Corporate Governance Quality in Selected Transition Countries

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Important questions that concern the notion of good corporate governance focus on what good corporate governance is, who benefits from good corporate governance, and how corporate governance quality can be measured. The aim of our study was to broaden our understanding of the role of standards and codes of good corporate governance in improving governance practices. We found that not only formal regulations, standards, and governance codes, but also corporate governance indices-which make the assessment of companies' governance practices possible-are important in measuring and improving governance quality. The results of the research based on the SEECGAN Index methodology indicated that mandatory requirements and voluntary recommendations of high governance standards had a positive impact on the corporate governance practice in Slovenia.

Key Words: corporate governance, index, quality, transition country
JEL *Classification:* G34, P20

Introduction

Numerous cases of fraud, accounting scandals, and other business failures in companies worldwide, often leading to lawsuits or even bankruptcy, have made corporate governance an extremely important topic in academic and professional discussion and research. Behind these cases is an assumption that the major cause of these problems lies in bad corporate governance (Larcker and Tayan 2011). In order to prevent such deviations in corporate governance, several formal regulations (i.e., hard law) as well as informal guidelines, recommendations and codes (i.e., soft law), and standards have been developed on the national and global level. Many of them have been proposed and established by different professional and international associations (e.g., OECD, ECGI, IFAC, SAC, IAASB) in different fields (e.g., legal, accounting, audit). Their main purpose is to determine basic rules and recommendations of good governance. Their abundance and content differ across national economies, reflecting the specifics of the national economy as well as the prevailing governance system (e.g., 'shareholder centric' in the UK and US or 'stakeholder centric' in Germany). However, some research studies have shown that systems of corporate governance in different surroundings have been converged (Nestor and Thompson 1999; Martynova and Renneboog 2010).

The main questions that we address in this paper are how a quality corporate governance system of a particular company or state can be defined, explained, and developed; which criteria should be considered in assessing corporate governance quality; and who should recognize the quality in order for investors to approve it and react. We focus our empirical research on transition economies where we are lacking in-depth insights into the specifics of corporate governance practices and their quality (Zattoni and Van Eees 2012; Kumar and Zattoni 2015).

In light of the previously stated research questions, we have structured our contribution in several chapters. The first chapter introduces the issues. In the second chapter, we explore some global approaches for improving the quality of corporate governance, among which special attention is devoted to standardization, corporate governance codes and 'comply or explain' principles, and different attempts to measure the corporate governance quality. In particular, we explore the most recent approach to measuring corporate governance quality using the SEECGAN Index, developed to address special circumstances in transition countries. In the third chapter, we present research on the corporate governance quality using the case of Slovenia. We discuss the research results related to the quality of corporate governance measured by the SEECGAN Index in Slovenia and provide findings from the comparative analysis of corporate governance with a selected transition country. We conclude our contribution with cognitions on expected future development in this field.

Good Corporate Governance

Good corporate governance is expected to reduce agency costs and information asymmetry stemming from separation between ownership and control (Bauwhede and Willekens 2008; Healy and Palepu 2001). Sound corporate governance is characterized by effective monitoring and disciplining mechanisms that should prevent the opportunistic behaviour of top managers (Renders, Gaeremynck and Sercu 2010; Tipurić et al. 2016) and provide a framework for the protection of shareholder interests (Patel and Dallas 2002). It encourages excellence and the optimal use of available resources, leading to improved company performance (Renders, Gaeremynck and Sercu 2010).

Traditionally, the governance literature has defined two governance systems. The open (Anglo-American) system of corporate governance is characterized by a fragmented ownership structure, an active market for corporate control, strong shareholders rights, and short-term equity financing. The closed (Central European) system of corporate governance is characterized by long-term debt financing, concentrated block holder ownership, inactive markets for capital control, and a substantial role of banks (La Porta, Lopez-de-Silanes, and Shleifer 1999; Larcker and Tayan 2011; Renders and Gaeremynck 2012). Solutions for corporate governance problems differ in these two systems. The market for corporate control and managerial compensation are prevalent mechanisms in the open system of corporate governance. In the closed system, control by large shareholders together with the board is the dominant mechanism for aligning the interest of managers and owners (Larcker and Tayan 2011; Tipurić et al. 2016).

STANDARDS AND PRINCIPLES OF GOOD CORPORATE GOVERNANCE

The OECD (2015) traditionally establishes standards, principles, and recommendations for good corporate governance. The proper and good execution of the competences of the management bodies are presented and explained in different corporate governance codes worldwide. Professional accounting, auditing, and other organizations (IFAC, IASB, etc.) prepare the accounting and auditing standards that should be followed by internal and external auditors in order to establish and/or supervise the execution of the competence of the different management bodies of the corporations. The assessment of the quality of the particular process of the production, services, organisation, etc., is also realized by quality standards such as ISO 9000, ISO 14000, ISO 26000, and EFQM.

ISO 14001 concerns the field of environmental management systems, environmental assessment, environmental performance evaluation, etc. Derivative standards derived from this standard are conducted to meet the requirements. ISO 14030+ represents the direction to achieve the performance and control of environmental management systems. All this concerns the attitude and conduct of the management of public companies regarding the environment and includes issues of reporting to shareholders as well as the enforcement of sustainable development policies of public companies).

ISO 26000 (International Organization for Standardization 2010) standard on social responsibility concerns organizations' activities to implement social responsibility. This standard started to develop more intensively in 2010. It provides only guidelines regarding the operation of the management bodies, which at this stage of development cannot yet be certified. Instead, this standard clarifies the concept of social responsibility and its contents. This allows businesses and organizations to follow the principles of social responsibility and translate them into measures providing the best management practices in the field of social responsibility (ISO 26000).

All such activities need to be reported to the shareholders. The obligations to report non-financial data have recently been demanded at the European Union level as well. The tendencies to standardize the reporting of non-financial aspects are detected in the terms of Accounting Directive 2013/34/EU (The European Parliament and the Council of the European Union 2013).

The assessment of practices and standardized operations of enterprises in several directions, not just in terms of production processes, are taking the path to the future (ISO 26000). They raise the question of how to report the demands and the pursuit of excellence to shareholders, which are corporate governance matters. Information for investors about the methods and consideration of the factors of the environment and sustainability are becoming increasingly important for stakeholders as well. They concern questions of the quality of the general leadership and management of companies and the costs created in these processes. They concern the general attitudes about corporate governance.

OECD 2015 principles of corporate governance target the following topics to enable equitable and fair relationships and treatments:

- Ensuring the basis for an effective corporate governance framework.
- The rights and equitable treatment of shareholders and key ownership.
- Institutional investors, stock markets, and other intermediaries.
- The role of stakeholders in corporate governance.
- Disclosure and transparency.
- The responsibilities of the board.

OECD principles 2015 stress the importance of high ethical standards, stating they are in the long-term interests of the company as a means to make it credible and trustworthy-not only in day-to-day operations, but also with respect to longer-term commitments. The overall framework for ethical conduct goes beyond compliance with the law, which should always be a fundamental requirement.

CG CODES AND 'COMPLY OR EXPLAIN' PRINCIPLE

Corporate governance (CG) codes play a crucial role in improving corporate governance practice (Nowland 2008). In most EU member states, compliance with CG codes and disclosure on corporate governance systems and practices are largely voluntary and based on the 'comply or explain' principle. The 'comply or explain' approach is the most common approach to corporate governance in the world. In addition to the EU member states, it is applied in Australia, New Zealand, Singapore, Hong Kong, and many other countries. The main idea of establishing and using CG codes stems from differences in the type and severity of agency costs that reflect the companies' ownership and control structures. As the ownership and control structures differ across countries and industries, corporate governance regulations (i.e., mandatory and voluntary ones) and practices should reflect such differences.

Another approach for regulating corporate governance is the 'one size fits all' corporate governance regulation, which is the legislated mandatory governance model (e.g., the most well-known version is the SOX-based regime in the US) that prescribes the same corporate governance practices for all types of companies (Bauwhede and Willekens 2008; Luo and Salterio 2014; Renders and Gaeremynck 2012). In Asian countries, considerable pressure has been placed on companies to improve governance practices due to the crisis. Voluntary corporate governance codes have been established in order to encourage companies to improve their governance and transparency practice and disclose more information in a timelier manner to different groups of stakeholders (Nowland 2008).

In Slovenia, the first CG code (i.e., Code of Governance of Public Companies) came into force in March 2004. The Ljubljana Stock Exchange, the Managers' Association of Slovenia, and the Slovenian Directors' Association adopted it. Several changes were introduced in 2005 and 2007; in 2009, a new code (Ljubljanska borza 2009) was enforced and is still in power in Slovenia. The provisions of the Slovenian CG Code have the nature of recommendations, which are not legally binding; the main purpose of this code is to define in more detail the governance and management principles of public companies and to recommend such principles to companies that have not gone public, but have the form of a joint stock company. Public companies should disclose any deviations from this code and reasons for them. Non-public joint stock companies that base their corporate governance statement on the Slovenian CG Code (Ljubljanska borza 2009) must also disclose all such deviations following the 'comply or explain' principle.

Few analyses have been carried out regarding the implementations of the CG codes in Slovenia (Djokić 2012; Ljubljanska borza 2012; 2015). The Ljubljana Stock Exchange, together with the Slovenian Director's Association, conducted the last analysis on the disclosure of the explanations of deviations from the Slovenian CG Code (Ljubljanska borza 2009) of the corporations between 2011 and 2014. A much bigger sample of companies was included in the analysis than in the previous one (i.e., 58 companies for 2011 and 2013, 57 companies for 2012, and 60 companies in 2014, all listed on the Ljubljana Stock Exchange). The results of the analysis show that the number of companies using the Slovenian CG Code (Ljubljanska borza 2009) increased from 63.8% in 2011 to 71.7% in 2014. The great majority of companies do not use any other corporate governance codes, even though the law enables such a solution. The average compliance with the Slovenian CG Code (Ljubljanska borza 2009) was 89.8% in 2011, 90.6% in 2012, 89.9% in 2013, and 89.8% in 2014. Half of the most frequent deviations are those from the transparency principles and recommendations. The results of the analysis show several improvements in corporate governance practice in Slovenia that follow the regulations of the legislation (i.e., Companies Act) and the provisions of the Slovenian CG Code (Ljubljanska borza 2009).

CORPORATE GOVERNANCE RATINGS AND INDICES

The idea of measuring corporate governance quality is a relatively new concept, and several approaches have been developed thus far (Daines, Gow, and Larcker 2009; Larcker and Tayan 2011; Renders, Gaeremynck, and Sercu 2010; Tipurić, Dvorski, and Delić 2014). One group of these approaches uses the form of ratings; numerous examples have been developed by consulting companies (e.g., Risk Metrics/ISS, Governance Metrics International/GMI, and the Corporate Library/TCL). The major purpose of such approaches is to rank companies by applying a set of corporate governance criteria. Companies with higher ratings are considered to be less risky and the most likely to grow the value for shareholders whereas those with lower ratings are believed to be riskier and have a higher potential for failure or fraud (Larcker and Tayan 2011). Some research results (Renders, Gaeremynck, and Sercu 2010) show a positive relationship between corporate governance ratings and performance. Nevertheless, Daines, Gow, and Larcker (2009) believe that commercial ratings do not provide useful information for shareholders as they 'do not predict governance-related outcomes with the precision or strength necessary to support the bold claims made by most of these firms' (p. 1). According to Larcker and Tayan (2011), the accuracy and predictive power of different ratings have not yet been proven. In the authors' opinion, ratings encourage a 'check-the-box' approach to governance while overlooking important contexts. The authors suggest that measuring corporate governance quality should be approached on a case-by-case basis that considers the interaction of various governance structures influencing the company's performance.

Another group of approaches takes the form of indices. Academic researchers in particular have been trying to develop models to measure corporate governance quality (Larcker and Tayan 2011). Corporate governance indices differ regarding governance dimensions incorporated in a particular index (Tipurić, Dvorski, and Delić 2014). Academics usually incorporate those governance dimensions in indices that they find to be an important component of good corporate governance practice (Bhagat and Bolton 2008; Larcker and Tayan 2011). A corporate governance index should make possible a comparison of a company's corporate governance practice with governance regulations and recommendations that are considered to be examples of the best governance practices (Tipurić, Dvorski, and Delić 2014).

According to Tipurić et al. (2016), there are several reasons for the development and implementation of corporate governance indices. First, corporate governance indices could significantly contribute to the governance regulatory framework and companies by providing an incentive to adopt better practices of corporate governance. Second, a corporate governance index calculated for a particular company provides important information to the investment community and other groups of key stakeholders. Third, companies with a higher index (i.e., with better assessed corporate governance practice) can develop on this basis a competitive differentiation in the market and consequently long-term business success and survival.

The SEECGAN Index and Its Application in Transition Countries

THE SEECGAN INDEX METHODOLOGY

The beginnings of the application of the SEECGAN Index of Corporate Governance for measuring corporate governance dates back to 2014, when the index was published as the result of research efforts of the members of the South East Europe Corporate Governance Academic Network. At the time, members were invited to apply the SEECGAN Index methodology in their countries in order to make possible comparisons of corporate governance practice and its quality in South Eastern European countries (i.e., Croatia, Bosnia and Herzegovina, Serbia, Montenegro, Slovenia, and Macedonia). The application of this methodology not only enables an in-depth study of governance practice and its quality in a particular company, but also provides insights into the quality of corporate governance within a national economy and makes it possible to compare governance practice among those countries where the same methodology is applied. This is especially important for former socialist countries sharing many historical, cultural, political, and economic similarities that make such comparison a fruitful approach for improving corporate governance practice and quality.

In order to provide comprehensive insights into such a complex phenomenon as corporate governance and to assess its quality, the SEECGAN Index methodology is based on seven broad categories believed to reflect the major corporate governance areas. These categories are (Tipurić, Dvorski, and Delić 2014; Tipurić 2015): (1) structure and governance of boards, (2) transparency and disclosure of information, (3) shareholders' rights, (4) corporate social responsibility, (5) audit and internal control, (6) corporate risk management, and (7) compensation/remuneration. In the case of Slovenia, the first category is divided into two subcategories (i.e., structure and governance of management board, and structure and governance of supervisory board) in order to reflect the country's specifics. Namely, the legal framework in Slovenia enables joint-stock companies to decide between a one-tier or a two-tier governance system. In the case of a two-tier governance system, two separate boards exist in a corporate structure system: the management board and the supervisory board (Djokić et al. 2015; Tipurić et al. 2016).

For each of the previously mentioned categories, several questions were prepared for measuring purposes; each question can be answered in the affirmative or negative in order to ensure objectivity (Patel and Dallas 2002; Tipurić 2015). A ponder is assigned to each question because the SEECGAN Index is developed as a weighted index. The score is then calculated for each category, presenting an index of that particular category, where the maximum score is 10 (describing the best possible practice) and the minimum score is zero (describing the worst possible practice). The overall SEECGAN Index score is the average value of scores of all seven categories, with zero being the lowest value and 10 being the maximum index value. The SEECGAN Index methodology enables the classification of the explored companies in different groups based on their index score (either of a particular category or for all categories). First-class companies are those where the value of the SEECGAN Index is equal to or higher than 7.5. Companies with good governance practice are those where the value of index is equal to or higher than 5.00 and lower than 7.5. Companies with unsatisfactory governance are those with the index value equal to or higher than 2.5 and lower than 5.00, and companies with poor governance practice have an index value lower than 2.5 (Tipurić 2015).

CORPORATE GOVERNANCE QUALITY IN SELECTED TRANSITION COUNTRIES

Sampling and Data Collection

During 2014–2015, the SEECGAN Index methodology was applied in three countries: Slovenia, Croatia, and Macedonia. A comparison of corporate governance practices among these three countries is possible and worth exploring because, in all three countries, the closed system of corporate governance is present and they have similar historical backgrounds. However, there are some indications that they differ regarding the developmental level of corporate governance mechanisms (Tipurić et al. 2016).

Research in Slovenia was done on a sample of 22 public companies listed in June 2014 on the Ljubljana Stock Exchange. Of these 22 companies, nine were companies of the prime market and 13 of the standard market (Djokić et al. 2014). The standard market is intended for larger companies that have a dispersed ownership structure and high levels of transparency of their operations while the prime market is a prestigious market intended for larger established companies renowned for their liquidity and transparency of operations (see http://www.ljse.si/cgi-bin/jve.cgi?doc=8371). Companies' annual reports were the major source of data. These annual reports also comprise corporate governance statements, in which companies disclose their compliance with the Slovenian Corporate Governance Code. Additional data were collected from the companies' websites (internal acts of the management boards, documents, reports, information for different groups of stakeholders). Governance practice for every company from the sample was assessed using 98 attributes based on the SEECGAN Index methodology. The results of the assessments were stored in computer files. The database (Djokić et al. 2014) for our study was created this way to enable an in-depth investigation of governance practice of a particular company and comparisons among companies from the sample as well as comparisons with countries that applied the same index methodology (i.e., Croatia and Macedonia).

In Croatia, 32 firms listed on the Zagreb Stock Exchange participated in the survey by responding to a questionnaire prepared based on the SEECGAN Index methodology. Half of the surveyed companies were listed on the official market and half on the regular market (Tipurić 2015). In Macedonia, 29 companies were included in the ongoing research (Vrboski and Hadzivasileva Markovska 2016; Tipurić et al. 2016). Research teams analysed responses and collected additional information from the companies' websites; when needed, interviews with responsible persons were conducted.

Results and Discussion

In this section we present research results on the corporate governance quality for Slovenia and the results of a comparative analysis with Croatia, for which detailed results were published in 2015 (Tipurić 2015). A comparative analysis with Macedonia was able only on the aggregated level because not all detailed results are available yet.

The average SEECGAN Index score of the listed companies in Slovenia is 5.49 (figure 1). Thus, the average listed company in Slovenia is characterized by good corporate governance practice. The best first-class company in terms of governance quality achieved an 8.16 SEECGAN Index score while the lowest score was 2.26, indicating the presence of poor governance practice in that company. Research results show that half of the surveyed companies in Slovenia have a SEECGAN Index score greater than 5.26. That is true for the majority of prime market companies, leading to the conclusion that mandatory requirements and voluntary recommendations for the presence of high corporate governance standards-especially for prime market companies-actually have a positive impact on corporate governance practices.

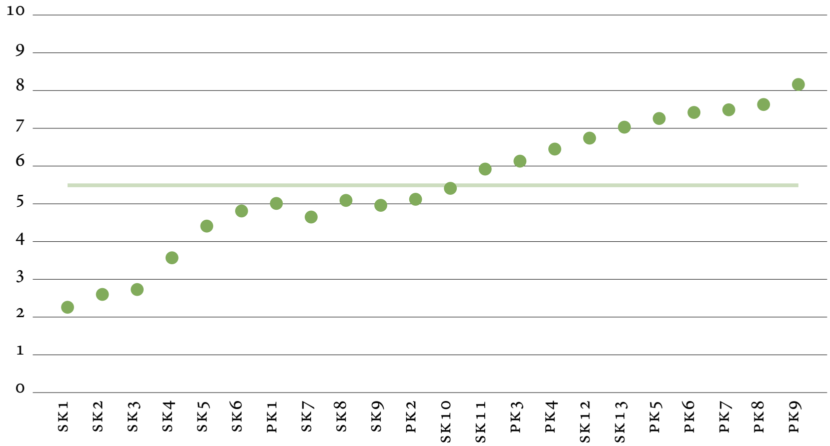

FIGURE 1 Companies' and Average Corporate Governance Index for Slovenia Based on the SEECGAN Index Methodology (dark – company's CG Index, light – average CG Index, PK – prime market companies, SK – standard market companies)

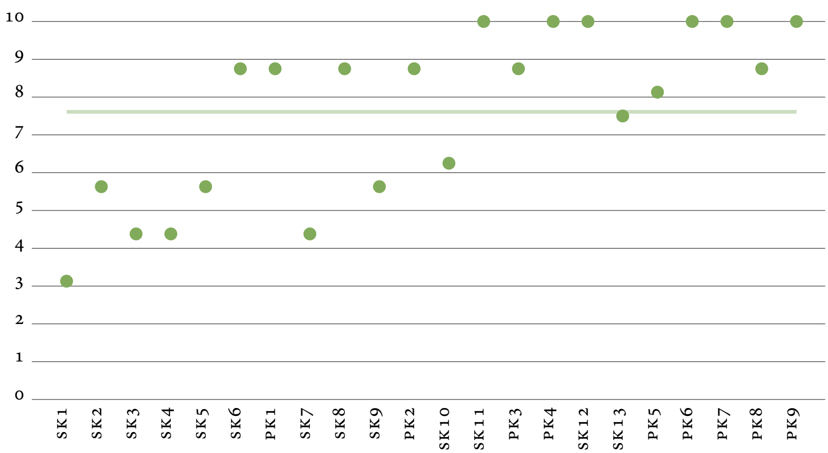

FIGURE 2 Companies' and Average Index in Risk Management Category (dark – company's Category Index, light – average Category Index, PK – prime market companies, SK – standard market companies)

Companies achieved the highest average index score in the risk management category (figure 2). The average company was assessed as a first-class company in this corporate governance category with an index score of 7.61. Half of the companies in this category have index scores higher than 8.75, indicating the first-class practice of risk management in such companies. Six companies (four prime market and two standard market companies) achieved the maximum index score in this category; all six

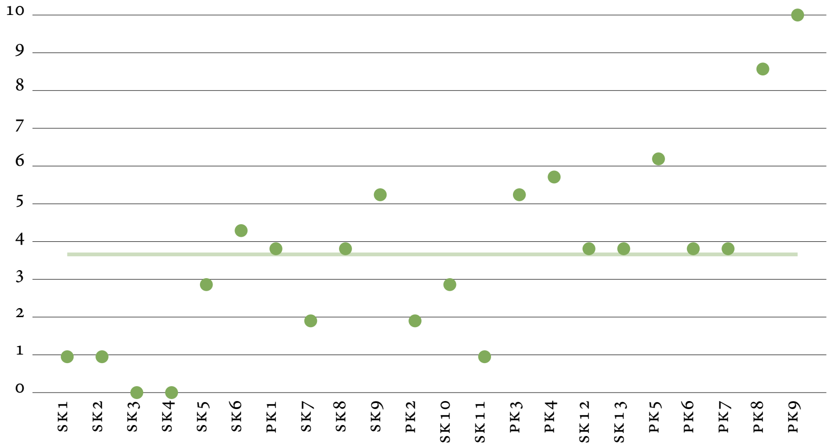

FIGURE 3 Companies' and Average Index in Social Responsibility Category (dark – company's Category Index, light – average Category Index, PK – prime market companies, SK – standard market companies)

companies were also above average for the total index score (see figure 1). The lowest score in this category was 3.13, indicating unsatisfactory risk management practices in that company (SK1). This was achieved in the company ranked as having the worst corporate governance practice among all the companies in the sample.

The category in which surveyed companies display poor and unsatisfactory governance practice is the social responsibility category (figure 3). An average company has unsatisfactory social responsibility practice, with an index score of 3.66 in this category. In this category, we can observe the highest deviation from the mean (2.55), and two companies even achieved a 0.00 index score. Seven companies were evaluated as having poor social responsibility practice, with an index score ranging from 0.00 to 1.90. Among these companies, one company (SK11) achieved an above average total CG index score. The by far best result in this category was company PK9 (with an index score of 8.57), which was also the highest ranked company on the total CG index. The results in this category indicate that, on one hand, academics' and professionals' special attention is needed on how to improve social responsibility practice; on the other hand, the SEECGAN Index methodology should be checked for this category and eventually improved. This could be done by using an in-depth study of individual cases and comparing the results and experiences among participating countries that apply the SEECGAN Index methodology in this category.

TABLE 1 Corporate Governance Index in Slovenia and Croatia Based on the SEECGAN Index Methodology

SEECGAN Index	Slovenia	Croatia
Total	5.49	3.91
Transparency and Disclosure of Information	6.62	4.91
Structure and Governance of Supervisory Board	5.66	3.19
Structure and Governance of Management Board	4.49	
Shareholders' Rights	4.79	4.66
Corporate Social Responsibility	3.66	4.03
Corporate Risk Management	7.61	3.87
Compensation/Remuneration	4.74	2.34
Audit and Internal Control	6.36	4.47

A cross-country comparison shows that corporate governance practice in Slovenia is better evaluated than in Croatia and Macedonia. Companies in Croatia have on average unsatisfactory governance practice, with an index score of 3.91 (Tipurić 2015). The same is true for Macedonia as well, where the average SEECGAN Index is 4.09 (Vrboski and Hadzivasileva Markovska 2015). The comparison of research results between Slovenia and Croatia indicates better corporate governance practice in all the SEECGAN Index categories in Slovenian companies with the exception of the social responsibility category (table 1). This is the lowest ranked category in Slovenia, while in Croatia social responsibility is ranked as the fourth best evaluated governance category. A comparison of the risk management category, where Slovenian companies on average have first-class practice and the category itself is ranked as the best evaluated category, shows that this category in Croatian companies ranks fifth (lower than social responsibility category), with an average index score of 3.87. The risk management category has the biggest differences among Slovenian and Croatian companies. A comparison of the research results between Slovenia and Croatia indicates that several differences exist in the corporate governance practice, calling attention to need for a more detailed analysis of particular categories and cases.

Conclusions

The state and quality of the corporate governance have been presented and evaluated in a particular company using different standards and principles or indexes and methodologies, which concern good practice and show as well as measure the execution of the competences of the governance and management bodies in practice while also expressing the level of corporate governance. The results of corporate governance can also be summarized at the national level to provide investors, shareholders, and stakeholders with faster and more efficient access to the information on corporate governance.

The use of the SEECGAN Index and corresponding methodology in this article provided insights into the corporate governance practice and its quality on the national level, thereby pointing to those areas needing improvements by either mandatory or voluntary regulations and recommendations. The use of the same methodology in a similar context (i.e., in Slovenia, Croatia, Macedonia) enabled comparisons of the state of governance across these transition countries as well as the analysis of differences and similarities. Our cross-countries comparison showed that corporate governance practice in Slovenia is of better quality than in Croatia and Macedonia. However, despite this finding, our research results show that improvements are required in Slovenian companies, especially in those corporate governance segments where governance practice is evaluated as unsatisfactory. These segments need additional research, either as case studies or as the exploration of good practices in an international context with similar contexts. This should serve to develop proposals of measures to improve corporate governance practices at the company as well as national level.

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