6th Changing Europe Summer School

The Impact of the Global Economic Crisis on Central and Eastern Europe. Economic, political and social aspects

Moscow (Russia) 1 - 7 August 2011

Organised by the National Research University - Higher School of Economics
and the Research Centre for East European Studies (University of Bremen)

www.changing-europe.org

Valeriya Zaozerna: Trends in Corporate Governance of Post-Socialist States

About the author:

Valeriya Zaozerna is a third-year PhD candidate at the University of Bamberg, Germany (Graduate School "Markets and Social Systems in Europe"), specialising in corporate governance. Previously, she studied at the National Mining University of Ukraine in Dnepropetrovsk (Faculty of Management) where, in 2007, she obtained her MA degree in international management and economics. This paper presents the early stages of her PhD dissertation topic as well some preliminary research results.

e-mail: valeriya.zaozerna@uni-bamberg.de

©
Publikationsreferat / Publications Dept.
Forschungsstelle Osteuropa an der Universität Bremen
Research Centre for East European Studies at the University of Bremen
Klagenfurter Straße 3
28359 Bremen
Germany
e-mail: fsopr@uni-bremen.de

Abstract

The collapse of state socialism at the end of the 1980s forced the countries of central and eastern Europe to choose new methods of socioeconomic development as they transitioned from a pluralistic socialist model to a neoliberal market economy. This paper discusses the current state of corporate governance in Poland, the Russian Federation, and Ukraine in light of the economic transformation process. To summarise the results of the research, the quality of the formal regulatory framework of corporate governance in post-socialist states can be evaluated as satisfactory, but it remains ineffectual because of a generally low level of compliance within the countries.

1. Introduction

"Good governance is essential not only for stability of the banking industry but also for economy as a whole. Effective governance is the means of building and maintaining the qualities that are at the foundation of all commerce: confidence and public trust. It is disheartening to see how many financial institutions lost sight of these basic truths" (Barton et al. 2009).

What is corporate governance? Is governance the same as management? What does corporate governance have in common with corporate constitution?

The term "governance" comes from the Greek word "cybernetics", which can be translated into English as "helmsman". The word "cybernetics" led to the English term "governor", which forms the basis for the collective term "governance". In conjunction with the Latin word "corpus", from which the word "corporation" is derived, "corporate governance" means, strictly speaking, "physical control".[1]

According to the definition of the Organisation for Economic Co-operation and Development (OECD) *"Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set and the means of attaining those objectives and monitoring performance."* [2]

2. Corporate Governance

2.1 Historical Perspective of Corporate Governance

Traditionally, economic discussion on corporate governance begins with the work of Berle and Means, *"The modern corporation and private property"*[3] (1932). In early American businesses, shareholders did not have limited liability provisions[4], a situation that led to personal bankruptcy in cases of poor management. The creation of such provisions for corporations in the beginning of the 1990s put further distance between shareholders and management with respect to the running of a company. This was also the time when large corporations and a powerful class of professional managers who *"were able to use*

1 Lattemann, Christoph: Corporate Governance im globalisierten Informationszeitalter. München, Oldenburg, 2010.
2 http://stats.oecd.org/glossary/detail.asp?ID=6778 accessed 25 May 2011.
3 Berle, Adolf / Means, Gardiner: The Modern Corporation and Private Property. MacMillan, New York, 1932.
4 Tricker, R.I.: Corporate Governance. History of Management Through Series. Ashcroft, Aldershot, UK, 2000.

the firm to further their own interests rather than the interests of shareholders"[5] emerged and dominated the scene

Berle and Means asserted that the separation of ownership and control in the large corporations resulted in the helplessness of capital owners and in managerial entrenchment. The main corporate governance issue in the United States during that period was focused on the requirement to establish fundamental regulations in order to implement the separation of ownership and control as stated in the Federal Security Act (SEC) 1933.

Jensen and Meckling, in their well-known paper "Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure" (1984), expressed the need to maintain equilibrium between management and owners, as these are the parties of the firm with the highest potential for conflicts of interest. The responsibility for maintaining an appropriate balance between management and owners was assigned to the board of directors, who were to oversee the functions of management and protect the interests of investors. To maintain such equilibrium, it is necessary to ensure the independence of the board of directors from the management of the company and provide better oversight to the independent directors through an effective system of corporate governance.

The legal framework for effective corporate governance was introduced in the American Law Institute (ALI) report titled "Principles of Corporate Governance" (issued 1994). These principles establish specific legally binding rules on how corporate boards should be structured and what functions the board of directors should perform.

The beginning of the era of corporate governance was defined through the interests of shareholders as owners of the firm. Therefore, the primary obligation of managers was *"to conduct the business in accordance with their (shareholders) desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical customs"* (Friedman, 1970).

2.2 Global Corporate Governance

Globalisation stipulates the development of business throughout the world. Financial markets and goods markets are affiliated with each other. The speed with which financial operations can be conducted encourages regulating institutions to establish global infrastructures with generally accepted rules. Thus, corporate governance regulations exist to protect investors' rights and to ensure the stable economic development of the firm, region and country. It is vital that regulated institutions from all countries work together to improve integrity and prevent a global crisis from affecting economies worldwide.

By adopting universally valid codes[6] of best practice by the state and/or the company, countries attempt to protect themselves from the unpredictable events of an economic nature. An example of one such set of codes can be found in the Principles of Corporate Governance (The Principles) proposed by the Organisation for Economic Co-operation and Development (OECD) in 1999. The Principles have since

5 Weisbach, Michael: Outside directors and CEO turnover, in Journal of Financial Economics 20, 1988, No. 20, pp. 431-460.
6 Such codes are constituted in Principles and Guidelines on Corporate Governance YEATTSP, the policies of corporate governance and transparency in emerging markets (IMF), Global Corporate Governance Principles CalPERS as well as in the OECD Principles of Corporate Governance.

become the international benchmark for policy makers, investors, corporations, and other stakeholders worldwide, has advanced the corporate governance agenda and has provided specific guidance for legislative and regulatory initiatives in both OECD and non-OECD countries.

The Principles are a living instrument offering non-binding standards and good practices as well as guidance on implementation that can be adapted to the specific circumstances of individual countries and regions. The Principles cover the following areas:

- The basis for an effective corporate governance framework: *"The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities".*
- The rights of shareholders and key ownership functions: *"The corporate governance framework should protect and facilitate the exercise of shareholders' rights"*.
- The equitable treatment of shareholders: *"The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights".*
- The role of stakeholders: *"The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises".*
- Disclosure and transparency: *"The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company".*
- The responsibilities of the board: *"The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders"*[7].

Corporate governance is rooted at both the national and the international levels. By analysing the typical principles of corporate governance, the fundamental and worldwide-recognised components of good corporate governance emerge. These include the protection of shareholder rights, participation of stakeholders, transparency, regulations of mergers and acquisitions, rights and duties of the board of directors, and audit rules.

2.3 Corporate Governance in Local Contests

Corporate governance, a rather unstable phenomenon, has evolved from its role of ensuring the interests of business owners to the role of creating stakeholder value. It is continually developing and varies from continent to continent, from country to country, and from firm to firm. For example, the systems of corporate governance in the United States, Canada, and the UK are characterised by widespread ownership; thus, the primary conflict of interests is between management and the dispersed shareholders. In western European countries such as Germany, ownership is concentrated in the hands of a few banks and organisations; thus, the conflict of interest arises between management and large sharehold-

7 OECD Principles of Corporate Governance, 2004, http://www.oecd.org/dataoecd/32/18/31557724.pdf, accessed 20 April 2011.

ers. In the post-socialist states such as Ukraine, the potential conflicts of interest are between the controlling shareholder and minority shareholders.

The structures of corporate governance are influenced by a country's historical and cultural traditions as well as its legal, economic, and institutional environments. Cross-country factors that differentiate corporate governance structures among different countries can be classified by their legal and market infrastructures.

A state's legal infrastructure significantly influences the structure of its corporate governance, its principles, and its functions. It also plays a vital role in corporate governance by defining legal rights of corporations and providing legal protection for investors. These rights include the right to elect a corporate board, to appoint management, to vote on important firm decisions, to demand reliable and transparent information about the company, and to hold directors and officers accountable for corporate affairs.

The market infrastructure consists of rules, regulations, and best practices that determine how capital markets function. The market infrastructure can influence listing standards of stock exchanges and set responsibilities and standards for corporate directors, shareholder voting processes, and requirements on financial reporting.

Most industrial countries have active competitive markets. Companies in such markets have the best chances for survival if they implement the most effective corporate governance mechanisms while companies with poor corporate governance are replaced. In this context, market mechanisms are important regulators of corporate governance as they resolve corporate governance problems by monitoring the firm's behaviour in competitive markets. For example, if investors are not satisfied with the corporation's performance, they can sell their shares, and if many shareholders choose this tactic, the corporation's stock price drops and can force managers to change their strategy. If management does not change its course, the corporation is more likely to be the target of a takeover. Such an event can lead to serious consequences for management, such as being fired or acquiring a bad reputation, among others.

All of these factors and their collective functions determine the system of corporate governance. Although each country has its own system of corporate governance suitable for its cultural, political, and regulatory traditions, corporate governance systems in some regions have similar characteristics. We can see evidence of the convergence and divergence of corporate governance practices in Poland, Russia and Ukraine.

3. Development of Corporate Governance Frameworks in Post-Socialist States

3.1 Transition Economies in Eastern Europe

This section focuses on transition countries located in eastern Europe and seeks to identify the main similarities and common tasks for improving the quality of corporate governance.

Transition economies undergo changes in the political and economic systems of a country. Economic transformations involve a change from a centrally-planned to a market-oriented economy. Conversely, political reforms, include changes in the role and structure of the state system as well as a shift from

communism to democracy. The political and economic systems of transition countries in eastern Europe possess basic similarities and therefore face similar challenges during transition.

Many sectors of former socialist economies were underdeveloped, inefficient and regulated and controlled by the state. Privatisation strategies, such as mass privatisation, were used to transfer assets from the state to the private sector. During mass privatisations, state assets were redistributed among the population for free or at a steep discount. Through this reallocation of ownership, potential resistance to privatisation was averted as people who now held a stake in a privatised company had gained a vested interest in the success of new privatisation policies.

To restructure their economies, state governments had to choose a new model of corporate governance. The choice of the right corporate governance model in the post-socialist states was not easy. First, there was the question as to which corporate governance model would be best. There are two main models in developed market economies: the Anglo-Saxon and the continental one. They reflect different philosophies of corporate governance, especially regarding the company's mission and method of corporate control.

Although the Anglo-Saxon model was best suited for the post-socialist states because of its policy of mass enfranchisement of the population, other reasons spoke in favour of the continental model:

- the participative character of the model that advocates employee participation;
- the availability of functioning internal supervision, as there was no effective external control;
- the weak investment potential of the local population; and
- the absence of management knowledge and archaic technical assets of the enterprises.

The evidence from Poland, Russia, and Ukraine provides an important opportunity to study this process. Poland has been among the forerunners of corporate governance in the region since the period of transition began. Poland was one of the first post-socialist states to choose a pro-European orientation and introduce corporate governance regulations.

The Russian Federation, which is authoritarian and territorially the largest and most powerful state among the CIS countries, accepted the importance of corporate governance and introduced a code of good governance on April 4, 2002.

Ukraine, still hesitating between east and west, was the last of the three countries under study to introduce a corporate governance code, doing so on December 11, 2003, and laws regulating the joint-stock market, which were adopted on September 17, 2008.

To compare corporate governance in post-socialist countries, a brief description of the transformation process in these countries with respect to corporate governance issues is helpful.

3.2 Corporate Law and Corporate Governance in Poland

The formation of the Polish governance structure began in 1989 with the beginning of the privatisation process. The aim of the new framework was to facilitate the companies' goals as well as the owners' interests through the securities market legislation.

The most important legislative framework for Polish companies is provided in the Commercial Company Code (CCC). The CCC, enacted in 1934, was updated and modified in 2000 and re-enacted on 1 January 2001. The CCC provides regulations on the establishment and operation of companies and deals with

general corporate issues, duties and rights of the management and the supervisory board, shareholder and creditor rights, mergers and acquisitions, and liquidation activities.

The Gdansk Institute for Market Economics (GIME), which acts as an independent non-governmental scientific research institution, published the Corporate Governance Code for Polish Listed Companies in 2002. The code is geared to principles and recommendations of good governance practice issued in other countries or by international organisations, such as the OECD Principles of Corporate Governance or the EASD Corporate Governance Principles. The Polish Corporate Governance Code aims to protect minority shareholders and their co-determination rights and strives to achieve a balance of all stakeholder rights within the company.

The Warsaw Stock Exchange (WSE) adopted the Best Practices in Public Companies in 2002 so as to establish further instructions on governance issues. The best practices aim to strengthen corporate governance regulations, foster a competitive market environment and increase the attractiveness of the exchange market. On 1 January 2008, the Code of Best Practice for WSE Listed Companies came into force. The code aims to improve the transparency of corporate operations and enhance the quality of information access and communication features. Additionally, it provides recommendations for the management and supervisory board.

3.3 Corporate Law and Corporate Governance in the Russian Federation

Russia's transition from socialism to capitalism came with privatisation between 1992 and 1994. In just two years, over 24,000 medium and large state-owned enterprises were transformed into joint stock companies; over 16,500 enterprises were privatised, and over 41 million Russian citizens became shareholders through either direct holding of shares in the newly privatised companies or through share ownership in investment funds. However, Russian privatisation was not accompanied by any effective corporate governance mechanisms.

Corporate relations in the Russian Federation are regulated through the following legislation:

- The Civil Code of the Russian Federation № 51-FZ of 21 October 1994 (part one);
- Federal Law № 208-FZ "On Joint Stock Companies" dated November 24, 1995;
- Federal Law № 39-FZ "On Securities Market" dated March 20, 1996;
- Federal Law № 46-FZ "On protection of rights and legitimate interests of investors in the securities market" on February 12, 1999;
- Federal Law № 178-FZ "On privatisation of state and municipal property" from November 30, 2001;
- Federal Law № 181-FZ "On the use of government securities of the Russian Federation to improve banks 'capitalisation'" of 18 July 2009;
- Federal Law № 175-FZ "On Additional Measures to improve the stability of the banking system prior to 31 December 2011" dated 27 October 2008.

In 2002, the Federal Commission for the Securities Market (FCSM) issued the Code of Corporate Conduct and suggested its voluntary compliance for listed and non-listed companies. The Code of Corporate Conduct covers recommended best governance practices across broad areas, including guidelines on board composition, independent board standing committees, voting procedures, and disclosure policies. In 2004, under the administrative reforms of then-President Putin, the FCSM was abolished, and its

functions for regulating the securities market were handed over to the Federal Financial Markets Service of Russia (FFMS).

3.4 Corporate Law and Corporate Governance in Ukraine

The development of the corporate governance system in Ukraine was accelerated through the strengthening of the role of the markets in the early 1990s. The formation of corporate governance has taken place simultaneously with the creation of the private business sector. The establishment of the private business sector is connected with the privatisation process during the period from 1992 to 1999, a time when more than 35,000 public companies with over 19,000 shareholders emerged.

In the beginning of the 1990s, corporate legislation in Ukraine was regulated through the Civil Code of 1963 and the corporate law of 1992. The concept of corporate governance, however, did not come into active use until 2002. An attempt to improve corporate governance standards in joint-stock companies was undertaken in 2002 through the decree of the President of Ukraine, "On measures to develop corporate governance in public companies". In 2003, the Corporate Governance Code was approved as a continuation of these measures.

The Corporate Governance Code is a collection of recommendations for the development of corporate governance within public companies. The most important parts of the code are dedicated to the effective protection of the rights and legitimate interests of shareholders, the improvement of disclosure, the regulation of relations between the governing bodies of the corporation and the introduction of generally accepted standards of corporate governance. Special emphasis was given to such topics as the protection of shareholder rights (e.g., equal rights for shareholders, acquisition from foreign capital, rights to acquire shares), management bodies (e.g., committee members, participation of independent directors and their powers, and remuneration of board members), disclosure and transparency, control of financial and economic activities and protection of stakeholders’ rights.

Since 2000, the Ukrainian government has been working to revise corporate law and corporate governance through the adoption of two new sets of legislation: the new Civil Code of Ukraine in 2000 and the Law on the Joint-Stock Companies in 2008. The latter, a new Ukrainian law, distinguishes two types of joint stock companies: private (with up to 100 shareholders) and public (more than 100 shareholders). With the adoption of the new law, the old forms of joint-stock companies – closed and open joint-stock companies - were eliminated.

The Civil Code and the Law on Joint-Stock Companies comprise the basis of the corporate law in Ukraine. These documents set forth the legal basis for founding and running a company, as well as establishing the details for joint-stock companies.

4. Convergence or Divergence of Corporate Governance in the Eastern European States

4.1 Country-Level Analysis of Corporate Governance

The following section presents a country-level study of corporate governance in the selected post-socialist countries. This study consists of comparative analyses of the corporate governance-related legal regulations of Poland, Ukraine and Russia in comparison to that of the United States and Germany.

The results show whether post-socialist countries have enacted supportive environments and requirements for corporate governance and, if so, to what extent.

Firms are among the key mechanisms in an economy to create wealth and prosperity. The lack of effective corporate governance poses a barrier for the sustainable development of emerging economies. The ways in which firms are governed have a strong influence on the functioning of the markets. Good corporate governance is essential for a firm's long-term productivity, as it helps to establish self-regulatory mechanisms to ensure that assets are well-managed and will not be expropriated through “selfish” management. Furthermore, good governance strengthens the credibility of national economies and helps capital markets to attract international investors and gain their trust. In contrast, poorly governed companies may not only compromise themselves but also reduce investors’ confidence and the stability of financial markets.

Studies concerning the regulations of corporate governance suggest that a country’s corporate governance practices are determined by the country’s formal and informal rules, or by *hard laws* and *soft laws*, respectively. *Hard laws* refer to corporate governance-related legislation, which may include a country’s corporate law, securities law, accounting rules, stock exchange-listing rules, and other related statutory provisions. Informal corporate governance rules - *soft laws* - refer to a self-regulating system of corporate governance, which may include a code of ethics, code of conduct, best practice guidelines, and other private initiatives for improving corporate governance. In the following country-level study, corporate governance-related legal regulation and stock exchange-regulation systems are examined.

The development of corporate governance can progress within both neoliberal and authoritarian environments. But do the paths of corporate governance formation differ in different institutional environments? What is the difference between the corporate governance frameworks within different institutional environments?

The above discussion leads us to the following hypothesis:

> *Differing conflicts of interest within the institutional framework of a country determine the development process of corporate governance.*

4.2 Methodology

The measurement of corporate governance-related legal regulations occurs at the level of the country’s corporate law, securities law, and listing rules for national stock exchanges. The OECD Principles and the corporate governance rules of the New York Stock Exchange (NYSE) are adopted as benchmarks for future evaluation.

The examined corporate governance issues at a country level include board independence, minority shareholder rights protection, audit committees, information disclosure, and codes of ethics.

4.2.1 Board Independence

The structure of the board of directors is a key component of corporate governance, as it aligns the interests of shareholders and management and reduces agency costs arising from the separation of ownership and control.[8]

According to the OECD Principles, the separation of the roles of the chairman of the board and the CEO is considered good practice as it prevents conflicts of interest and balances competing demands on the corporation.[9]

Board independence and objectivity are essential for preventing conflicts of interest and for monitoring managerial performance. The OECD Principles suggest that a company should consider assigning a sufficient number of non-executive board members to exercise independent judgment.[10] Kim et al. [11] note that the proportion of independent directors is positively and significantly associated with firm value. Even when independent directors do not represent a majority of the board, they are still essential for minority and institutional shareholder protection. Chen et al.[12] find that firms with more independent directors have fewer propensities to commit fraud.

4.2.2 Minority Shareholder Protection

According to the OECD Principles, good corporate governance should protect and facilitate the exercise of shareholders' rights.[13] Durnev and Kim[14] find that efforts of companies to improve their corporate governance will have only limited effectiveness unless the country's legal infrastructure is strong and favourable for protecting shareholder rights.

Compared with developed economies, emerging economies usually have heavily concentrated equity ownership.[15] Large public companies' shares are normally held by one or two block holders, who are often affiliated with the companies' top management. These block holders may have enough power to manipulate board decisions with little consideration for the minority shareholders. Combined with the weak legal protection of shareholder rights, the conflicts of interest in emerging economies are normally

8 Fama, E. F. and Jensen, M. C. 1983. "Separation of Ownership and Control." Journal of Law and Economics, V. 26, June 1983, pp. 301-325. Available from the Social Science Research Network Library at: http://papers.ssrn.com/paper=94034. Reprinted in Michael C. Jensen, Foundations of Organizational Strategy, Cambridge: Harvard University Press, 1998.

9 OECD Principles of Corporate Governance, 2004, pp.24-25: http://www.oecd.org/dataoecd/32/18/31557724.pdf, accessed 20 April 2011.

10 OECD Principles of Corporate Governance, 2004, p. 25: http://www.oecd.org/dataoecd/32/18/31557724.pdf, accessed 20 April 2011.

11 Kim, W. / Black, B. S. / Jang, H.: Does corporate governance predict firms' market values? Evidence from Korea, in: Journal of Law, Economics, and Organization, 2006 (Vol. 22), No. 2: http://ssrn.com/abstract=311275 accessed 10 December 2009.

12 Chen, A. / Kao L. /Tsao, M. / Wu, C.: Building a corporate governance index from the perspectives of ownership and leadership for firms in Taiwan, in: Corporate Governance: An International Review, 2007 (Vol. 15), No. 2, pp. 251-261.

13 OECD Principles of Corporate Governance, 2004, pp. 18-20: http://www.oecd.org/dataoecd/32/18/31557724.pdf, accessed 20 April 2011.

14 Durnev, Art / Kim, E. Han: To steal or not to steal: Firms attributes, legal environment and valuation, in: The Journal of Finance, 2005 (Vol. 60), No. 3, pp. 1461-1493.

15 Lattemann, C.: Corporate Governance im globalisierten Informationszeitalter, Oldenburg: Oldenburg Verlag, 2009.

between the controlling shareholders and the minority shareholders. These conflicts are often called principal-principal conflicts.[16][17]

Adopting cumulative voting procedures for board elections is regarded as an efficient method to strengthen minority shareholder protection.[18] In terms of equitable treatment of shareholders, the "one share, one vote" principle suggests that all shareholders of the same series and the same class of shares should be treated equally.[19]

4.2.3 Internal Audit

Audit committees play a critical role in providing oversight of a company's financial reporting system. Effective audit systems ensure the accuracy and integrity of a company's financial statements. Studies indicate that the independence of audit committees is positively correlated with the effectiveness of the oversight of the financial reporting process.[20]

Further criteria for measuring the effectiveness of the audit committee is adopted from the corporate governance rules of the NYSE, which require audit committees of the listed companies to have at least one member who is qualified as a financial or accounting expert.

4.2.4 Information Disclosure

Timely and accurate information disclosure helps companies attract investors and build public trust in the capital markets. Durnev and Kim[21] find that firms with higher transparency rankings are valued higher in the stock markets. According to the OECD Principles, public companies should ensure the timely and accurate disclosure of all material matters and prepare audited annual financial statements in accordance with the high quality standards of accounting principles, such as the internationally recognised IFRS, US GAAP, or other similar standards.[22]

4.2.5 Code of Ethics

The OECD Principles suggest that companies should set forth codes of ethics or codes of conduct for the board and management as a standard.[23]

Each country that implemented the mentioned guidelines in its *hard law* is assigned a value of "1"; if not, the country is assigned a value of "0".

---

16 Dharwadkar, R. / George G., / Brandes, P.: Privatisation in emerging economies: an agency theory perspective, in: Academy of Management Review, 2000 (Vol. 25), No. 3, pp. 650-669. Morck, R., Wolfenzon, D. & Yeung, B., 2005. Corporate governance, economic entrenchment, and growth. Journal of Economic Literature, 63, 655–720.

17 Morck, R. / Wolfenzon, D. / Yeung, B.: Corporate governance, economic entrenchment, and growth, in: Journal of Economic Literature, 2005 (Vol. 63), pp. 655–720.

18 Kim, W. / Black, B. S. / Jang, H.: Does corporate governance predict firms' market values? Evidence from Korea, in: Journal of Law, Economics, and Organization, 2006 (Vol. 22), No. 2: http://ssrn.com/abstract=311275 accessed 10 December 2009.

19 OECD Principles of Corporate Governance, 2004, p. 20: http://www.oecd.org/dataoecd/32/18/31557724.pdf, accessed 20 April 2011.

20 Klein, A.: Audit committee, board of director characteristics, and earnings management, in: Journal of Accounting and Economics, 2002 (Vol. 33), pp. 375-400.

21 Durnev, Art / Kim, E. Han: To steal or not to steal: Firms attributes, legal environment and valuation, in: The Journal of Finance, 2005 (Vol.60), Iss. 3, pp. 1461-1493.

22 OECD Principles of Corporate Governance, 2004, pp. 22-23: http://www.oecd.org/dataoecd/32/18/31557724.pdf, accessed 20 April 2011.

23 OECD Principles of Corporate Governance, 2004: http://www.oecd.org/dataoecd/32/18/31557724.pdf, accessed 20 April 2011.

4.3 Findings

4.3.1 Board Independence

Poland. The election of a supervisory board in the joint-stock companies is compulsory in Poland. The board generally supervises all areas of the company's activities, but it cannot give binding instructions to management concerning the running of the business. The board must have at least three members. The independence of the board is guaranteed by the fact that the company's chief accountant, legal advisors, managers, directors, or employees who are directly subordinate to one of the management board members are barred from sitting on the supervisory board.

Russia. Russia requires public companies to separate the positions of CEO and chairman of the board. Under the Russian Federal Law on Joint-Stock Companies, public companies are required to have a board of directors composed of at least five members, and up to 25 per cent of its members are allowed to be executive managers.

Ukraine. In Ukraine, it is obligatory for joint stock companies with 10 or more shareholders to have a supervisory board. Ukrainian Corporate Law states that members of the board should serve personally and should not transfer their powers to another person. The Law on Joint-Stock Companies forbids members of the supervisory board to simultaneously be a member of the executive body or a member of the audit committee.

Table 1- Legal Requirements for Board Independence

References	MI	Issue	Poland	Russia	Ukraine
OECD Principles (VI e)	Bd.1	Do laws require CEO non-duality?	1	1	1
OECD Principles (VI e)	Bd.2	Do laws require 1/3rd of board members to be independent directors?	0	0	0
OECD Principles (VI e), Corporate Governance Rules of the NYSE	Bd.3	Do laws require 50% of board members to be independent directors?	0	0	0
OECD Principles (VI e1)	Bd.4	Do laws require that at least 50% of board members be non-executive directors?	0	0	0

4.3.2 Minority Shareholder Protection

Poland. Minority shareholders have enhanced rights for group voting, including preferential shares that grant their voters two votes per share. Any shareholder or group of shareholders who owns at least 5 per cent of the voting rights can appoint an external controller to audit the company's internal problems. Shareholders who hold at least 20 per cent of all shares have the right to request the election of mem-bers of the supervisory board in cumulative voting and the possibility to delegate a representative of their group to the supervisory board.

Russia. Minority shareholder protection in Russia is primarily found in the mandatory requirement of cumulative voting procedures. Russian law requires companies to adopt supermajority voting procedures for significant company actions, such as large transactions, charter amendments, and mergers and acquisitions (M&A).

Ukraine. A clear definition of minority shareholders is not contained in the current Ukrainian legislation. Thus, there are different types of minority shareholders:

- Individuals who received shares in the process of privatisation;
- Financial intermediaries who accumulated privatisation securities from individuals and then purchased securities on their behalf;
- States owning small holdings that were not sold in the process of privatisation;
- Foreign portfolio investors.

The protection of minority shareholders in Ukraine is embodied in the obligatory cumulative voting procedure and right to repurchase shares in cases of disagreement with the decision being made at a general meeting on M&A. Shareholders who own 10 per cent of the shares of the company have the right to call the shareholder meeting and submit certain issues to its agenda. Shareholders with 25 per cent + 1 share have the right to block the decision of the general shareholder meeting with respect to changes to the statute or the elimination of the company. Shareholders with more than 50 per cent of the company's shares have greater control over the company's strategies. However, greater leverage is in the hands of those shareholders who together hold 60 per cent of the statutory fund; as such, a packet size can provide a quorum at the general meeting. A rightful owner is considered to be someone who has obtained more than 75 per cent of the company. Based on this classification, minority shareholders can be defined as those who own less than 25 per cent of the company's statutory fund.

Table 2 - Legal Requirements for Minority Shareholder Protection

References	MI	Issue	Poland	Russia	Ukraine
OECD Principles (III a2)	MiSP.1	Do laws allow cumulative voting procedures for board elections?	1	1	1
OECD Principles (III a2)	MiSP.2	Do laws require cumulative voting procedures for board elections?	1	1	1
OECD Principles (III a)	MiSP.3	Do laws stipulate that all shares within any series of a class carry the same rights?	1	1	1

4.3.3 Internal Audit

Poland, Russia and Ukraine have implemented a two-tier system of corporate governance with a separation of functions for the board of directors and the board of supervisors.

Audit committees in Poland are not currently compulsory, but they are recommended by the Code of Best Practice for companies listed on the WSE. However, listed companies were required to establish

audit committees by the middle of December 2009. According to this change in legislation, the supervisory board of a listed company is required to appoint an audit committee with at least three members, one of whom is both independent and qualified in accounting and finance. However, supervisory boards with only five members (the legal minimum) are allowed to perform the audit committee tasks themselves.

Under the Russian Federal Law on Joint-Stock Companies, public companies in Russia are required to establish a permanent audit committee. In Ukraine, internal audits are only required for companies with more than 100 stakeholders. In both Ukraine and Russia, corporate law does not require it, but the law suggests that members of the audit committee should not be associated in any way with the company.

Table 3 - Legal Requirements for International Audits

References	MI	Issue	Poland	Russia	Ukraine
OECD Principles (VI d7)	IntAu.1	Do laws require listed companies to establish audit committees?	1	1	1
OECD Principles (VI d7)	IntAu.2	Do laws require majority audit committee members to be independent directors?	0	0	0
Corporate governance rules of the NYSE	IntAu.3	Do laws require at least one audit committee member to be an accounting or financial expert?	1	0	0

4.3.4 Information Disclosure

The legal requirements for information disclosure in Poland, Russia and Ukraine are fairly weak in comparison to those in the United States or Germany. Corporate law in Poland and Russia does not have any mandatory requirements for public companies' information disclosure. Disclosure standards are only guided and regulated by the stock exchange listing rules.

The Ukrainian law on joint-stock companies imposes a listing requirement for all joint-stock companies with a minimum of 100 shareholders. Thus, the legal requirements for information disclosure in Ukraine are indirect as the joint-stock companies are forced, by law, to go public and disclose internal information, according to the rules of the stock exchange.

Table 4 - Legal Requirements for Disclosure Rules

References	MI	Issue	Poland	Russia	Ukraine
OECD Principles (V)	ID.1	Are listed companies required to disclose related party transactions?	1	1	1
OECD Principles (V c)	ID.2	Are listed companies required to submit annual financial statements prepared by independent auditors?	1	0	1
OECD Principles (V b)	ID.3	Do laws require listed companies to prepare financial statements in accordance with IFRS or standards similar to IFRS?	0	0	0

4.3.5 Code of Ethics (Code)

All three countries, Poland, Russia and Ukraine, have enacted codes of corporate governance or codes of conduct; however, none of these countries requires listed companies to publish their codes.

Table 5 - Legal Requirements on Codes of Ethics

References	MI	Issue	Poland	Russia	Ukraine
OECD Principles	Code	Do laws require listed companies to publish codes of ethics or codes of conduct?	0	0	0

4.3.6 Regulation by Stock Exchange Listing Rules

Poland. The Warsaw Stock Exchange (WSE) is the most important stock exchange in Poland and one of the largest among the countries of central and eastern Europe. The WSE conducts trading of financial instruments in four markets: *The Main List, NewConnect, Catanlist and Poee*.

The Code of Best Practices in public companies was introduced by the WSE in 2002 and updated in 2005. The code outlines the fundamental principles of corporate governance and applies to all companies listed in the WSE on a “comply or explain” basis.

Russia. The two major stock exchanges established after 1994, the Russian Trading System (RTS) and the Moscow Interbank Currency Exchange (MICEX), have created five different listing levels: A1, A2, B, V, and I. Both exchanges have implemented the FCSM released Code of Corporate Conduct in the listing rules. The various stock exchanges have imposed different corporate governance requirements based on the listing level of a company. However, regardless of the level, all companies are required to submit quarterly information in compliance with the corporate governance requirements.

The Russian stock exchanges require public companies to adopt a section of the code based on the principle "comply or explain", whereby companies must report their compliance with the code provisions and explain any deviations from these provisions.

Ukraine. Ukraine's two largest stock exchanges are the Ukrainian Stock Exchange and the First Stock Trade System. They both have two different listing levels and recommend using the principles of corporate governance.

Table 6 - Stock Exchanges' Corporate Governance-related Self-regulation

References	Issue	Poland	Russia	Ukraine
Stock Exchange 1	Have stock exchanges created different corporate governance listing levels or similar practices?	1 (Main and alternative markets)	1 (A1,A2, B,V,I)	1 (A,B)
Stock Exchange 2	Have stock exchanges implemented codes of best practices into the listing rules and urged corporate compliance?	1	1	1

The overall evaluation of the country-level corporate governance in selected countries and a comparison with the United States and Germany is summarised in Table 7.

Table 7- Overall Evaluation of the Corporate Governance in Poland, Russia and Ukraine

Issue	MI	Poland	Russia	Ukraine	USA	Germany
Board Composition	BD.1	1	1	1	1	1
	BD.2	0	0	0	1	1
	BD.3	0	0	0	1	1
	BD.4	0	0	0	1	1
Minority Shareholder Protection	MiSP.1	1	1	1	0	0
	MiSP.2	1	1	1	0	0
	MiSP.3	1	1	1	1	0
Internal Audit	IntAu.1	1	1	1	1	1
	IntAu.2	0	0	0	1	1
	IntAu.3	1	0	0	1	1
Information Disclosure	Di.2	1	0	1	1	1
	Di.3	0	0	0	1	1
Code of Ethics	Code	0	0	0	1	1

As Table 7 shows, the mechanism of corporate governance depends on the source of the conflict of interest. If the main conflict of interest arises between shareholders and management of the company, as in the United States and Germany, the main efforts of corporate governance will be directed towards

the settlement of interests between these groups through mandatory inclusion of independent directors on the supervisory board. If the conflict of interest originates between minority shareholders and majority shareholders, corporate law is focused on the regulation of this relationship by strengthening the protection of minority shareholders' rights. This is the case in Poland, Russia and Ukraine.

5. Conclusions

The building of an efficient corporate governance model is one of the most important tasks in the post-socialist states. Effectively functioning corporate governance mechanisms help to address the obstacles to increasing efficiency and productivity in the enterprise sector present in the communist systems and help to avoid economic crises.

In the last twenty years, the economies of central and eastern Europe have grown rapidly. State-owned businesses have been privatised, and foreign investors have been setting up shop throughout the region. In the western European countries, investor-driven guidelines are an important source of corporate governance. The absence of a large number of large listed companies and powerful investor groups in the CEE region at the beginning of the 1990s have shaped the regulations of corporate governance such that they are state-oriented rather than investor-driven.

To summarise the research results, it can be concluded that the transition economies of Poland, Russia and Ukraine have modest, but ineffective, legal frameworks for corporate governance. The higher standards of corporate governance are embodied not in laws but in so-called codes of best practice, which are only recommended to be followed by listed companies. The corporate governance codes in Poland, Russia and Ukraine are implemented on a voluntary basis. There are no mandatory requirements for formal compliance with the code in any of the three countries. However, compliance with the code is enforced by stock exchanges based on the principle “comply or explain”, which requires firms to disclose and explain their non-compliance if they are going public or are already listed on the national stock exchange.

Based on the examples of Poland, Russia and Ukraine, one can see that the development of a corporate governance framework in these countries was largely predetermined by the direction of the privatisation policy and that its development shifted the focus of the conflict of interests from the shareholder – manager to the minority - majority shareholder level.

Despite its authoritative oversight role, governance remains the most understudied, undeveloped, least rational element in enterprise.

(John Carver “A theory of Governance”)