probable without serious consequences for the business.

Main goal of the company's management during crisis is to minimize threats and ensure successful renewal and recovery, while the factors of complexity and intensity from the surrounding are implying different reactions (Table 1) from the crisis managers.

Table 1: Actions taken in corporate renewal

Management's actions	Turnaround – focus: loss elimination	Crisis solution – focus: survival
Product review and expiration	X	
Right size the workforce	X	
Determine full products costs	X	
Reprising products	X	X
Establish new wage and benefits levels	X	X
Downsize operations	X	X
Restructure debt	X	X
Lay off employees	X	X
Improve working capital management	X	X
Extend or compose debts	X	X
Negotiate partial settlements with creditors		X
Liquidate		X
File for bankruptcy protection		X

Source: Platt, 1998, p. 5.

During crisis companies are reaching a point from which they cannot return and suffered losses and damages are significant and measurable. Speed and intensity of changes are demanding from crisis managers to manage process of the crisis effectively. During beginning phase of the crisis company is experiencing problems, but is has enough time and resources to find operational solution for recovery – it is constantly showing loss in business, but they are not interpreted as a possible threat to the existence of the company. But if the losses continue to occur, company will relatively fast face threats to its existence. To avoid the danger of breakdown and a possible bankruptcy company must in the shortest possible time start creating profit (previously diminished) and positive cash flow that ensures solvency. If this doesn't occur company will come close to its business end and its existence is threatened. In this situation possibility of company's survival is in question and a threat of bankruptcy increases unless drastic radical actions toward recovery and survival are conducted.

In terms of the scope of change from management perspective, reactions to the crisis which threatens the survival are necessarily radical – management response to crisis must be fundamental change (Nadler, 1998). Radical change is usually very intense – it extracts a lot of energy from the organization, it is very stressful and highly risky (with high probability of failure). Focus of change is on entire organization, main initiators of strategic decisions of critical importance are crisis managers and they should create new requirements for the process and new vision – usually survival and recovery of the company together with optimism and radical reduction of resistance to change. Radical changes in crisis are characterized with high level of intensity and complexity; they demand direct action from top management in formulating and implementing anti-crisis strategies. Managing company in this very sensitive period is not only priority, but very often only and most important job of crisis management.

All companies need a way to manage a crisis and assure the continuity of their operations. For a corporation in crisis to sustain it, there are certain preconditions. It must be economically viable. At least at its core, it must have a sound economic *raison d'être.* It must have the human, financial and physical resources that can be deployed to meet a challenge or take advantage of an opportunity. Most importantly, it must have a management that is sensitive to internal as well as external challenges (Bibeault, 1999). In other words, core business, resources and management represent *conditio sine qua non* for a potentially successful business. Problems occur when previously set assumptions for continuing business activities are not met – case when company is losing the purpose of its existence, when resources of the company are collapsing, when returns on production are starting to diminish and cause loss in business, when advantage over competition is lost and when management is not reacting to changes and challenges. When insolvency and illiquidity are added to all of this (which are always present when a company in a situation of business crisis) then the most common crisis symptom occurs – company's inability to pay in time its financial obligations. This symptom is manifested as cash shortfall on the company's account or in worst case as complete blockade of the company's account (frozen account).

Majority of managers, specialists for "saving" companies in crisis, consider as the ultimate indicator of effectiveness, ability to generate and ensure continuity of cash flow or to generate money from new, fresh, most often credit sources. Priority in crisis condition is to ensure enough money for everyday business operation and to provide solvency for the company, which is confirmed by the correct attitude (Sučević, 2010) by which *company's income represents vanity, its profit represents virtue, but the money is the king!*

2.3 Choice and implementation of crisis strategies

Management as an initiator of implementation of crisis strategies must know how to manage change during crisis – it is expected that it acts as a change agent and that it leads the battle for survival. Under symptoms of crisis (indebtedness, reduced growth potential, ignoring losses, not optimal production capacity usage and lagging behind competition) crisis management must make decisions concerning the direction and intensity of crisis actions and create and apply one or more of crisis strategies. Crisis management's main focus during the crisis is survival of the company. Company must be oriented towards different possibilities of short-term recovery and leave development strategic orientations temporarily aside. But in a case when there is no profitability if the company manages to survive, it is necessary to consider one of the exit strategies.

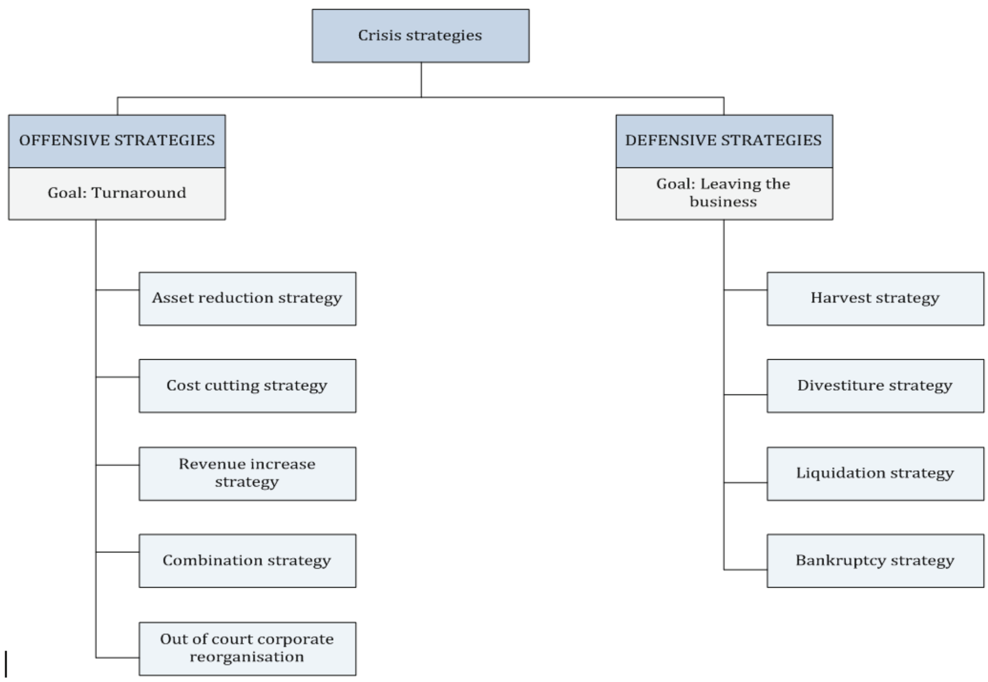
Corporative turnaround, based on the nature of actions that it includes, can occur in a form of operative turnaround or strategic turnaround (Hofer, 1980). Main goal of operative turnaround in short run is to increase company's performance and this is a basic assumption for survival. Activities conducted when company's goal is operative turnaround are done in a case when a company is "gliding" toward crisis or is in a phase when business crisis is obvious and company's existence is threatened due to decrease in profitability, decrease in sale and deterioration of relative business performance indicators. The goals are to turnaround negative trends and return the company to a position that ensures success. Operative turnaround is focused on radical change and elimination of the cause for financial and/or competitive weaknesses.

The goal of strategic turnaround is to change existing, or introduce new corporative strategy. While operative turnaround is focused on revenues, costs, assets, equity and cash flow, strategic turnaround is focused on marketing, production and development. Strategic turnaround ensures long run results and it is not desirable in early stages of the fight for survival in crisis. Based on the situation in the company and desired outcome, strategies applied during crisis can achieve two diametrically opposite effects – survival of the company, as a result of successful turnaround or leaving the business – by selling a part or a whole company, as a result of liquidation or business failure and bankruptcy. Different strategies can be applied in crisis conditions (Tipurić, Kružić, Lovrinčević; 2013) and all of them, based on the goals which should be met by their implementation, can be grouped in two basic categories:

- *Offensive crisis strategies* – their main goal is turnaround and they include: asset reduction/asset retrenchment strategy, cost cutting/cost reducing strategy, revenue increasing/revenue generating strategy, combination strategy and out of court corporate reorganization strategy and
- *Defensive crisis strategies* – their main goal is leaving the business, and they include: harvest strategy, divestiture strategy, liquidation strategy and bankruptcy strategy.

Choice of crisis strategies (Figure 1) is based on the identification of healthy business activities that must be preserved, business activities that must be rejected and activities that should be developed.

Figure 1: Crisis strategies



Source: Tipurić, Kružić, Lovrinčević, Strateški menadžment, op. cit., p. 169

The purpose of offensive crisis strategies is company's survival and recovery in its core business areas by increasing its competitive advantage. Company's position during crisis conditions is not stable and it is necessary to quickly carry out exigent, radical actions with the purpose of changing the current state. In order to consolidate its business a company can focus on strategies that are aimed at generating increased revenue, reduced/cut cost, and reduced assets or on a combination of them, all with the goal to increase money inflows in short run.

Asset reduction/asset retrenchment strategy is essential for a company in crisis when it cannot ensure free (non-interrupted) cash flow (most often due to impossibility to borrow money and/or to get „bridge capital“ which is essential to continue with business process). In this situation companies sell their assets, usually the assets that is not required for performing core business activities and they use the money from sale to help company's effort and fight for consolidation and turnaround in core business activities. The most common reason for selling the assets is saving and empowering the remaining business activities with the money earned by selling of the assets. Integral part of this strategy is reduction of potential investment in assets, which leads to elimination of expenditure on this basis and increase in financial stability of the company, when measured in cash flow.

Cost cutting/cost reducing strategy is implemented with the goal of improving the business result (caused by decrease in costs) and empowering cash flow of the company in conditions when company's cost structure shows high costs and some of them can be decreased or fully avoided. This strategy is usually implemented through decreasing salaries, decreasing number of employees, decreasing marketing costs, decreasing volume of orders with goal of decreasing stocks, substituting supplier by cheaper ones, eliminating non-profitable activities and activities which generate low added value. In other words, basis of this strategy is cutting every possible cost. Cost cutting strategy is usually used when the company is relatively close to its break-even point.

Revenue increasing/revenue generating strategy is orientated toward creating increased sales volume and increased company's revenue. There are many options available in achieving higher revenue: introducing new products, improving features of existing products, action sales without decrease in price but by offering additional offers to customers, decrease in prices, additional services for customers, introducing additional services and guarantees etc. with the goal of increasing money inflows in short run (cash flow empowerment).

Combination strategy is usually used in crisis situation in which management must act fast because the survival of the company is endangered. Under these conditions management (usually new crisis management) doesn't have time to wait for the effects of one of the previously used strategies (assets reduction, cost cutting, revenue increasing) to become visible. The more the situation is difficult for the company, the more probable is that the combination of previously listed strategies will be successful in terms of profit and loss account, decrease in assets, decrease in obligations and especially empowerment of company's cash flow.

Out of court corporate reorganisation should ensure creditors and company in crisis to make an agreement based on both sides backing down with the purpose of financial, proprietary and operative restructuring and bankruptcy avoiding.

If strategic analysis shows that one of the company's activities or the company as whole doesn't have a promising future, then this activity should be left and the business should be reoriented into another industry, either by selling off the company, liquidation or in the end, bankruptcy. Defensive strategies (harvest strategy, divestiture strategy and liquidation strategy) main purpose is to generate maximum quantity of money with fast or gradually leaving the business. Main goal of bankruptcy defensive strategy is paying out creditors by selling the assets of the bankrupted company. From all said up to now, it can be concluded that defensive crisis strategies represent *end game strategies/exit strategies.*

Harvest strategy is defensive strategy that is consisted from controlled disinvestments from a company with the goal of improving the cash flow in the period when company is exiting the industry. Company is decreasing its capital investments, far less is spent on maintenance, marketing, research, distribution channels, number of products in assortment is decreased, and smaller buyers are eliminated with the goal of decreasing costs and increasing money inflows in short run. Harvest strategy is implemented in a situation when exiting the industry is wanted option for a company.

Leaving the business by using *divestiture strategy*, by selling a part or a whole company, is used in case when there is no competitive advantage for the company, when there is significant change in mission and vision of the company or when special financial reasons of the owner of the company exist. Usage of divestiture strategy can ensure substantial revenues for the company and then they can be used for development and empowerment of core segments of the business.

Liquidation strategy represents a strategic choice used in situations when selling of the company is not an option and its main goal is minimization of the damage created towards all stakeholders in long run. Liquidation strategy is least preferred defensive strategy (together with bankruptcy strategy) that results in the end of business - it is end game strategy and it is used only in a situation when no other strategy can succeed. Liquidation means that the company will stop existing by selling its assets and bringing its business operations to an end.

Bankruptcy strategy is together with liquidation strategy end game exit strategy. Bankruptcy is a legal procedure led by court with the aim of satisfying creditors of the company in crisis by selling it assets and dividing the resources among them. Bankruptcy strategy is not implemented by company's crisis management, but by the decision of the court, it is led by bankruptcy trustee with the assistance of the creditors.

During a crisis a company comes very close to its business end and its existence is endangered. Ability of survival is questionable and the threat of bankruptcy exists unless drastic actions toward survival of the company are not undertaken. Condition of crisis demands extremely fast and rational action from the crisis management as well as application of offensive and defensive crisis strategies, where the amount of "painful and drastic" actions is larger when the level of the problem that must be solved is higher.

The outcome of the crisis doesn't have to be business failure. Successful turnaround and positive solution of the crisis is a possible option, but a possibility of this option doesn't mean that it is the most probable option. Successful turnaround is not spontaneous - it is triggered by successful crisis management, its creativity and courage to implement radical change.

3. SAMPLE, METHODOLOGY AND EMPIRICAL RESEARCH RESULTS

3.1. Sample and methodology

The aim of this research was to investigate corporate response during crisis in Croatian business setting - to diagnose major causes of business crisis, both external and internal, as well as to determine crisis strategies implementation in order to enable corporate turnaround and resolve business crisis or to enable possible application of end game strategy for leaving the business.

In that sense, a pilot study was conducted on the random sample of 200 Croatian companies. Questionnaire was specially designed in accordance with previously defined types of offensive and defensive crisis strategies and used as a main research instrument, consisting of 16 closed type questions. Out of 200 questionnaires addressed to the Presidents of Management Board, 39 questioners were collected during January and February 2013, so that overall response rate was 19.5%. Considering the delicacy of the issue of crisis and general economic conditions in the Republic of Croatia (more than 20% of the companies are facing insolvency and have frozen accounts) response rate is considered to be highly acceptable.

SPSS 18.0 for Windows was used for statistical data analysis.

3.2 Empirical research results

As it can be seen from Table 2, by legal form, 20.5% of the corporations in the sample are joint stock companies while 79.5% of the companies are limited liability companies. By employment size, 69.2% of the companies in the sample employ up to 50 employees. There is almost equal distribution of medium sized companies (12.8%) and large scaled companies (17.9%).

With respect to equity, 50% of the joint stock companies have reported equity ranging from 20 to 300 HRK million, while 37.5% of the joint stock companies have reported equity that exceeds 300 HRK million. Only 1 joint stock company has equity lesser than 20 HRK million (according to the Companies Act in Croatia, the minimum capital requirement for the joint stock company is HRK 200.000). On the other hand, nearly 50% of the limited liability companies have reported equity ranging from HRK 20.000 to 200.000 (minimum capital requirement for the limited liability company is HRK 20.000), while significant proportion of limited liability companies (38.7%) have reported equity ranging from HRK 200.000 to HRK 20 million. Just fewer than 13% of the limited liability companies have reported equity that exceeds HRK 20 million.

Table 2: Legal form and employment size of companies (research results)

Legal form/Employment size	Frequency	%	Valid Percent	Cumulative %
Legal form				
Joint stock company	8	20,5	20,5	20,5
Limited liability company	31	79,5	79,5	100,0
Total	39	100,0	100,0	
Employment size				
Micro and small companies (up to 50 employees)	27	69,2	69,2	69,2
Medium sized companies (51 to 250 employees)	5	12,8	12,8	82,1
Large companies (more than 251 employees)	7	17,9	17,9	100,0
Total	39	100,0	100,0	

We asked respondents to estimate the proportion of accumulated losses (if any) in equity. As it can be seen from the Table 3, respectable proportion of companies in the sample (65.8%) has no accumulated losses, but 15.8% of the companies in the sample have accumulated losses that cover overall equity. Moreover, 23.7% of the companies in the sample have accumulated substantial losses that exceed 40% of equity. Additionally, companies that have reported the proportion of accumulated losses in equity that equals 100%, in fact have accumulated losses that exceed overall equity.

Table 3: The proportion of accumulated losses in equity (%) - research results

Accumulated losses in	% of equity	Frequency	%	Valid %	Cumulative %
Valid	0	25	64,1	65,8	65,8
	1 -20	1	2,6	2,6	68,4
	20-25	2	5,1	5,3	73,7
	25-40	1	2,6	2,6	76,3
	40-60	1	2,6	2,6	78,9
	60-100	2	5,1	5,3	84,2
	more than 100	6	15,4	15,8	100,0
	Total	38	97,4	100,0	
Missing	System	1	2,6		
Total		39	100,0		

Since corporate crisis is undesired, unfavourable and critical phase in the life of a company, which is driven by both external and internal causes, we analyzed main causes that, from the perspective of Presidents of Management Boards of the companies in the sample, have endangered the further existence and growth of their companies. The results are summarized as follows.

Nearly three quarters of respondents (71.8%) have reported changes in industry or market structure as an external cause that, in the long run, has the potential to jeopardize company's future growth and survival. Loss of market or major customers is another important external cause that potentially generates crisis from the perspective of Presidents of Management Boards of the companies in the sample (64.1%). Loss of creditors or problems with ensuring "fresh money" has been reported by 61.5% of the respondents, while 23.1% of the respondents recognize changes in Government legislation as an external cause of crisis. Loss of major suppliers has been reported by 5.1% of the respondents.

With respect to internal causes that have potential to generate crisis, low responsiveness to changes in business environment (manifesting through opportunity losses) have been reported by 66.7% of respondents. Another important internally generated factor is inadequacy in control systems (especially0 regarding cash-flow and costs) which are reported by nearly half of respondents (46.2%). Bad credit loans decisions have been reported by third of the respondents as an internal factor that has the potential to endanger company's survival and growth, while management mistakes have been reported by 30.8% of the respondents. None of the respondents has reported conflicts between major governing bodies (Management and Supervisory board) as a cause of crisis.

Table 4: External and internal causes of corporate crisis (research results)

External causes	Number of companies	Percent
Changes in industry/market structure	28	71,8
Loss of market/major customers	25	64,1
Loss of major suppliers	2	5,1
Loss of creditors-problems with ensuring "fresh money"	24	61,5
Changes in legislation	9	23,1
Internal causes	**Number of companies**	**Percent**
Management mistakes	12	30,8
Low responsiveness to changes in business environment/opportunity losses	26	66,7
Conflicts between Management and Supervisory Board	0	0
Bad credit loans (debt) decisions	13	33,3
Inadequate control systems	18	46,2

Symptoms are signals which point to or predict a crisis. Their timely detection and adequate response by company with proper actions and activities can reduce negative consequences of an already present crisis or even prevent it. Almost every company in our research sample (94.9%) has problems with getting claims timely paid and 87.2% of the companies in the sample have recorded decrease in profit-margins. Just over three quarters of respondents (76.9%) have reported decrease in sales volume as a signal of potential crisis, while increase in the level of debt has been recognized as a symptom by 74.4% of respondents. There is almost equal distribution of companies in the sample that have recorded inability to meet obligations and reduced ability for new contracting (56.4% and 51.3% respectively). Suboptimal production capacity has been reported as a crisis symptom by 41% of the respondents and 33.3% of the companies in the sample has recorded inability to get significant proportion of claims paid. Finally, 23.1% of the companies in the sample have frozen/blocked giro accounts.

We asked respondents if corporate survival is, from their point of view, challenged or jeopardized. Just over half of the respondents (53.8%) think that their company's survival is endangered. Offensive strategies, as seen from Table 5, are more often implemented than defensive strategies. Namely, cost cutting strategy is the most used crisis strategy (92.3% of the companies in the sample) followed by revenue increasing strategy (61.5%) and combination strategy (59%).

Asset reduction strategy has been used in 46.2% of the cases, while 2 companies have reported out of court corporate reorganisation (5.1%) plan. Out of defensive strategies, divestiture strategy is the most often implemented crisis strategy (15.4% of the companies in the sample), followed by harvest strategy (7.7%) and liquidation strategy (2.6%).

Also, our research results demonstrate that all of the crisis strategies are to a greater extent present in companies where top management believes that firm's survival is endangered, with exception of divestiture strategy which is underrepresented.

On the other hand, all of the strategies are to a lesser extent implemented in companies whose survival isn't endangered (compared to overall sample, and specially compared to jeopardized companies). Moreover, we applied the two-proportion z-test and results show that in companies where top management believes that company's survival is being threatened asset reduction strategy is significantly more implemented (Z=1.947, p=0.051) as well as the combination strategy (Z=2.360, p=0.018).

Table 5: Implementation of crisis strategies (research results)

Crisis strategy	Overall sample		Survival is jeopardized		Survival isn't jeopardized	
	Number of companies	Percent	Number of companies	Percent	Number of companies	Percent
Offensive strategies						
Asset reduction strategy	18	46,2	14	66,7	4	22,2
Cost cutting strategy	36	92,3	21	100	15	83,3
Revenue increasing strategy	24	61,5	14	66,7	10	55,6
Combination strategy	23	59,0	16	76,2	7	38,9
Out of court corporate reorganisation	2	5,1	2	9,5	0	0,0
Defensive strategies						
Harvest strategy	3	7,7	2	9,5	1	5,6
Divestiture strategy	6	15,4	2	9,5	4	22,2
Liquidation strategy	1	2,6	1	4,8	0	0,0

In order to determine efficiency of selected crisis strategies, a Likert type scale was developed to capture respondents' perception of strategy efficiency (scale ranges from „1"–not at all efficient to „5"–very much efficient). Research results demonstrated in Table 6 show that liquidation strategy is the most efficient crisis exit strategy (even though only 1 company has implemented liquidation strategy). It is followed by cost cutting strategy (mean score 4.86) which is implemented in nearly every company in our research sample.

Table 6: Implementation of crisis strategies and corporate effectiveness (research results)

Crisis strategy/Corporate effectiveness	Overall sample		Survival is jeopardized		Survival isn't jeopardized	
	N	Mean	N	Mean	N	Mean
Asset reduction strategy	17	4,12	13	4,08	4	4,25
Cost cutting strategy	36	4,86	21	4,81	15	4,93
Revenue increasing strategy	24	4,33	14	4,36	10	4,30
Combination strategy	24	4,58	16	4,50	8	4,75
Out of court corporate reorganisation	3	4,00	3	4,00	0	0,0
Harvest strategy	3	4,33	2	4,00	1	5,0
Divestiture strategy	6	4,33	2	4,00	4	4,5
Liquidation strategy	1	5,00	1	5,00	0	0,0

Among the most efficient crisis strategies is combination strategy (mean score 4.58) and it is followed by two defensive strategies: harvest strategy and liquidation strategy (for both strategies mean score recorded is 4.33). Asset reduction strategy is implemented in nearly half of the companies in the sample and it is perceived to be efficient (mean score 4.12). Only 3 companies in the sample have started the procedure of out of court corporate reorganisation plan and it is, from the perspective of Presidents of Management Boards, efficient (mean score 4.0).

Our research results suggest that, in general, perceived crisis strategy efficiency is slightly lower (managers are more pessimistic about results) when company's survival is being threatened. We applied Mann-Whitney test, but found no statistically significant differences in the strategy efficiency levels with respect to management's perception of company's survival being jeopardized (due to small sample size).

Next, as seen from Table 7, we analyzed the perceived importance of various stakeholder groups in the process of company's recovery from the perspective of Presidents of Management Boards of companies in the sample.

Table 7: Perceived importance of various stakeholder groups (research results)

Stakeholder groups	N	Minimum	Maximum	Mean	Std. Deviation
Top management	39	1	8	4,10	1,714
Shareholders/owners	39	1	8	5,51	1,652
Employees	39	2	6	3,72	1,213
Customers	39	1	6	1,54	1,253
Suppliers	39	2	9	5,44	1,832
Creditors	39	1	8	3,56	1,847
Government/local community	39	1	9	5,31	2,567
Media	39	2	8	6,95	1,589
Universities	39	7	9	8,87	,469
Valid N (listwise)	39				

We asked respondents to sort (rank) stakeholder groups by relevance and their active contribution to the recovery process importance, whereas "1" is attributed to most important stakeholder. As it is demonstrated in the Table 7, customers are perceived to be the most important stakeholder group for the process of company's recovery, while universities (including research institutes) are perceived to be the least important group.

This research investigates and evaluates a role of major stakeholders in the process of expected corporate recovery. Among important stakeholders, customers (mean score 1,54), creditors (mean score 3.56) and employees (mean score 3.72) can be identified as the most important stakeholders. It is interesting to point out that shareholders, commonly recognized as the most important stakeholder group, are being only at the ranking number 7 (mean score 5.51). This could mean that crisis has the potential to deeply and structurally affect company-stakeholder relations, whereas shareholders are becoming a stakeholder group with secondary importance (seventh of nine groups) and that firm's survival and crisis recovery process depend on other relevant stakeholder groups – especially customers, creditors and employees.

4. CONCLUSION

The aim of this paper was to investigate corporate response during crisis that could broaden our basic understanding of strategy implementation role in the extremely delicate moment of company's life. Since corporate crisis is damaging corporate goals and can lead to business breakdown, it is of great importance to determine ways how management of a company in crisis manages change and how they choose and implement strategies suitable to crisis conditions.

The results of our empirical research show that most common external sources of corporate crisis are changes in market structure of demand, loss of main customers and problems with providing „fresh money". With respect to internal causes that have potential to generate crisis, low responsiveness to changes in business environment (manifesting through opportunity losses), inadequacy in control systems (especially regarding cash-flow and costs) and bad credit loans decisions have been reported as most common internal factor that has the potential to endanger company's survival.

The results of our pilot-study show that offensive and defensive crisis strategies implementation during crisis is applicable on a wide range of companies. Using management's estimation about company's survival being threatened as a reference point, we found that almost all of the crisis symptoms are to a greater extent present in jeopardized companies. This finding suggests that managers are able to detect early signs of potential crisis. Also, our results point to a situation in which crisis strategies are to a greater extent implemented in jeopardized companies even though perceived crisis strategy efficiency is slightly lower. This means that managers are able to develop and implement crisis strategies, even though managers seem to be more pessimistic about results of action taken in jeopardized companies. It should be stressed that lower indicator scores of crisis strategies effectiveness don't necessarily reflect management's ineffectiveness but rather a stage of company's financial illness where symptoms can be so severe that management manoeuvre space is limited, in terms of strategies they implement and their consequential efficiency.

This research investigates and evaluates a role of major stakeholders in the process of expected corporate recovery. Customers, creditors and employees are identified as most important stakeholders. It is interesting to point out that shareholders, commonly recognized as the most important stakeholder group, are being almost at the end of the stakeholder importance ranking list. This could mean that crisis has the potential to deeply and structurally affect company-stakeholder relations, whereas shareholders are becoming a stakeholder group of secondary importance, and that firm's survival and crisis recovery process depends on other relevant stakeholder groups.

Of course, our study has limitations itself. Future studies in the field should include industry analysis on a larger sample of companies. Also, different corporate governance structures and different constellations of power relations between relevant stakeholder groups can shape different contexts for exploring strategy implementation effectiveness in a crisis surrounding.

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GOVERNANCE OF HEALTH CARE SYSTEMS IN THE ERA OF INCREASED INTERNATIONAL INTEGRATION

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Abstract

Governance of a health care system in conditions of intensified international integration requires aquiring new knowledge, innovations, more cooperation and introducition of new methods and strategies of development that will enable it to adjust to the turbulent and changing environment. The main purpose of this paper is to analyze the challenges concerning governance of health care systems in a period when international relations and interdepenedance are constantly being intensified through the processes of regionalization and globalization. Special attention was given to the issue of Croatian health care system governance after joining the European Union (EU). Potential effects that the EU membership will have on health care system governance, as well as the need of adaptation to the new EU regulations are analyzed with the purpose of bringing conclusions and prospective course of action for healh care governance and reforms. Functioning within the EU framework might result in convergence to the EU standards but it will surely require different approach to governance and organization. Thus, when Croatia joins the EU it will face new rules and priorities in accordance with the current European health strategy and this will affect the governance and overall functioning of the national health care system.

Keywords: *governance, health care system, regionalization, EU, Croatia.*

JEL Classification: *F6; G30; I18;*
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1. INTRODUCTION

Governance and functioning of any system in a contemporary environment cannot be explained without taking into consideration the intensified processes of regional economic integrating and, on the other hand, the process of globalization. The concept of globalization and opening to the world assumes that every country is connected to other countries, deepening of those relations and building mutual collaboration. Globalization means the convergence of economic, political and cultural systems (Kabamba, 2008). It may be characterized by many accomplishments of the world economy: from regional trade agreements proliferation to the acceptance of international standards.

Opposite to the globalization, a new trend of regionalization has emerged in the last few decades. In certain sensitive areas regional initiative may be more or less successful then the activities on multilateral level. It also offers countries an opportunity to retain their autonomy over political processes on different levels. The growth in the number of regional trade blocs represents one of the most significant trends in international relations in the past years. The possibility that liberalization on regional level will bring better results for the total global welfare than liberalization on the global level, can not be excluded. Finally, it could be said that regionalization is halfway between a national state and the world that is not ready to become one (Nye, 1968).

Both trends of globalization and regionalization affect functioning, governance and different strategies of a country. Governance of a health care system, which is an important part of a country's economic and social system, under the terms of intensified international integration and conectivedness requires new methods and strategies that will enable it to adjust to the turbulent

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and changing environment. There are differences in the quality, safety and equality among health care systems of different countries. The objective of all these systems is to increase the effectiveness and quality of health care and improve allocation so as to achieve an added value (Fraser et al, 2008).

To decide what authority, or what sector, has the central role within a health care system is a potential challenge to its functioning and governance. Health care systems depend on a wider economic environment in which they function. The health care system personnel, institutions and funds necessarily reflect structural characteristics of the national economy (Saltman, 1997). It has become evident that the more developed a certain country is in terms of higher income per capita, the more it earmarks for health care (Maxwell, 1981). Finding funds is among most serious issues of health care system's functioning. An increase in health care system expenditures may be explained through an increased demand resulting from an altered way of living, larger number of retired people and longer lifespan. Moreover, it can be concluded that demographic changes are potentially the biggest challenge to the performance of health care systems. Simultaneously with the decline in fertility rates (in developed countries) and longer life expectancy, the number of inhabitants decreases, whereas the number of elderly people increases. That demand for health services disproportionally goes up with the age is a generally known fact.

Although competition and free market are considered to be foundations for effective allocation of resources and maximisation of well-being, ample literature deals with studies on the reasons of failure of the market mechanism in the health care system. There are several market imperfections appearing in the health care. Firstly, externalities occur frequently in the course of health service consumption, e.g. when treating contagious diseases and when performing immunisation. In the presence of such externalities, the consumption defined by market forces is socially sub-optimal and state intervention is required. Besides, certain activities such as research and development have features of public goods (Smith, 2008).

In order to increase efficiency without scarifying either equality or quality when it comes to the use of health resources in the following four areas: (a) financial liability of patients, (b) public purchase, (c) health care governance, (d) competitiveness among providers; the below listed political activities are suggested (Cremer et al, 2007):

- controlled increase in the sharing of expenses with patients
- increase in the competition for contracts with hospitals
- better vertical coordination and integration of health service contracts
- *ex ante* competition of providers for groups of patients.

The main purpose of this paper is to analyze the challenges concerning governance of health care systems in a period when international relations and interdepenedance are constantly being intensified through the processes of regionalization and globalization. Special attention was given to the issue of Croatian health care system governance after joining the largest regional integration in Europe, namely the European Union (EU). Potential effects that the EU membership willl have on health care system's governance as well as the need of adaptation to the new EU regulations are analyzed with the purpose of bringing conclusions and prospective course of action for healh care governance and reforms. The paper consists of four parts. The first part is the introduction and it describes perspectives of a health care system development in a globalized and regionalized enviroment. The second part deals with new trends and challenges in health care system governance as well as with analyzing the need of measuring health care system output, while the third part describes the issue of governance of Croatian health care system after joining the European Union. The fourth is the conclusion.

2. NECESSARY CHANGES IN HEALTH CARE SYSTEM GOVERNANCE

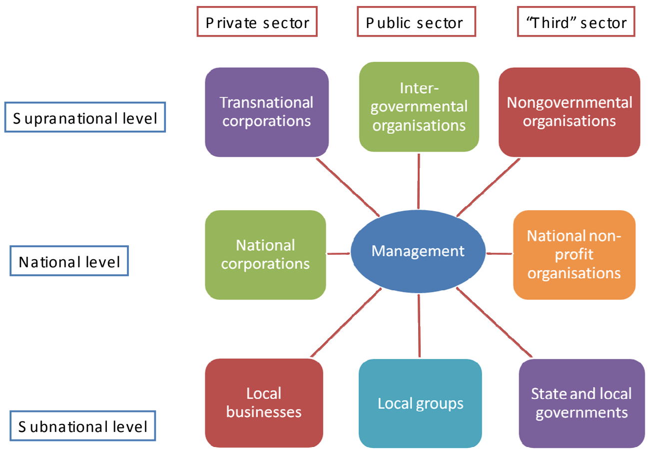
2.1 Principles of good governance

Considering numerous new challenges that countries and their governments encounter, there have been some changes as to the form of governance, which are related to health care as well.

Some of the changes include contextual drivers such as interdependence, complexity, co-production and new governance dynamics described through diffusion, democratization and shared value (Kickbusch and Gleicher, 2012). The existing models of governance have become inappropriate for addressing system-related shocks or for managing globalization fairly.

Adherence to the principles of good governance as well as willingness and ability to introduce new governance approaches will depend largely on the strength of democratic institutions. The role of the state is interpreted differently by various political parties and this factor is of great relevance to health, in particular from the aspect of ensuring equity and health. It can be said that in the current conditions of constant changes, the governance process is determined by trends in the distribution of power and authority. Nye and Kamarck (2002) indicate that governance diffusion is realised simultaneously in several directions in response to incongruence between government capacity and complex challenges (Figure 1).

Figure 1: Governance in the 21st century



Source: adapted according to: Nye, J., Kamarck, E. C. (2002) *Governance.com: democracy in the information age*. Washington DC: Brookings Institute Press.

Uncertainty is recognised as a key problem in decision-making processes. Nine features of governance and decision-making processes required in the 21st century may be discerned (Government of Northern Ireland, 1999):

- forward looking: a long-term view based on statistical trends and informed predictions of the probable impact of the policy,
- outward looking: taking account of the national and international situation and communicating policy effectively,
- innovativeness and creativity: questioning the established methods and encouraging new ideas,
- using evidence: using the best available evidence from a range of sources and involving stakeholders at an early stage,
- inclusiveness: taking account of the impact of the policy on the needs of everyone directly or indirectly affected,
- joined-up: looking beyond institutional boundaries and orientations to the government's strategic objectives; establishing the ethical and legal basis for policy-making,
- evaluation: including systematic evaluation of early outcomes into policy-making,
- reviewing: keeping established policy under review to ensure that it continues to address the problems for which it was designed,
- learning lessons: learning from experience of what works and what doesn't.

There are two new approaches to governance which include multilevel governance and multiple stakeholders. The first approach is known as the whole-of-government approach, whereas the other one is known as the whole-of-society approach (Kickbusch and Gleicher, 2012). The whole-of-government approach represents diffusion of governance vertically across the levels of government and arenas of governance and horizontally throughout sectors. This approach is considered appropriate for solving problems within the government. The whole-of-government activities are multilevel, from local to global, and involve groups outside the government. The whole-of-government approach is often used to address a perceived lack of command and control of power with respect to an issue or overall goals by using a new organisational design and reorganisation.

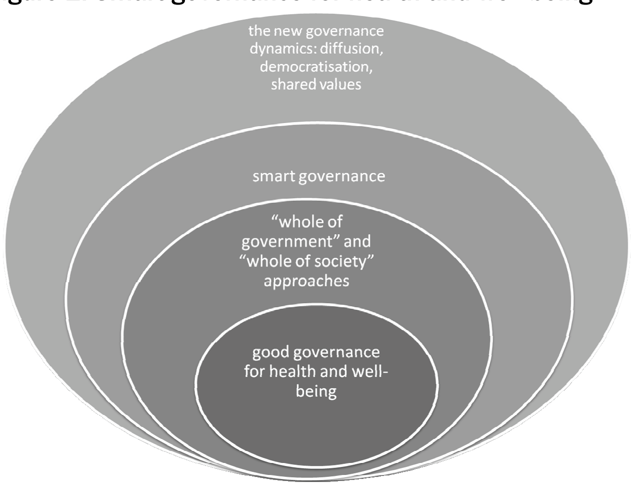
The aim of the whole-of-society approach is to extend the whole-of-government approach by placing additional emphasis on the roles of the private sector and civil society, as well as politically active participants. This approach implies new, increased capacity for communication and collaboration within complex, networked settings and highlights the role of the media and new forms of communication. Each participant must invest resources and competence into the strategy. The whole-of-society approach goes beyond institutions since it influences and mobilises local and global culture and mass media, rural and urban communities and all relevant sectors, such as the education, transport, environment, etc.

2.2 Governance for health

Governance concerns how governments and other social organisations interact, how they relate to citizens and how decisions are taken in a complex world (Graham et al, 2003). Governance, functioning and the development perspective of health care systems depend on various factors and trends in the global environment. Decentralization, contracting, improving health and efficiency are some of the factors that need to be included in new governance models. Moreover, the organisation and effective functioning of the health care system of a certain country is considered to be a key element of a wider sustainable development strategy.

The general aim is to reach good governance, but the question is what good governance is. In the context of maintaining health and well-being, good governance has two important features: (a) relation between values and (b) role of guiding value systems for ethical governance. The World Health Organization stresses, as often as not, the importance of value systems and points out four interlinking concepts which constitute the value framework of good governance for health: (a) health as a human rights, (b) health as a component of well-being, (c) health as a global public good, and (d) health as social justice (Kickbusch and Gleicher, 2012). In addition to being good, governance is also supposed to be smart. Wilke (2007) described the smart governance concept as an ensemble of principles, factors and capacities that constitute a form of governance able to cope with the conditions and exigencies of the knowledge society (Figure 2).

Figure 2: Smart governance for health and well-being



Source: adapted according to: Kickbusch, I., Gleicher, D. (2012) *Governance for health in the 21st century*, Geneva: WHO, p.32

Although it is necessary to adapt the form of governance so that it may become governance for health, the role of the government is still crucial. The number of new mechanisms and approaches to governance for health has grown exponentially at all levels and there is a trend of creating new forms of collaboration, inciting democracy and multilevel accountability for health. The dichotomy between government-centred approaches and those society-centred is somewhat false because in most cases, the two sides collaborate. Capable, expert and informed ministries and other public bodies are still crucial for the creation of conditions designed to enable well-being and sustainable health. What is necessary to change is the method of their performance. In terms of this, ministries of health and other public bodies play an important role in good governance for health, which they may realise by engaging in transformational leadership within the government, which presupposes (Kickbusch and Gleicher, 2012):

- creating the environment to send the message that changes are required and that it is necessary to move away from territorial identity
- taking positions on health in the cabinet and initiating cross-departmental cooperation supported by the Ministry of health
- using their authority to reach out to other stakeholders for joint initiatives, set the framework for micro-decisions which direct society- and government-oriented policies
- encouraging exchanges of opinions with citizens and community-based action groups to understand people's concerns and needs.

The key principle of performance is placing health and well-being in the centre of a development strategy and all the approaches irrespective of whether they are society-oriented or government-oriented. If we take into consideration the complexity of the health care system, it may be stated that successfulness of its performance depends on the quality of governance and managing various relations among numerous actors within the system.

2.3 Measuring of the health care system outcomes

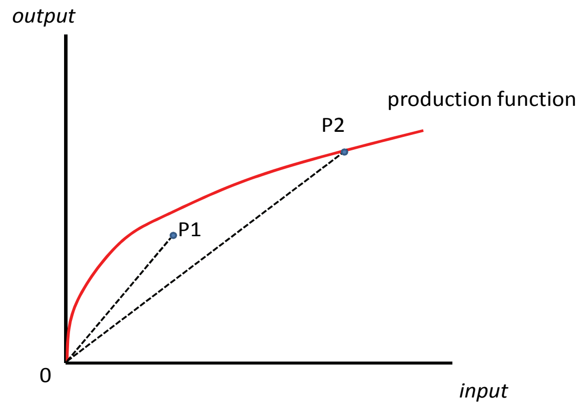
Good governance is, among other things, based on the availability of quality information. Moreover, data are crucial in the health care system if all the system's functions are to be fulfilled and the population's health improved. They are necessary in all processes of the health care system, particularly in the course of making decisions and ensuring stakeholders' liability. Despite the great potential of outcome measurement systems in contemporary health care systems, there are still certain hindrances and disputes regarding the method of their most efficient use. Health care systems are still in an early stage of measuring their outcomes and there is plenty of space to increase the efficiency. Levels of applications of particular types of IT are different, and more industrialised countries have generally more computerised health care systems than less developed ones (Ash and Bates, 2005).

It is crucial to determine what is to be found out by using outcome measurement systems and to use the obtained information for proper purposes. The basic objective of each health care system is to improve health. For this very reason, the majority of measurement instruments refer to population health data such as mortality, birth rate and similar. Furthermore, for better governance and functioning of a health care system, data on clinical outcomes are essential since they are the standard for measuring health care effectiveness. However, performance outcome measurement is not always appropriate. The outcome-oriented approach may be expensive and time-consuming, and data may be obtained too late, which undermines preventive actions. There exist various health status indicators, but they all have both advantages and disadvantages. Most frequently applied health status indicators may be classified into six categories: (a) raw mortality and longevity indicators, (b) indicators of mortality that could have been avoided in the presence of timely and effective health care, (c) mortality indicators adjusted for the prevalence of diseases, disability or for quality of life, (d) indicators of the volume of health care services, (e) survival rate after specific diseases, (f) other health related indicators, such as the number of sick-leaves and public satisfaction with the health care system, etc. (OECD, 2010).

In addition to measuring outcomes, it is necessary to point out health impact assessment, which has become a standard technique and tool in the decision-making process with the aim to simplify selection among several options and to envisage possible impacts of different decisions on health (Kemm and Perry, 2007). Health impact assessment is actually a combination of procedures, methods and tools, by which a policy, a programme or a project may be judged as to its potential effects on the population's health and the distribution of these effects (Kemm, 2007). Besides, measuring the health impact involves all potential health care system stakeholders affected by the decisions that have been made. This method is also useful for inciting cooperation between various stakeholders and for raising health awareness in the community and among decision-makers. Generally, it is considered that there are five stages of health impact assessment: (a) screening, (b) scoping, (c) assessment of impacts, (d) reporting to decision-makers, and (e) monitoring the consequences of implementation (Kemm, 2007).

Productivity is among most difficult health care features to measure. Productivity and efficiency are two different concepts. Sometimes they are distinguished according to what is measured. Figure 3 shows the difference between productivity and efficiency. Let us imagine two organisations (P1 and P2) which use a single input to produce a single type of output. As may be seen, the P1 organisation has a higher level of productivity, i.e. a higher ratio of output to input. Furthermore, technical efficiency is measured in relation to the production function implying the amount of output that can be produced at different levels of input on the assumption of diminishing marginal productivity (which implies diminishing of outputs with the use of each additional unit of input). Consequently, the other organisation, P2, is operating at the limit of its production capacity and achieves a lower level of productivity but is producing the maximum level of output that is technically feasible given its input levels, which means that it is technically more efficient than P1. On the other hand, P1 stands for inefficient production.

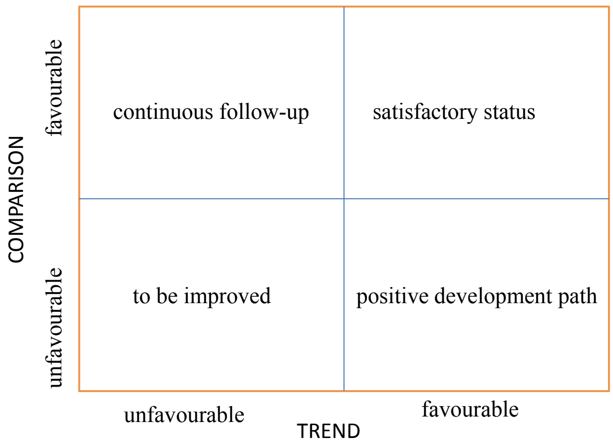
Figure 3: Difference between productivity and efficiency



Source: adapted according to: Street, A., Hakkinen, U. (2009) Health system productivity and efficiency. In: Smith, P., Mossialos, E., Papanicolas, I., Leatherman, S. (eds) (2009) Performance incentives for health care providers. Cambridge University Press, p. 228.

Although multiple goals are among the features of health care services, a limited number of goals focused on individual segments are most often singled out within the system, which requires complex political decisions and, therefore, progress fails to occur in many fields (Busse and Wismar, 2002). International comparisons of health care systems enable governments to obtain a valuable insight into health care policies of other countries and to revise their own policies and methods of collecting and allocating resources (Figure 4). In order to upgrade the health care system, it is necessary to use and implant international comparisons into the outcome measurement system and integrate business data into the decision-making process. A comparative analysis is useful in different stages of the business cycle of the Ministry of Health and may result in better implementation of strategic information for the purpose of improving performance and outcomes.

Figure 4: International comparisons, information collection and decision-making



Source: adapted according to: Veillard, J., Garcia-Armesto, S., Kadandale, S., Klazinga, N. (2009) International health systems comparisons: from measurement challenge to management tool. Smith, P., Mossialos, E., Papanicolas, I., Leatherman, S. (eds) (2009) Performance incentives for health care providers. Cambridge University Press, page 664

3. GOVERNANCE OF THE CROATIAN HEALTH CARE SYSTEM AND IMPLICATIONS OF JOINING THE EUROPEAN UNION

As mentioned, regionalism has become a significant mechanism that mitigates tensions between the pressures of globalization and the need for more local control. Regional agreements widely differ one from another, but they have all a common objective: to lower trade barriers among their member states and enhance economic growth, development and reduce poverty. There are opinions that participation in a regional integration is a step towards easier inclusion into the global flows. The EU is the largest regional integration in Europe but it has global influence. Joining the EU will have various implications for Croatia and its economic, social and political system.

The key principle of EU governance is solidarity. In line with this principle, the EU supports the development of social services for all residents of its member states and the realisation of the "European social model". In 2000, EU member states articulated their social model in the Charter of fundamental rights of the European Union. As for health, the Charter claims that everyone is entitled to access preventive health care and medical treatment under the conditions established by national laws and practices.

Although all EU member states have their own health care systems and policies, these are directly affected by the rules and objectives of the EU. There are three distinguishable categories of EU measures (Hatzoupolos, 2009). The first category comprises the acknowledged measures for achieving free movement of workers, free provision of services, and free establishment of institutions. The second category refers to the measures that seek to ensure free movement of goods, especially pharmaceuticals and medical devices. The third category includes the measures that arise from other areas of EU policy, which can be directly related to health.

As mentioned, although formulating and implementing health care policies is still a task for national policies, the development of the internal EU market and the performance of the EU institutions (in particular the European Court of Justice) have transformed the legal environment so much so that health systems now employ people, purchase goods, finance services, and organize themselves (Montanari and Nelson, 2010).

Cooperation between member states is recommended, and countries can improve governance of their health care system using the best practice experiences. New model of governance within the EU implies, among other things, the development and application of new health technologies, improvement of the system of monitoring and responding to health threats, introduction of regulations related to tobacco, alcohol, mental health and other social and economic issues that may potentially affect human health. Significant reforms that are currently being implemented in the Croatian health care system, such as the financial recovery of hospitals or reorganizing public procurement, are also affected by the EU rules and managing those reforms will have to be adapted to the new regional concept. The hospital secotor is of great importance in the Croatian health care sector. However, governance of hospitals was not adequate and today, those institutions face serious managerial, financial and other problems. To be more exact, current problems of the hospital sector in Croatia include, among others, slow accreditation of hospitals, lack of professional staff, the threat of the brain drain, unequal distribution of hospitals, excessive dependence on hospitals in the city of Zagreb, lack of hospital governance by local authorities (Ostojić, Bilas, Franc, 2013). Cosequently, financial recovery of hospitals wiil be preformed and it is currently one of the largest reform iniciatives in Croatian health care sector. Financial recovery assumes government paying for all of hospital debts accumulated by the 31st December 2012, which are the result of ample factors, among others, inadequate governance and mismanagement. Therefore, it is of great importance to ensure quality management of hospitals and other health institutions, which will have necessary know how, competences and education.

In general, up to this moment Croatia has succeeded in harmonizing national regulations with EU regulations in the area of health, in particular as regards: cross-border health care, regulated professions, prices of medicinal products and their inclusion in the Essential and Co-Pay medicines lists of the Croatian Health Insurance Institute, medical devices, blood, tissues and cells, and environmental protection (noise, chemicals and biocide preparations, food, and radiations) and from this point of view, health sector is considered to be ready to join the EU (Ostojić, Bilas and Franc, 2012).

It can be concluded that functioning within the EU framework might result in adaptation to the EU standards but it wil require different approach to governance. When Croatia joins the EU, it will face new regulations and priorities in accordance with the current European health strategy and this will affect governance and functioning of the national health care system. Certain national governance bodies will be abolished and new regional institutions and regulations will be introduced. It is of utmost importmance to define clear objectives and priorities in health care and to organize the functioning of the health care system in a way that will enable those national objectives to be achieved, having in mind national resources and regional rules and policies.

4. CONCLUSION

Today, there are numerous challenges regarding governance and development of health care systems: from an ageing population and a consequential growth of demand for health services, low fertility rates, reduced number of active insured persons, growth of chronic diseases, growth of health care service provision in a situation of less available funds due to financial crisis, the need to pursue technological innovation and achievements, investment in research and development, the need for the quality of services provided to increase, possibilities of labour migrations, patient mobility, to the potential for developing health tourism.

The development of policies that would support individual efforts and investments of the community into the health care sector and encourage laws on health protection and safety is of utmost importance. In terms of this it is necessary to ensure supervision over public procurement, plan the health care at the local level that is coordinated with national and regional plans, conduct strategic planning and governance, study household needs and include them in planning of the health care system, set up national and local committees for control of the health care, conduct food inspections and other activities influencing the people's health.

In addition to the national perspective, when defining its governance objectives and direction of helath care development, Croatia must take account of the EU guidelines and decisions listed in the main health care strategic documents. Moreover, governance will undoubtably be affected by the fact that functioning in a regional integration and more widely, in a global environment intensifies the need to cooperate, integrate, adjust to international trends and adopt innovations, new knowledge and skills, while simultaneously satisfying national needs.

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DIFFERENCE BETWEEN WISH AND NEED – EVIDENCE OF BUILDING CSR INDEX IN CROATIA

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Abstract

Issues relating to Corporate Social Responsibility (CSR) have taken a centre stage in modern societies Strategic accent of CSR is strongly emphasized by the new EU Communication on CSR that was issued in October 2011 which puts forward a new understanding of CS. This understanding no longer refers to CSR as a voluntary action beyond compliance but highlights that every corporation causes impacts which it is then responsible for. Contemplation of the concept of corporate social responsibility as a derivative of certain conditions markets create, thus determining the nature of relations between various stakeholders, positions it in the context of major forces in today's economic and social changes. In order to assess voluntary practices of Croatian companies, the Croatian Chamber of Commerce and the Croatian Business Council for Sustainable Development started developing a benchmarking methodology, which was launched in 2008 in the form of the CSR index of Croatian public and private enterprises. The used methodology for index development was context based, although it was initiated in accordance with similar comparative methodologies such as BITC CR Index. Since 2008, the index was revised, improved and conducted on an every year basis through a voluntary questionnaire that covers six different fields. The principle goal of the project of CSR index was to accelerate development of CSR as a strategic integration tool among Croatian companies and foster a knowledge sharing process among its participants. In this paper we will describe how a project evolved from an idea to an ongoing important national project, and how all stakeholders involved in that process tried to build a benchmark of acceptable corporate behavior among all participants involved.

Keywords: *corporate social responsibility index, index development, stakeholder management.*

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1. INTRODUCTION

Society has come to ask more and more from business. At the start of the new millennium, the established power balance and division of labor amongst governments, corporations and civil society are shaken with globalization as the most important force for this erosion (Palazzo and Scherer, 2008). Western economies and capitalism established a new way of doing business where companies have to fight fiercely for their market share and consider the wider social and environmental consequences of their actions (McWilliams and Siegel, 2001). More than ever it can be seen that if a company is acting in a socially irresponsible manner, there will not only be consequences in the form of lawsuits, but also sales declines, increases in the cost of capital, market share deterioration and costs related with negative reputation etc., and that its success and therefore survival depends on satisfying normative expectations coming from its environment (Hopkins, 2003).

Company without passion towards its clients, respect to its employees, quality of its products and social responsibility will never become great (Collins, 2001). Furthermore, a company seen as bad in society will have a hard time attracting clients, employees and investors (Lange and Washburn, 2012). Therefore, the European Union's concern to create and develop the necessary framework to express the relationship between corporate social responsibility (CSR) and sustain-

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able development should be taken into account (Hristache, Paicu and Ismail, 2013). After the Lisbon Treaty was signed on 13th December 2007 as an international agreement that improves the two treaties which comprise the constitutional basis of the European Union (hereafter EU), the EU is on its way to become a smart, sustainable and inclusive economy, and these mutually reinforcing priorities should encourage the Member States to deliver high levels of employment, productivity and social cohesion. Also, in the 2008 European Competitiveness Report, the European Commission published an analysis of the links between CSR and competitiveness, where it examined the effects of CSR on six different determinants of competitiveness at firm level: (a) cost structure, (b) human resources, (c) customer perspective, (d) innovation, (e) risk and reputation management, and (f) financial performance. It is concluded that CSR can have a positive impact on firm-level competitiveness in the case of all six determinants, but that it will not always do so, being very dependent on the sector, size and circumstances of the company. The strongest evidence of a positive impact of CSR on competitiveness was found in the cases of human resources, risk and reputation management, as well as, innovation (Bird, 2007). For most of the competitive determinants examined, there was evidence that the impact of CSR is as relevant to SMEs as it is to larger companies (Jenkins, 2006; Udayasankar, 2008; Russo and Perrini, 2009; Sacconi, Blair, Freeman and Vercelli, 2011). Because of this, in March 2010, the European Commission made a commitment to renew the EU strategy to promote CSR as a key element in ensuring long term employee and consumer trust. Since Croatia has applied for the EU membership in 2003, and is considered to have a functioning market economy, as well as its pending accession to the EU as the 28th member in July 2013, this issue is of growing importance.

The concept of CSR is so broad and has many forms, scopes and implementations, that there is not one correct definition. The concept of CSR is based on the growing belief that modern companies have more responsibility towards their role in society. Stronger civil society pressures, technology development, resource gaps and other trends are forcing companies to integrate CSR into all elements of business. If the CSR is seen as a narrow conception, corporations have little or no obligation to society other than creation of economic rents that can accrue to the shareholders with recognized rights (Baller and De Bry, 2003). On the other hand, if it is seen as an expansive concept, the corporation should serve as an instrument of public policy by other means (Devinney, 2009). However, it represents practice that should go beyond legal requirements, and each company should have the right to decide to which areas they should pay more attention to, in line with their own strategic objectives, sources of risk and business opportunities which contribute to enhancing their competitiveness by increasing reputation, reducing operating costs, monitoring industry trends, meeting customer needs, motivation and attraction of the best employees, risk management and access to cheaper capital. It is also often described as discretionary corporate activity intended to further social welfare on a voluntary basis, beyond the interests of the firm or requirements of the law (Barnett, 2007). It is applicable to businesses of all sizes, although most are investigating the impact of large companies because their influence is most visible, and their power greatest. However, small and medium enterprises should also be socially responsible.

At the core of the CSR concept is the idea that reflects the social imperatives and the social consequences of business success. Therefore, it empirically consists of clearly articulated and communicated policies and practices of corporations which reflect corporate responsibility for wider societal good (Matten and Moon, 2008). The fundamental three lines of CSR inquiry are characterized as: (a) stakeholder driven (CSR is viewed as a response to the specific demands of largely external stakeholders), (b) performance driven (the link between external expectations and company's CSR action, with the focus on measuring the effectiveness of such actions) and (c) motivation driven (examines either the extrinsic reasons for CSR engagement in the company or intrinsic rationales building on philosophical concepts to advance particular notions of its obligations and responsibilities) (Basu and Palazzo, 2008). Corporate social responsibility is not a static and linear concept, but a process of constant negotiating and redefining the feasible. Outcomes that responsibility covers are changing over time with regard to the cultural and political aspects. Being responsible is not an immutable, constant state established by applying business activities in practice and how they are incorporated into the business. The concept of corporate social responsibility (CSR) postulates exceeding a standard compliance with law and as such it becomes an expectation that companies will actively engage in fulfilling their duties towards the stakeholders. It is an expectation that corporate codes of conduct will be backed up by more profound strategic deeds (Fryzel, 2011). It refers to the will, capacity and capabilities from which companies learn and incorporate changing expectations of the society into its risk management, change and opportunities, as well as the ways in which they meet the expectations of their business environment. CSR can be a platform for short-term performance and long-term health of the company, to set proper goals and to create a timeline for achieving them (Bačun, Matešić and Omazić, 2012). Likewise, it is important because corporations are the most efficient way of determining social needs and delivering social solutions. There are four main reasons why society would benefit from companies acting in this manner: (a) companies with more acceptable practices within a society would have more satisfied stakeholders (customers, employees and owners) and would last longer and thrive in more adverse circumstances, (b) corporations possess more knowledge than individuals and governments so they are more likely to be able to use that information for tailoring products and services to the appropriate constituencies, (c) corporations have a better understanding of trade-offs, technologies and trends which are operating within a society so that they can act in a way more rational and realistic than the government, and (d) being free of the transparency required by governments and many civil society organizations, corporations are more easily engaged in social experimentation (Devinney, 2009; Garriga and Melé, 2004).

Nevertheless, most mainstream economists have ignored this perspective and continue to maintain that the multi-stakeholder corporation, even if imagined for a desirable purpose, does not have a uniquely defined objective function, so that a multi-stakeholder objective function would open the way to managerial slack and self-dealing. Stakeholders, government and public in general are therefore calling companies to account for the actions of their senior management and corporate board members, and the success of a company and its board members will be measured not only in financial terms, but also in human and social benefits and costs (Kemp, 2011; Lacey and Kennett-Hensel, 2010). The complete integration of CSR in accordance to the sustainability is one of the viable solutions to face the problems of the contemporary society more and more characterized with global economic crisis, the loss of public confidence, criticism and debate about the role of business in the current context (Omazić, 2008).

2. DEVELOPING CSR INDEX IN CROATIA – BRIDGING THE GAP

Corporate Social Responsibility initiatives, of diverse kinds, address the gap between current practice and what is seen as more appropriate conduct by companies (Idowu and Louche, 2011). Since CSR is a very broad concept, it is hard to formulate its definition and state its forms and implementations, especially if it is case on country in transition. First National Conference on corporate social responsibility in Croatia was organized in December 2004. The overview of the activities brought participants to a conclusion that an evaluation and awarding process would be a good incentive to boost implementation of CSR practices in Croatian business. The project started in 2006, when Croatian Chamber of Economy (CCE) and the Croatian Business Council for Sustainable Development (HRBCSD) signed the Cooperation Agreement which sought to present a common interest for mutual cooperation and consultation of all interested stakeholders to increase understanding of the importance of corporate social responsibility and development of methodology for evaluating socially responsible practices among the members of the CCE and HRBCSD. The agreement set grounds for funding application which was submitted to the Academy for Educational Development (AED). The funding was granted and also United Nations Development Project (UNDP) expressed willingness to support some of the activities of the project.

The goal of the signed agreement was to create a methodology for assessing voluntary CSR practices of Croatian companies named CSR Index and to initiate the award design that would valorize responsible business practices of companies and award the best of them annually. The concern was to allow comparative annual assessment of the most successful Croatian companies with respect to their responsibility and application of the principles for sustainable development, affirmation of the best local practices by awarding an annual award, popularize CSR in the business community, the media and the general public, participative companies to facilitate the process of internal analysis, planning and reporting on CSR and sustainable development, to encourage mutual learning and advancement of responsible business among a large number of Croatian companies and track trends of CSR in the Croatian context. It should have also facilitated the process of internal analysis for the companies involved, as well as planning and reporting on CSR and sustainable development. Also, one of the goals was to target and popularize CSR in the business community, the media and the general public which would also allow customers to make more informed purchase decisions

The project started by formation of working group which consisted of local experts in various fields of expertise, this way covering all major CSR dimensions. It consisted of experts from (a) business associations (HRBCSD and CCE), (b) academic, scientific and research institutions (Faculty of Economics and Business – University of Zagreb, Zagreb School of Economics and Management, (c) local nonprofit organizations (Odraz, CEPOR, Otok znanja), (d) private company experts (Ericsson, IPSOS Puls, Hauska & Partner and MAP Savjetovanja), (e) Government institutions (National Competitive Council) and (f) financing institutions (AED and UNDP). Criteria upon which they were chosen were their interests in playing an active part in the project and their capacity to perform and influence others.

Although the extent and nature of CSR programs vary greatly from one organization to another, the aim of the methodology was to create a common ground and allow Croatian companies an objective assessment, benchmark of their socially responsible practices and comparison with other companies. The working group consulted with similar methodologies such as the Dow Jones Sustainability Index, FTSE4Good Index and Business in the Community CR Index and created the methodology which included self-assessment in six main areas defined with a set of criteria developed according to their relevance, availability and verifiability: (a) economic viability and sustainability, (b) inclusion of CSR in business strategy, (c) working environment and HR practice, (d) environmental protection, (e) market relations and (f) relations with the local community. A complex set of indicators was determined for each category that was translated into a set of related questions whose answers gave adequate, measurable and verifiable information. Prior to its official release, as a part of methodology design, a pilot project was conducted with 16 companies where decision makers/managers gave their comments on all unclear questions and open issues. After processing all the comments, the current form was set with six dimensions consisting of a maximum of 600 points altogether; 100 points for each category. All six categories have the same relative value, and the Index measures achievement in each of the dimensions from 0-100 percent, where the number of points of an individual company is put in relation to the maximum possible points in each dimension, with additional qualitative assessment of the quality and credibility for the responses to open questions from the Expert Committee.

Since the resources at the beginning of the project were rather limited, it was very difficult to widely promote the launch of the CSR Index to approximately 70 000 business organizations registered in Croatia. Thus, it was decided that an opportunity to participate in the evaluation is going to be given to business organizations which were rated as most successful in the Republic of Croatia for the past fiscal year. These criteria included a range of financial indicators of business efficiency with which companies are ranked already used by Croatian Chamber of Economy in the awarding process for the most successful business. In order to have better coverage, it was decided that access and participation in the contest is going to include 500 best rated small (less than 49 employees), medium (from 50 to 249 employees) and large (with 250 and more employees) business organizations which met the previously mentioned criteria. Those companies were contacted via e-mail that was directed towards the key person within each of them. The questionnaire itself was converted to an on-line application which was located on the website of the Croatian Chamber of Economy and needed to be completed on-line. Since, the methodology of the Index highlights and rewards development and implementation of the management system, which is usually better developed in large enterprises, the size of the company plays role in the overall success in CSR Index. To eliminate that advantage at the beginning of a project, two questionnaires were developed: larger and more detailed for large and medium and smaller, and less detailed for small companies, with a special questionnaire in both for the manufacturing companies.

The questionnaire contains of 119 questions for medium and large companies and 61 questions for small companies. In order to protect the confidentiality of data, completion of the questionnaire is only possible when entering a user name and password separately assigned to every organization. It was decided that the questionnaire was going to be open for completion in the period of four to six weeks.

The data obtained from the completed questionnaires provides the first comprehensive insight into the socially responsible practices of Croatian companies and identify the areas where it is possible to achieve concrete and constructive steps forward, and thus facilitate further economic growth and development of the Croatian economy.

3. IMPLEMENTATION OF CSR INDEX AND ITS RELEVANCE IN CROATIA

Corporate entities of our age have accepted that social responsibility issues are corporate issues which consequently have now become part of their core activities. The first phase of the project started on November 12th, 2008 when the companies (small, medium and large) which met the pre-selection financial criteria were invited to participate in an on-line questionnaire. To publicly promote the project, a press conference was held on November 17th, 2008. The application process was closed on December 1st, 2008 and the results showed that from 1364 companies invited to participate, 152 companies opened the questionnaire (11%) and only 32 closed it (2.4%). These were 9 small, 12 middle-sized and 11 large companies. Industrial sector was presented by 18 while service sector by 14 companies. The highest score obtained this year was 523.02 points out of the possible 600 (87%) and the lowest was 94.47 points (16%), with an average of the 309.8 points.

Since the project was only launched, the Expert Committee decided that the quality of the open questioned will not be specifically rated. Instead, every company that won more than 75% of the possible 600 points was decided to be pronounced winners to give an acknowledgement to the pioneers in the CSR implementation process and to give greater visibility to the project and CSR in general. The seven winners in the first year evaluation process were, in alphabetical order: Coca-Cola HBC Croatia Ltd., Dalmacijacement p.l.c., Ericsson Nikola Tesla p.l.c., Hauska & Partner, Holcim Croatia p.l.c., Končar – Institut za elektrotehniku Ltd. and Vetropack straža p.l.c.

Next year, the second phase of the project started on November 4th, 2009 and the application process was closed on November 18th, 2009. This time, 1450 met the criteria and were invited to participate; 199 companies opened (13%) the questionnaire and a total of 42 (2.89%) finished and closed it, from which 12 were small, 12 middle-sized and 18 big companies. This year 27 companies were from industry sector and 15 were service companies. The number of companies that filled the questionnaire increased by 0.49% in comparison to 2008The scores in the evaluation process were also slightly higher: (1) the highest 539.82 points (90%), (2) the lowest 107.41 points (18%) and (3) average 331.81.

This year, the Expert Committee evaluated the quality of open questions and awarded best answers, at the same time punishing those whose answers were not satisfying. Also, because of the need to further define the awarding process, the Committee decided to create three regular categories, awarding separately large, medium and small companies. Each category announced three winner but they were all communicated in alphabetical order to maximally avoid ranking details in public and give most attention to the awarded companies and the CSR concept itself. In the category of small companies the winners were : (a) Euro-Unit Ltd., Hauska & Partner Ltd. and Oikon Ltd. . In the category of medium companies, the winners were: (b) Hartmann Ltd., Končar – Institut za elektrotehniku p.l.c. and Atlantic Grupa division for health care – Neva p.l.c. In the category of large companies the winners were: (c) Cemex Croatia p.l.c., Ericsson Nikola Tesla p.l.c. and Holcim Croatia Ltd. Furthermore, the Committee created an additional award for companies with the most significant progress in the number of point won in comparison to the previous year and the awarded company was Banco Popolare Croatia p.l.c.l.c.

After the first two years of the successful implementation of the CSR Index, as well as, the attention it was receiving in the business community, the project was ready to be taken onto the next level. It was applied and got funding from the structural CIP pre-accession EU fund in July 2010.

After applying the funds won, the third phase of the project was executed in 2010. The extra resources allowed implementing organizations to organize a series of educational workshops throughout the country, inviting companies to hear about CSR, its relevance for business performance and also to give instructions on how to aply and fulfill the questionnaire. The number of invited companies grew to 1535. During the process, 378 companies (24.63%) opened the questionnaire and 98 (6.45%) filled and closed the questionnaire. These were 35 big, 30 middle-sized and 33 small companies. This time 43 were industry sector and 55 service companies; this year the service companies prevailed. The highest score was 574 points (96%), lowest 68 (11%), with an average score of 300. The number of companies participating and their overall results for years 2008-2010 can be seen in Chart 1 and 2.

The award was once again given in three categories: (a) Energy Pelets Ltd., Hauska & Partner Ltd. and Oikon were awarded in the category for small companies, (b) Hartmann Ltd., Končar Institut za Elektrotehniku p.l.c. and Holcim Croatia p.l.c. were awarded in the category for middle-sized companies and (c) Cemex Croatia p.L.c., Ericsson Nikola Tesla p.l.c. and Coca-Cola HBC Croatia p.l.c. were awarded in the category for big companies. Moreover, the award for the company with the most significant progress of CSR in relation to the last year was given to Jadran Galenski Laboratorij p.l.c.

Chart 1: The number of companies participating in the CSR Index 2008-2010 (authors)

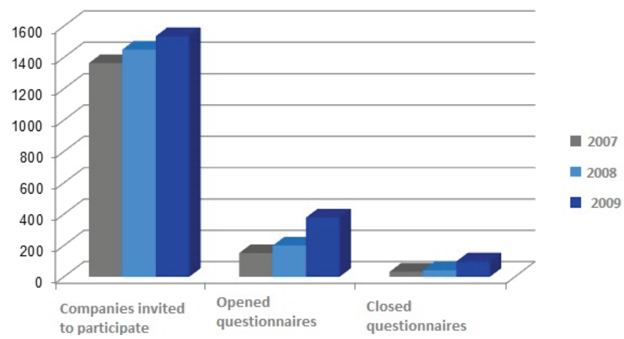
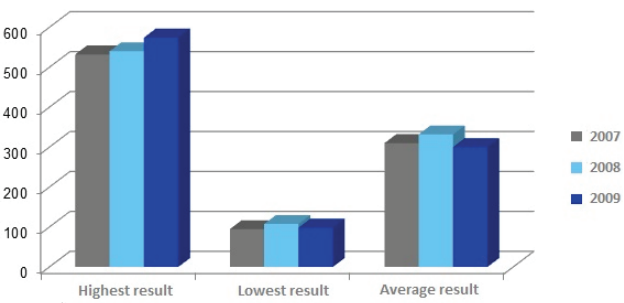


Chart 2: Overall results in CSR Index 2008-2010 (authors)



The results also show that companies listed on the stock exchange achieved higher results, as did those with certain percentage of foreign ownership, and there is no difference in the results between manufacturing and service companies. These findings confirm the assumptions: (a) financial markets are strongly CSR driven and (b) there is positive impact of international business cooperation and integration on the development of business profiles and social responsibility reputation. In addition, the overall results for 2010 showed positive correlation between the

Index results and number of employees, revenue per employee, and the amount of the added gross value. These results are shown in Table 1.

Table 1: Results of the CSR Index 2010 (based on the results in 2009) compared to results of the all companies which report to the National financial agency (Škrabalo, Miošić, 2011)

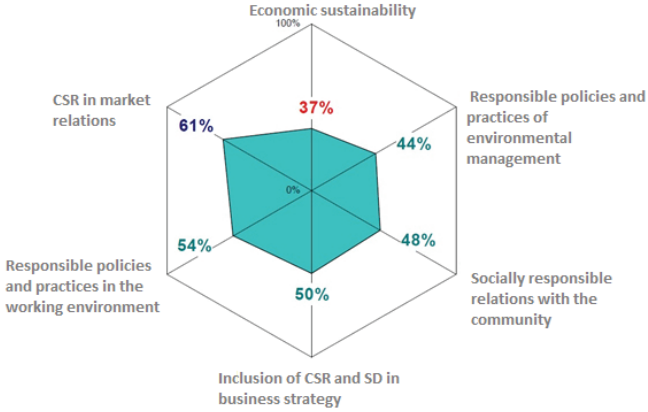
	All companies which filed report to the National financial agency (FINA), 2009	*Companies in CSR Index, 2009*
Average export of companies in overall income	13%	23%
Average monthly salary	4.634,00 kn	6.070,34 kn
Average income per employee	689.644,00 kn	1.089.637,11kn

In other words, the Index results in 2010 suggest that companies are more productive when they are more socially responsible. What certainly features the best positioned companies that participated in the Index 2010 is a systematic approach to CSR. 90% of the companies that participated in the Index 2010 belong to some of the business associations for CSR and Sustainable Development (SD), 84% of them look at CSR and SD in business decisions, and 72% report on CSR and SD. 66% of them have annual programs and budgets for environmental protection, and 64% mention CSR and SD in the basic documents, which in 60% is reflected in their organizational structure. A particularly important finding was that the success in the field of CSR is associated with systematic approach. Specifically, CSR is regularly integrated into the organizational structure, business strategy and management systems in 25% of the most successful companies in the Index 2010, and a statistically significant correlation was found between the total score on the Index and the process of reporting on CSR, certified management systems and the existence of an organizational unit for CSR (department and cross-sector board).

4. LESSONS LEARNED AND ROAD AHEAD

After the third phase was finished, additional data was obtained from the questionnaires implemented in 2010 and areas for improvement connected to CSR in Croatian companies could be determined. Taking into account all the dimensions and their specific aspects, according to the Index 2010, CSR is most developed in relationships with suppliers and competitors, areas of the employee's evaluation and investment in their education, as well as in relationships with clients. The worst results were achieved in relationships with shareholders and corporate governance, lobbying and advocacy, monitoring the impact of environment and employment policies. The dimension of economic sustainability has a relatively modest number of points related to the investments into research and development. Among the other topics that are in this dimension, strategic planning, mission and vision have the best results, and it can be concluded that strategic planning has become the rule amongst the companies in the Index.

Chart 3: The development of the CSR according to the Index 2010 dimensions (Škrabalo, Miošić, 2011)



The biggest challenge in this dimension is reporting financial indicators. This is certainly one of the key messages to be transferred to companies in the future. In the domain of market relations, it can be concluded that CSR is very well integrated in it because there are many examples of good practice (see Chart 3 below).

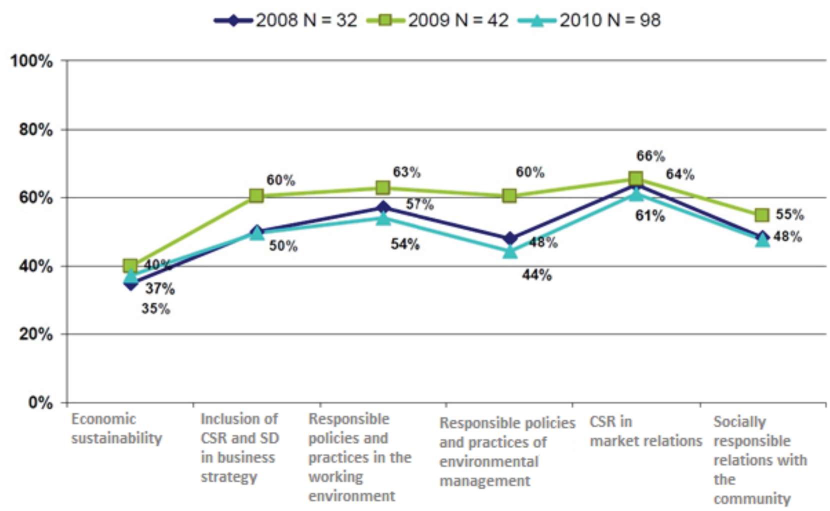
Companies that participated in the Index 2010 showed that they have written procurement policy and commitment to suppliers that include regular payment. Even two thirds of large and medium-sized companies in the 2010 sample have invested into business development of their suppliers, and half of them have adopted codes of corporate governance. In the dimension of CSR in the workplace, mixed results are obtained. Specifically, growing awareness of the need for investment in a stimulating work environment can be seen; 94% of companies in the Index 2010 reported that business performance is reflected in the compensation to the employees. Also, continuous professional development is the rule rather than the exception, and is evident from the fact that 84% of the companies devote 25% or more above the average for its industry in employee education. On the other hand, there is also a disparity of good practice with regard to the specific issues and goals, and the type and status of employees. Specifically, 90% of the company's managers have more benefits than what is mandated, as in vast disproportion to zero companies that provide the same benefits for their workers. Average percentage of women in higher management among CSR Index companies is 27.5 while the results show that the higher the score on Index, the higher the percentage, resulting in 32.5% of women managers in 25% most successful Index companies. Comparison with the average results in Croatia which are about 18% women managers in 500 biggest Croatian companies (Office of Gender Equality Ombudsman, 2013), show advantage in Index companies. Socially responsible employment policy is a topic that requires significant advances in the future, since the CSR Index 2010 showed that 72% of companies have no system for informing employees about the programs or activities that facilitate new employment, and 44% are without a process of consultation on the layoffs. CSR is still not widely and systematically communicated to all employees, according to the result that 43% of companies do not in any way educate or inform their employees about various aspect of CSR.

Furthermore, in the dimension of responsible policies and practices of environmental management are widely recognized opportunities for significant savings of resources, and the best results in this dimension were realized in the implementation of environmental protection measures. Around half of the companies in the Index 2010 have an environmental management system: 44% of them integrate environmental concerns into strategic and operational goals, 50% have a person responsible for environmental issues, and 43% include environmental criteria in the selection of suppliers. Companies that monitor impact of their operations on the environment are the best example of CSR practice which should be widely promoted among those companies that have not yet begun with similar practices.

Dimension of CSR in the local community represents an area for change in the sense of understanding the interaction and contribution of companies to the society, above corporate philanthropy. In this dimension, large companies lead the social dialogue at the industry level and in shaping public policies, while small and medium-sized companies have not yet found their niche in which to participate and attempt to influence public policies affecting their business and ultimately survive in the market. Similarly, monitoring the impact of the business on the community represents areas of underutilized opportunity for understanding the competitive context. Specifically, 51% of the companies in the past three years did not in any way monitor relations between local communities and their businesses. If the results relating to the issue of financing political parties and issue advocacy and lobbying are compared, significant differences are evident.

On the issue of financing political parties, 80% of the companies had the official position (47% against), while lobbying and advocacy demonstrates the need for clearer and more systematic approach. 40% of the companies had no official stance on lobbying and advocacy, and in only 8% of the companies had officially been banned to participate. Although the issue of regulation and self-regulation of lobbying and corporate funding of political parties only recently appeared on the horizon of public and political debate, it could soon become very important in the context of Croatian membership in the EU and the growing sensitivity to the problem of political corruption and clientelism. These aspects of the Index have educational function because they encourage companies to think and refine their own policies and approaches. There overall results on the Index 2008-2010 dimension, can be seen on the Chart 4.

Chart 4: Average score of the CSR in the on Index 2008 - 2010 dimensions (Škrabalo, Miošić, 2011)



5. CONCLUDING REMARKS

As this paper suggests, the index development is continues process. Therefore, each year a lot of research is done on improving the scope and usability of index. Since Croatia as a traditional economy is yet on its way to define its system of social values, public policy, as well as, political system is not supportive for CSR and relevant public institutions are not educated enough to support CSR practice, companies are still not having benefits from responsible business behaviors. The general objective of this project was to raise the level of understanding how important CSR should be in Croatia. To do so, it was necessary to create an alliance of the existing CSR activities performed by various organizations that will give added value to the future efforts. It was very clear from the beginning that only few companies understood all the benefits coming from integration of responsible practice to all activities in the companies and even though CSR is often mentioned in missions and visions of companies, it was not integrated into strategies and business plans. The only way for this to be changed was through systematic education of the companies, as well as, monitoring of the practices in Croatian companies.

CSR is becoming increasingly popular in Croatia. Using Index as a benchmark tool it can be seen that in the first year of its implementation only 152 companies out of 1364 opened the questionnaire and 32 of them filled it and one year later that number only slightly raised, 199 companies out of 1450 opened and 42 filled the questionnaire. However, in 2010 the number of companies has grown significantly, mainly due to the workshops "CSR Index - how to fill in a questionnaire on corporate social responsibility" held in Zagreb, Split and Osijek as a part of the project of the National CSR Network development , which was conducted in cooperation of HR BCSD and Croatian Chamber of Economy. Therefore, the number of companies participating in the Index was three times higher than in the first year even though there was no increase in the number of invited companies. Still, this comparative comparison is the first attempt to analyze the results of the CSR Index in order to monitor CSR development trends in Croatia, but taking into account that until 2010 only small portion of Croatian companies participated, all the results obtained should be viewed as preliminary indicators of future tendencies, so it is necessary to involve more companies every year and to continuously monitor their performance in the years to come. Each of previously mentioned relationships between business organization and its stakeholders is an essential peace of puzzle, and therefore must be managed in a way that a two-way flow of value exists and that interests of both parties are aligned.

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CORPORATE GOVERNANCE AFTER 20 YEARS IN SLOVENIA

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Abstract

The implementation of corporate governance in the Republic of Slovenia is particularly important due to the transformation of the equity ownership company system and, consequently, corporate governance, which has been evolving since Slovenia's independence 20 years ago. The implementation of EU directives and regulations brings about positive legal effects in corporate governance following 2004. Positive assessments are provided of the development of Slovenian codes of corporate governance. However, studies, findings and analyzes show some negative phenomena, which should be overpassed in the search of effective corporate governance model in the future. Some tools and methods (disclosure and transparency, auto evaluation, legal actions, etc.) are scrutinized to introduce the improvements and enable better results of corporate governance in Slovenia.

***Key words**: corporate governance, privatization, disclosure and transparency, revision, legal actions, equity.*

JEL classification: K22;
Review
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1. INTRODUCTION

The implementation of EU directives and regulations brings about positive effects in corporate governance in the Republic Slovenia (RS) following its accession to the European Union (EU) in 2004 (Bohinc 2010; Kocbek et al 2010; Djokic 2011). RS complied with all the amendments of EU regulation regarding company law, accountancy, financial reporting and revision (ZGD-1-UPB3 2009). Legal analyses also give positive assessments of the development of Slovenian codes of corporate governance (Djokic 2010).

Still the questions remains: What purpose take the legal resources integrated into the Slovenian legal order in accordance with the European requirements and recommendations? Which goals are being pursued in the area of corporate governance and supervision while 'learning by doing'? Are we aware of the significance of legal instruments used for the development of corporate governance? When and how are we going to create sustaining social and responsible corporations, according to the future trends? After 20 years, it is reasonable to question corporate mentality, consciousness and values that were shaped through constant changes and adjustments RS faced in this period of time.

2. TWENTY YEARS OF CORPORATE GOVERNANCE

The RS traces its corporate governance beginnings to the 1990s when the country initiated ownership transformation of companies. (ZTLR et al 1992) Companies with the social capital as an equity source have been on the basis of a law transformed into the companies with the equity capital in private ownership. Corporate governance of companies in the RS has been implementing for 20 years (Djokic, 2011a).

It seems that the redistribution of both social and national capital and, consequently, power and control in the country, influenced the governance. The basic interest currently observed in the society is to amass capital and control of the companies. Media scandals suggest that corporate

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assets and funds are not spent on the development and progress of a corporation, but to acquire or increase the ownership of managers as inside corporate owners or groups of home owners or to acquire premiums on the share sale to the outside corporate owners (Finance 2006-2011).

3. PHENOMENA, FINDINGS AND STUDIES RELATING POST PRIVATIZATION OF THE SOCIAL CAPITAL OF COMPANIES IN SLOVENIA

The transformation of the legal basis of governance 'from labor to capital' has taken its toll. Administrative procedures were implemented and completed successfully, but with no significant added value. Nontransparent corporate pyramid structures and other 'negative aspects' of corporate governance during the secondary privatization period 2000–2010 did not contribute to the development of corporate governance (Damijan, Gregorič, and Prašnikar 2009).

What is permissible in a developed legal system of the global economy is not necessary positive or beneficial in light of long-term and effective operation of joint stock companies. Besides that RS involves a specific national environment and corporate governance system, previously based on different equity ownership grounds.

The key role of managers is to ensure successful and effective operation of a corporation. If a corporation does not do business, it cannot perform its activities and fulfill its existential goals.

If managers are using the assets of a company as a legal entity for financing or acquiring equity capital of the corporation, the results tend to be harmful for the company. In case a corporation as a legal entity is not run in a way to profitable manage its assets (through profitable business), but its funds are being used for realizing insider equity takeovers instead, the corporation as a joint stock company is subject to property damage (damages and loss of profit). The value of property of the company is decreasing and its ongoing and future business is either questionable or already lost; thus, the corporation cannot remain competitive and, as a result, cannot fulfill the conditions to conduct business effectively.

After 20 years, it seems that in RS the property transformation has not been exploited to the utmost so as to increase operation effectiveness of joint stock companies. Instead, processes, administrative procedures and corporate governance leverage were used to create equity owners who, in the process of acquiring the ownership, did not expend their own capital, but used the assets and funds of joint stock companies for the purpose (Djokic 2011, 2011a, 779-786).

3.1 Studies and research findings on corporate governance

Even without taking a look at any scientific research and studies, everyday life and media reports already suggest that legal instruments and institutes are being used contrary to the interest and goals of corporate operation and successful existence of a corporation as economic and legal entity on a long term. Nevertheless, some studies and research findings have been executed, which help to justify the assessment of the situation in the RS regarding corporate governance.

Individual economic researches show how managers managed credits and corporate funds. In addition, the data sent a warning about significant discrepancies between the effects of corporate governance and actual managing which does not guarantee long-term effectiveness of corporate operation.

To illustrate the situation, the following research findings may be indicated (Prašnikar et al., 2010):

– Cvelbar et al 2010 researched the area of productivity and ownership. The central thesis suggested that certain ownership structures in a specific situation increase productivity. The aim was to analyze the relation between productivity and ownership as well as to establish which ownership types can boost productivity during the time of crisis. The following ownership structures were classified as more effective: dispersed ownership, cap companies, financial holding companies with undefined ownership. The research data also show that dispersed ownership creates positive impact on productivity as it is improving despite the crisis, and that it provides better fundamental conditions in large as well as in 'blue chip' companies. Large stake owner companies and MBO companies proved to be part of the less effective ownership structures. However, large owners have shown greater potential for productivity growth in small companies, while their indebtedness was high as a result of managers' buyouts by credits. Such companies have felt the impact of debt as early as in 2008 (Ibid.).

- Czerny et al 2010 explored how investments influence tangible assets, presuming that fixed capital formation increases both productivity and competitiveness. The authors analyzed the influence of ownership structures upon fixed capital formation and the effects of internal resources and turnovers on fixed capital formation (Ibid.).
- Bole et al 2010 dealt with the relations between the increase of financial debt of companies and their investments. The research presupposed that prior to the economic and financial crisis, the total debt of Slovenian companies (as % of GDP) increased significantly from 50% in 2004 to 80% in 2008. The study aimed to analyze the differences in financial indebtedness with regard to the ownership structure in place and identify the connection between increased debt and the kinds of assets. The authors established that in the period 2006–2009, financial debt in MBO companies increased by 74%, with the same trend observed in 2009 as well. In addition, the profit of those companies in 2008 declined by 99% and reached a negative point in 2009. While short-term financial investments are on the decline, long-term financial investments are on the increase (Ibid.).
- A research conducted by Ojsteršek et al 2010 from the Faculty of Economics on investments in tangible and intangible capital in Slovenian industry for the period 2006–2009 suggests that financial indebtedness of Slovenian companies during the upturn in the economy increased significantly, thus boosting the financial leverage. As a result, companies will need time to conduct financial restructuring. In the period 2007–2008, merely 43% of the increase in debt was intended for additional financing of operation; most of it was earmarked for additional financial investments and investment properties. Companies that were subject to management buyouts suffered profound consequences; for this reason, their strategic and financial restructuring will be extremely difficult (Ibid.)

3.2 Regulatory framework, practice and court actions

Besides findings, the discrepancies between the regulatory framework, standards and principles and their execution in the practice are demonstrated also by studies and research from 2007 to 2010 funded and performed by the Slovenian Directors' Association (SDA, 2009)

However, almost no court actions regarding the described anomalies, took place in the previous 20 years of the existence of corporate governance in Slovenia. Criminal prosecutions and/or actions (claims) for compensation (damages) among the corporate stakeholders were very rare. The court cases therefore have not suggested the possible ways or present results in relation to media reports and phenomena of corporate governance in RS, yet.

In this context, one may question whether more frequent enforcement remedies, such as: actions and/or claims for compensations (damages), regular and extraordinary audits and revision processes in the corporations, would contribute to the development of good practices in corporate governance.

Legal options for the exercise of shareholders or creditors rights have existed in Slovenian regulations for a long time. After 2000, minority stockholder rights and the responsibilities of managers and supervisors were enacted; the operation of financial services was regulated; the Securities Market Agency's functioning was regulated as well (Djokic 2011, 219) .

Nevertheless, legal remedies were usually not pursued as there were no active (injured) parties applying for compensation so as to prove the existence of criminal offences, and no stockholders claiming their rights. Such a situation suggests that during the period of 20 years time, corporate governance did not work de facto, but only and exclusively de jure.

3.3 The Role and importance of legal and other remedies

As far as enforcement of legal and/or court remedies in “the corporate governance cases” are concerned, it is possible to consider them in the a) past or b) future context:

a. If legal remedies were pursued more often even in the past, more managing bodies could be found either liable for damages or criminally responsible. This would indicate that there exist negative, criminally prosecutable or otherwise unfavorable phenomena in the area of corporate operation and governance, all of which suggesting that corporations as legal entities are being subject to abusive practices. Court practice could not necessarily realize the limitations of the abuses of corporate governance system in the past. However, the existence of the phenomena would most certainly be proven. The reactions against such phenomena could help in building higher moral values and standards, regarding the execution of the responsibilities of the management bodies of the companies. To this end, the operation of courts should be organized in a way to allow rapid and preferential treatment of various statutory actions or actions for damages in respect of corporate governance.
b. It is essential that the functions and tasks of individual company bodies be performed carefully and responsibly. If standards and principles of good and effective corporate governance come into practice in the past, legal remedies will not be needed. The development of good and effective corporate governance cannot be based only on written rules and standards. Effective corporate governance is demonstrated by actual implementation of the rules in practice which must promote the objectives of the corporation. It is necessary to address the detected errors or anomalies and improve the system with a view to make it good and effective (Djokic, 2010).

Legal remedies for the execution of the corporate goals, are extreme measures. They show that something is already very wrong in the governance of the corporation and should be taken as final act. They are also expensive and time-consuming. Are there any other ways to overpass the existing problems of Corporate Governance in Slovenia? The facts that good operation yields positive results and that effective corporate governance meets the goals of corporations should be recognized and become generally acknowledged, much earlier, before they become detrimental for the corporations.

From this point of view, the disclosure and transparency principle regarding corporate information must be used as a means to increase the shareholders and public awareness and ensure better, positive supervisory incentive for corporate governance (Djokic 2011b). The disclosure and transparency principle will represent also the pressure to the management bodies, to perform their duties more diligently and liable. Corporate interest is going to become more recognizable and transparent. By that it should be faster and easier for the stockholders or other interested parties to seek their wright and court protection.

The other measure that in Slovenia could bring positive results is the specified auto evaluation of the management bodies. Presuming that managers and supervisors are qualified and professional enough, their work combined with the work of their professional associations can contribute to better supervision of the corporation. It is advisable that auto evaluation of a management bodies on this stage is substantiated by regular exchange of opinions or value judgments by professional associations. The auto evaluation documents should also be selectively reviewed or open to the supervision.

It is crucial time for Slovenia to develop an effective corporate governance model which is going to encourage also an economic development in the country.

4. Effective future model of Corporate Governance in Slovenia

The intellectual challenge of corporate governance is finding the right mix of instruments, answering whether and to what degree mandatory of fall-back law is needed and if it is needed, what the role of the European Union should be (Hopt 2010, 8).

The present situation is calling Slovenia to become more aware of the importance of competent and effective corporate governance model. There is no systemic and analytical examination of corporate ownership structures in place in order to assist the development of potential and effective corporate governance models in RS. In addition, examinations and researches are merely a domain of academic domains or projects.

The creation and use of an economically successful model, should be supported by the use of different legal techniques of regulators and others, involved in the regulatory process. Soft law and obligatory provisions, enacted by laws should be used and combined (Djokic, 2013). In a country where close personal and business connections are obvious to everybody, the use of the disclosure and transparency principle could encourage corporate governance bodies to be more professional and effective. The Corporate Governance Code realisation should be monitored and judged, as well. The goal should be to enable social peace and sustainable development of the Slovenian corporations, on a long term.

5. CONCLUSION

The media reports, researches and annual report reviews of public corporations in Slovenia constantly worn, the practice exercised by joint stock companies and other companies is not in line with the written rules. According to the trend identifiable in the RS throughout the twenty years since its independence, companies do not favor publishing corporate information on the basis of the recommended standards for effective corporate governance; the transparency of corporations is rising due to the binding provisions which stipulate that corporations must implement concrete legal instruments, such as the corporate governance statement.

In view of this, it is necessary to devote special attention to the actual implementation of the written rules in practice. The implementation of corporate governance in the RS is particularly important due to the transformation of the equity ownership company system and, consequently, corporate governance, which has been evolving since Slovenia's independence 20 years ago. Twenty years is a short period of time compared to other (Western) countries. For this reason, the practice of corporate governance is extremely important for its future development. Furthermore, the majority of Slovenian corporations are not of public nature; thus, they are not bound to implements the rules and standards that are formally in place for public companies. Some researches suggest that the formal development of transparency in Slovenian public corporations needs more time. Consequently, it is relevant to consider for how long and how does this area develop in private companies. From the legal perspective, it is important to explore both legal and technical possibilities for the development of effective practices of governance of companies (not only corporations) with a view to include the development of corporate governance and supervision as its constituent elements, for the benefit of general progress and encouraging business results of business entities in the RS.

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