



SUMMARY

The basic aim of this study and the underlying empirical research (carried out between 1999 and 2000) was to give a systematic, expert and empirically-based analysis of the main aspects of corporate governance in Croatia. Special attention was given to ownership (d)evolution, management control and their impact on enterprise structures.

The author's approach was based on three preliminary hypotheses. Hypothesis *one*: the Croatian corporate governance model is designed according to laws which follow the German corporate governance model, but in reality the Croatian model is still unshaped and far from the planned design. Hypothesis *two*: in Croatian joint-stock companies, the ownership structure is not the key determinant of corporate control – it is rather the managers' ownership-governance "know-how" which is most influential in real situations. Hypothesis *three*: foreign investors, banks, insurance companies and other financial institutions have not played a significant role in corporate control.

In an attempt to present the basic relations between owners on the one side and top management on the other, *agency theory was analyzed* in the first chapter. Here the author tried to explain some of the basic concepts that are linked to agency theory, corporate governance and management control such as: Anglo-American and German corporate governance models, management entrenchment and management control, privatization and management control in postsocialist countries, and possible evolution of management in privatized enterprises.

Bearing in mind the mentioned basic aim of the overall study, *the main research project objectives* were defined as the following: 1) identification of a new ownership structure and its evolution within the analysed joint-stock companies since privatization to the present day (with special focus on top managers and supervisory boards), 2) identification of possible relations between the new ownership

structure, enterprise performance and ownership control, 3) identification of key shareholder strategies (managers, employees, state, institutional investors) regarding: a) ownership stake within an enterprise, b) corporate control practice, c) the economic and social performance of an enterprise, 4) a description of the possible development of corporate governance in Croatian joint-stock companies in the near future (attention given to the (d)evolution of management control).

Concerning the study sample of joint-stock companies and managers, the analysis of the available secondary data showed that the Croatian Privatization Fund's documentation was the most appropriate for our final joint-stock companies' sample (publication "Privatizacija" - *Special Issue 1998*). The study sample of enterprises/joint-stock companies are from the following areas in Croatia: Zagreb and its environs (50 enterprises), Northern Croatia (11), Slavonia (Osijek and its environs - 15 enterprises), Lika, Kordun and Banovina region (10), Istria, Rijeka and Gorski Kotar (20), Dalmatia (Split region - 20 enterprises). We used two different questionnaires as the main research tools: one for top managers and one for SB-members; every questionnaire had approximately 50 closed questions, covering relevant data on personal, enterprise and corporate governance problems. We also used a semi-structured questionnaire for interviews with capital market professionals and PIF's managers. By the end of the investigation (spring, 2000), we had collected research data on corporate control and capital markets in Croatia from enterprise managers (n = 70), supervisory board members (n = 135), and 40 (interviewed) professionals.

Undoubtedly *the practice of corporate governance and corporate control in Croatian joint-stock companies is subject to the detrimental influence of key privatization actors and a very unstable ownership structure in these joint-stock companies*. We most frequently found that employees, the state and institutional actors (Croatian enterprises and privatization investment funds (PIFs)) were the dominant owners in our sample of joint-stock companies. However, the majority of our respondents expected major changes within the ownership structure in most of these joint stock companies/enterprises. They think that the ownership stakes of the most important owners - the state, employees and domestic enterprises - will decrease and that the ownership stakes of managerial groups, individual (domestic or foreign) owners and privatization investment funds (PIFs) will increase in the near future.

Under the present post-privatization circumstances, the main actors show different patterns of behavior.

1) *Employees as "small shareholders" or "minority owners"* generally do not play a significant role in corporate control within the majority of Croatian privatized enterprises. Namely, as long as the firm does well in business, they are satisfied with their stakes and with the policy of preserving existing jobs. This latent coalition with managers falls apart in at least two typical situations: a) When incumbent managers plunder the enterprise's resources and when their methods of internal rent-seeking seriously threatens workers' wages and jobs, b) When someone else outside the enterprise tries to take over the company. In these situations, witnessed mostly in the last year (e.g., affairs with Petrokemija-Kutina, Čateks - Čakovec, Nama - Zagreb, Šavrić - Zagreb, etc.), the conflict between workers and managers becomes very obvious and *workers as workers - and not as small shareholders* - defend "their enterprises" through collective actions (strikes, pleas to the government, coalitions with "small shareholders" outside the enterprise, etc.). This means that the new ownership and management elite has not produced the desired economic and social output within these newly privatized enterprises. Since the state still has some ownership stakes in many of these enterprises, the workers initially appeal to the government in such conflicts! Thus, for ideological and other reasons, the new government wants to get rid of state ownership within enterprises as soon as possible, to keep the growing number of conflicts inside the enterprises. Moreover, this is why more responsibility is being demanded from managers and supervisory board members.

2) *Our research confirmed once again that wherever possible Croatian managers are trying to increase their ownership stakes within a particular joint-stock company.* The whole privatization process in Croatia (from 1991 to 1997) was mainly based on (politically controlled) "insider privatization". Former socialist directors (now "managers") as "insiders" took the opportunity to become (co)owners of a certain part of enterprise shares. The Croatian project of limited mass privatization in 1998/1999, which introduced the PIFs as corporate governance actors in Croatia, intensified managers' (co)owners' aspirations once more.

According to our research data, supported by data from other empirical sources, about 35.7% of the surveyed managers do not have shares in the enterprises where they are managing, 58.6% have shares which do not enable them to have enterprise control and almost 6.0% have

shares which enable them to have most or absolute ownership control of particular enterprises. Members of the managerial elite think that the success of their firms would improve if, in the near future, the ownership stakes of the state, domestic enterprises, PIFs, workers and small shareholders outside the enterprise decreased; at the same time, the ownership stakes of foreign investors (as strategic partners!), local individual owners and the ownership stakes of incumbent managers should be increased. The mass privatization project during the last two years and the policy of new state administrators towards the role of the state within enterprises has helped some of these managers' dreams come true.

Nevertheless, what is behind these managers' desires? Two reasons are crucial here: a) The idea that they can through their double status – as managers and (co)owners – have a stronger influence on corporate control which is very important if a old/new player outside the enterprise (the state, PIFs, foreign investors, individual buyers) wants to enter the ownership structure of the company; b) The managers' idea of desired enterprise ownership structure shows that majority of Croatian managers prefer joint-stock companies with strong shareholders that adhere to the rigid concept of corporation. This can be called “the majority owner concept of corporation” because the concept does not include other stakeholders as relevant corporate governance players under present conditions. The question is to what extent is such a “majority owner concept of corporation” widespread among the governing groups within Croatian society?

Our research data also showed that owners in Croatian joint-stock companies are represented by two types of supervisory boards. The first type are small supervisory boards, mostly with 3 to 5 members, and the second type are large supervisory boards, with 6 to 9 members. We found that one third of the incumbent supervisory board members are simultaneously members of supervisory boards in other enterprises. Assuming that the number of parallel SB-functions directly affects the quality of SB-member involvement in enterprise problems, these findings are very alarming. This means (hypothetically speaking) that at least one third of SB-members can be blamed for the unprofessionally managed SB-member duties.

It is worth noting that in most cases SB-members come from “broader business systems”, which also encompass other enterprises in which they are “supervisors”. This means that within most of the studied enterprises there are

supervisory boards where the chairperson and all SB-members were appointed internally within these enterprises! This mostly occurs in enterprises which are owned by employees or by the employees and management groups. These joint-stock companies are in reality “true insider forts”, where management teams rather than the real owner appoint their own SB-supervisors.

With regard to the existing practice of owners’ control, the data showed that managers registered definite owners’ control in 38.6% of all enterprises and SB-members recognized it in 31.9% of enterprises. The incumbent managers are mostly controlled by regular business reports to SB but also by direct chairmanship of the owners within the supervisory boards. This means that in these enterprises there is a personal link between the owner’s and supervisory role, which is only one of the expressions of absolute owners’ control within this part of the researched companies. When evaluating the work of SB-members, we noted some differences between our respondents. Managers maintain that the key measures of SB-members’ work include the following criteria: realization of owners’ goals, increased enterprise profit and increased shares value. The SB-members stressed the following criteria as the main evaluation variables: increased profit followed by realization of owners’ goals. Moreover, they unanimously stressed the owners’ goals as one of the key criteria concerning the evaluation of SB-members’ work. However, the problem is often related to the Croatian context: namely, some new (post-privatization) owners do not have a clear idea about their real goals, or alternatively are working intentionally against their own workers and the enterprise itself.

Only one tenth of our respondents think that the SB-members’ fees should not be dependent on the enterprises’ economic performance. Such an attitude is interesting because it decreases the autonomy of SB-members with regard to their judgment and operational behavior. Moreover, the idea that SB-members’ fees should be linked to actual enterprise economic performance is quite different from international recommendations and codes of “best corporate practice” concerning the position of (external) board members.

However, admittedly at an explicit level, our respondents are aware that the autonomy of SB-members is very important. Namely, when they were asked to judge the key features of their boards, they stressed that they are very satisfied with the general level of education, comprehension of business/management reports and with professional

knowledge. In contrast, they are most dissatisfied with the lack of autonomy in their problem solving, with the inefficiency in decision-making as well as with the level of knowledge in relation to enterprise problems. Managers are much sharper here: they think that supervisory boards would work in a more professional way if they were composed of more competent people who understand financial/business reports more efficiently than present-day SB-members.

Besides, some managers think that further privatization is a *sine qua non* pre-condition for more professional work of present-day supervisory boards. Moreover, all these opinions can be summarized in the following question: what kind of competent SB-members are we talking about here if they do not know enough about the problems of the enterprise whose managers they are supervising? In addition, how should we define “professional competence” required for supervisory board functions inside Croatian joint-stock companies? We still do not have the answers to these questions from our respondents and interviewed professionals.

Some interesting relations between our variables were found following statistical analysis. First, where owners’ control is very strong, there is a very high probability that the ownership structure will not change in the near future! We concluded that possible reasons for this is that the newly established ownership structure determined such control and not vice versa. Second, the majority of enterprise owners where economic performance is poor are to a much higher extent PIFs and the state rather than other owners. This finding can be explained as a product of mass privatization and the present CPF – enterprises portfolio.

An interesting tendency can be detected concerning the relations between the level of economic performance and possible changes within ownership structure: enterprises that have performed poorly over the last three years are expecting that “their” strategic investors enter into the ownership structure to a greater extent than other enterprises. According to our respondents, the enterprises that performed very well do not plan to change their ownership structure in the near future. With regard to the institutional origin of SB-members, we found two statistically significant relations: a) SB-members from banks and PIFs are located to a greater extent in enterprises that performed poorly, b) in a similar way, SB-members that are representatives of the state are also located to a much higher extent within weak enterprises. These differences

were due to the different ways in which particular banks and PIFs entered the ownership structure of these enterprises: through new capital inputs, by swaps with the state or through the mass privatization project in 1998/1999. Alternatively, in cases where the state has ownership of enterprises for which there is no interest because of their poor performance in the past and inherited large debts.

In the end, a very important relation was identified between business performance and ownership control type. Namely, the statistical analysis used suggests the following possible relation: that within enterprises which experienced stronger owners' control, there exists a higher possibility that they performed very well in the last three years. Yet, we also detected other interesting findings: in our sample of enterprises we identified about 42.3% enterprises that are very successful; but within 19.5% of them we observed very strong owners' control, while within 22.8% weaker owners' control was noted. Thus, we can assume that strong owner control is not the only possible reason for good economic performance in joint-stock companies in Croatia.

3) *The behavior of PIFs.* Seven (7) privatization investment funds in Croatia were established recently - by the Croatian mass privatization project in 1998/1999. The PIFs' ownership role is mostly determined by their capital, management capacity and by their enterprises' portfolio "earned" within the mass privatization process, as well as in the newer swaps of some enterprises with the state. First of all, PIFs were - (bearing in mind the economic quality of the enterprises included in the mass privatization project) - very good players with regard to the role of "collector" of vouchers/certificates from the citizens involved in that project (about 200,000 different categories of war affected persons). Second, the whole design of the mass privatization project prevented the PIFs from the very beginning from obtaining the majority of ownership stakes within the available enterprises. Consequently, PIFs as the new (co)owners could not take stronger actions toward incumbent managers in enterprises and prevent enterprise assets from being subject to different modes of managers' "rent-seeking" and "asset stripping". Moreover, this slowed down the process of finding possible foreign or/and domestic investors for more successful enterprises. However, positively the "rules of the game" were established: they caused different cooperative models of behavior between PIFs themselves from the very beginning and oriented them especially toward the state as a regulator and one of the owners of non-privatized ownership stakes in other en-

terprises. This is why new swaps of some enterprises with the state were realized so that PIFs could improve their enterprise portfolios (and have larger ownership stakes in particular enterprises).

The most important conclusion is that Croatian PIFs, with regard to their enterprise portfolio, followed the “exit strategy” and not the policy of restructuring domestic companies. For this reason, PIFs’ are trying to find new investors for most of their enterprises and are becoming very serious players in corporate control (especially by suppressing management control in these enterprises). Managers’ aspirations toward (co)ownership status in “their” enterprises helped PIFs in this way so that some small enterprises were completely sold to incumbent managers through classical MBO operations.

According to the last data (given by PIFs managers in interviews in 2000), most PIFs follow the policy of ownership concentration within portfolio enterprises. The reason for this is clear: only the majority ownership stake is attractive to external investors, and only this kind of ownership allows PIFs some sort of enterprise restructuring – when necessary! The ownership concentration policy is also realised by mutual swaps between the PIFs themselves, because this practice has not as yet been strictly regulated in positive laws.

Overall the PIFs’ behavior so far suggests that they are not behaving like “active restructuring agents” within Croatian joint-stock companies. Namely, PIFs – with all their managers and external experts, available capital, knowledge, business philosophy and with their primary goals – are not oriented toward the important role as restructuring agents in these companies.

4) *The behavior of the state as owner.* During the last nine years, the behavior of the state as corporate actor was determined by several variables: a) by the privatization model from 1991, b) by the negative attitude of the former political elite (in power from 1991 to 1999) to development of different forms of entrepreneurship and ownership, c) by using the state as a “general entrepreneur”, which served the political elite for collecting and distributing the surplus value according to desired political criteria, d) by the formal and informal development of political clientele and the very narrowly politically designed entrepreneurship of elite, e) by illegitimacy of the privatization process and state institutions in the eyes of the public, f) by the negative attitude of the new political administration (in power from 2000) toward state ownership.

This is why new administrators want to withdraw the state as owners from domestic enterprises as soon as possible. At the same time, being aware of a deep workers' dissatisfaction with the economic performance of enterprises, managers and restructuring claims by new (co)owners, the government wants to include workers' representatives in supervisory boards.

The legitimacy pattern of the former political elite (in power from 1991 until 1999) was based on several theses: that through privatization the previous socialist non-ownership system would be replaced by an efficient ownership rights system; that through the privatization process, fair distribution of socialist assets and peoples' capitalism would be attained; and that a "market economy of the Western type" would also be developed soon afterwards. At the ideological level, utopian goals were stressed while in reality privatization results were diverted to certain revenues for the state budget and toward the development of a primitive type of capitalism.

The new political elite (in power after parliamentary elections on January 3, 2000) stress in terms of utopian goals "the correction of injustice within the former privatization process" and the survival of "small shareholders" (by CPF's new policy) - as long as it is possible; on the other hand, new officials increased the number of pragmatic goals (very directly): from withdrawal of the state from enterprises to obtaining money for the state budget through privatization of large infrastructure companies (telecommunications, electricity, etc.).

With regard to correcting injustice within the former privatization process, the government has formulated (through new laws) a revision policy of privatization. However, the final economic results of this policy are still very doubtful. Moreover, in an attempt to suppress the possible conflicts between new owners, managers and workers and to improve the quality of corporate performance, the government has decided from autumn, 2000 to include workers' representatives in supervisory boards. This is happening simultaneously with other measures directed toward the improvement of the employee social security rights. Clearly, the main contradiction within this new government policy is linked with the incongruence between basic utopian and pragmatic goals. While selling off the remaining state enterprises implies withdrawal of the state as a corporate governance actor, the announced revision policy of privatization facilitates new state interventionism in a significant number of enterprises that have already been privatized.

5) *Desirability of other corporate governance models.* We can only draw a few conclusions here.

First, the relative majority of managers and SB-members accept the idea of workers' representatives in supervisory boards as a starting point for the possible reform of the present model of control within joint-stock companies. Second, we investigated the thesis that incumbent managers can make up to one third of SB-members. This opinion is acceptable to more than a half of the surveyed managers while 65.2% of the current SB-members are opposed to that thesis. The author assumes that these SB-members are opposed to that idea because they think that such a change is quite different from the Croatian legal tradition and that radical change is not a good remedy for current corporate governance problems. Besides, perhaps some SB-members are opposed to such an idea because they are concerned about their positions and monthly salaries, which are also the products of the existing supervisory model. Third, managers and SB-members are to a large extent against the idea that the chairpersons of management teams can also be appointed as chairs of new corporate boards. No one is willing to accept such an open Anglo-American model of corporate control as a way of improving today's corporate governance structures.

Retrospectively, all these findings allow us to make the following conclusions about these data.

1) The Croatian corporate governance model will evolve toward "The German co-determination system in a Croatian way";

2) The current joint-stock company ownership structure and the behavior of the state as regulator and owner produced two dominant types of corporate control: a) absolute control of an individual / a few owners, and b) managerial control (very often supported by managers' (co)owners' status within current Croatian joint-stock companies); the latter will decrease with the arrival of strong shareholders into the enterprises, that may also have positive effects on the professionalization of the management function;

3) Although the external (foreign) investors, banks and insurance companies still do not play a significant role in corporate control, the Croatian mass privatization project from 1998/1999 introduced PIFs as new institutional owners that have played an important role in the corporate control of a (part) of Croatian joint-stock companies during the last two years.

4) The quality of corporate governance practice in Croatian joint-stock companies will also depend on the rapid development of Croatian capital markets as well as on new regulations which will introduce new standards of communication between shareholders themselves, as well as between managers and owners, shareholders and stakeholders, companies and potential investors, and companies and state regulators in the next few years.

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