
Situation and Corporate Governance Framework in Public Enterprises in Kosovo

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Abstract:

In order to be successful and competitive in the market, public enterprises (PE) should adhere to the principles of corporate governance (CG). A segment of this problem is the development of standards for achieving scores at CG. Scorecard development objective is to create a tool for evaluating the application of best practices and principles of the CG. Structure scorecard contains key criteria that include CG standards (OECD, 2004) in seven key areas with relevant group of questions for each area. During the research 17PE of Kosovo were analyzed as a sample. Applied research methods for this study are: survey based on questionnaires with 50 questions in 7 areas of the principles of CG, interviews with responsible persons in 17 surveyed PE. Scorecard development for CG standards is based on the German model. The data obtained from this study are important for the future development of standards and best practices of CG in general.

Key words: Corporate Governance, framework, public enterprises.

Introduction

Corporate Governance (CG) is one of the most debated issues in contemporary literature, and in the last decade has attracted and is receiving widespread attention across the globe, as well as in Kosovo. Empirical studies confirm that companies with good CG standard are valued higher in financial markets (McKinsey, 2002). Promoting CG has become a global movement developing wide array of standards, codes and criteria for evaluation. Countries and companies that have not addressed the problems of the CG are threatened to be left behind in the global race for capital.

For investors, one of the most important aspects when making investment decisions is the level of implementation of the principles of CG (information disclosure, protection of shareholders rights and equal treatment of all shareholders and other stakeholders) and profit that provides return on their investment. The aim of the research is to determine the level of implementation of the principles of CG in PE in Kosovo. The importance of adherence to the principles of the OECD in PE in Kosovo will be evaluated using analysis of scores to assess the implementation of best practices and principles of the OECD CG.

Concept and Theory of Corporate Governance

Following the financial scandals of the last decade and numerous debates held concept of separation of ownership and control was developed, known as the problem (cost) of the agency "(Berle & Means, 1932). Many researchers have come to the conclusion that the CG problems are due to a conflict of interest between the parties involved in CG (Fama & Jensen, 1983). According to (Shleifer & Vishny, 1986, 1997) interest conflict can be reduced if shareholders increase their ownership in the company being motivated to monitor carefully the

managers, making sure that their interests are not ignored. Agency problem is an essential element of the so-called contractual view of the firm, developed by (Coase, 1937), (Jensen & Meckling, 1976), and (Fama & Jensen, 1983a, b), and others. CG theme is becoming increasingly important on a global scale after the Asian financial crisis of 1997, Russian in 1998 and bankruptcy and scandals in the USA during 2001 and 2002 and the outbreak of the financial crisis that engulfed the global economy in 2008 (GCGF, 2012). In response to these scandals OECD developed a set of standards and guidelines on CG. OECD Principles on CG were accepted in 1999 and were reviewed in 2004. The OECD Principles are internationally recognized, and treat the entire CG framework. OECD Principles have served as a reference point for the development of a growing number of CG standards in different countries. After infamous scandals, many academic, expert and professional organizations presented their recommendations (Bech, 2005). Experiences show that the issue of salaries of managers and their relation to performance was at the center of debates and literature from CG (Baker, 1988) and (Jensen & Murphy, 1990). OECD has developed guidelines on CG state enterprises, designed to meet the OECD principles on CG (OECD, 2005). OECD is seeking to push the implementation of the OECD principles on non-CG member countries by organizing round tables, such are organized in Asia, Latin America, Russia, Eurasia and Southeast Europe (OECD, 2003). PE in Kosovo are government owned (03/L-087 Law, 2008), and may be subject to guidelines (OECD, 2005). PE in Kosovo turned into corporations in 2005-2007 where CG was adopted for the first time. Different authors define the concept of CG in different ways. Universally accepted definition of the term is derived from the ratio of CG Sir Adrian Cadbury, as the system by which the company is directed and controlled (Cadbury, 1992). Internationally accepted definition is given (OECD, 1999, 2004).

Other authors define as: Relations between the various participants in determining the direction and performance of corporations.

The main participants are 1) shareholders, 2) management, and 3) the board of directors (Monks & Minow, 2001), and other definitions (Keasy & Wright) and (Shleifer & Vishny, 1997). In summary, we will provide the following definition: CG is a system of relationships, defined by the structures and processes, (IFC, 2009). Kosovo government supported by international institutions operating in Kosovo: International Development Agency of the United States (USAID), IFC, World Bank (WB), OECD, etc., has shown a commitment to CG improved. The Government of Kosovo has achieved inter alia approved the Law on Commercial Companies (Law No. 02 / L-123, 2007) , the Law on Public Enterprises (PE), (Law No. 03 / L- 087, 2008) which was amended later (Law No. 04 / L-111, 2012), Code of Ethics and Corporate Governance for PE 2010, the amended and published in (July 2014),and has established, Policy and Monitoring Unit of PE (PMUPE).

Scorecard Methodology

The research samples were 17 PE government-owned Kosovo. The purpose of developing a scorecard is to create a tool for assessing the application of best practices and principles of the CG. Basis of preparation of a scorecard are CG standards (OECD, 2004). Scorecard for CG standards should enable users to evaluate the principles and practices of CG in a fast and systematic way (Strenger, 2003). Scorecard structure contains key criteria that include standards of CG principles (OECD, 2004) in seven key areas with relevant group of questions for each area of the CG principles as: 1) Commitment to the principles of the CG, 2) the rights of shareholders, 3) equal treatment of shareholders, 4) Role of Stakeholders in CG, 5)

disclosure and transparency of information, 6) the role and responsibilities of the board, 7) audit and internal control system. Each individual area of the scorecard contains important factors. Within seven fields each question carries its weight factor, which is calculated after the answers (Yes, Partially, No) according to standard MS Excel software program. Summary of all fields produces overall score, which provides an overview of the implementation of standards and best practices to CG. Developing standards for CG scorecard are based on the German model (DVFA).

The survey was based on a questionnaire (50 questions Scorecard) and interviews with responsible persons in Policy and Monitoring Unit of PE (PMUPE) and boards in PE. In principle, evaluation of the application of the principles of the CG standards and an active commitment must attain a score of 65% -75% potential. The remaining percentage should be achievable if the other important elements of CG are met. 75-100% score is intended to stimulate companies to track higher standards than the recommendations.

Results and Discussion

The overall result of scorecard for evaluation of the implementation of standards and best practices of CG in PE's in Kosovo is presented as Figure 1:

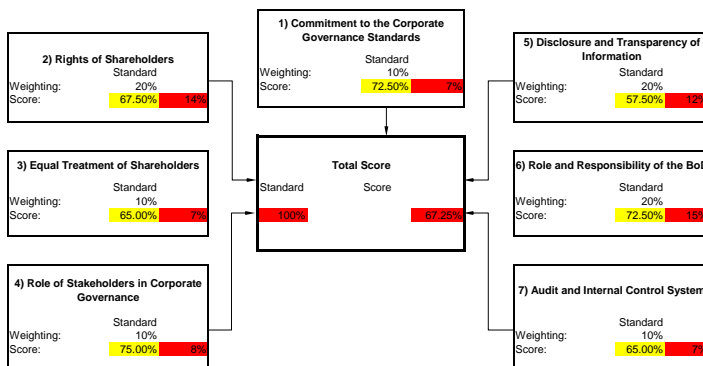


Figure 1: Review of results and overall assessment scores and implementation of standards of best practices of CC principles in PE in Kosovo.

1) Commitment to the principles of the CG;

Average score of 72.5% is satisfactory. Law for PE No. 03/L-807 (2008), Article 37, has enabled the establishment of the Policy and Monitoring Unit of PE (PMUPE) which has adopted a Code of Ethics and CG (2010) and is mandatory to be implemented by all PE in Kosovo and is published on its website. Of the 17 surveyed only 9 PE have their website, while only 3 PE have published on their website CG and the code of ethics? As above only one PE published application of this code in practice, other companies have not reported how the code is implemented. Detection and reporting of this information is done by the Ministry of Economic Development (MED) in annual reports but with delay.

2) Rights of shareholders;

Average score of 67.5% is partially satisfactory. Protection of shareholders rights in Kosovo is guaranteed by law. No business has disclosed sufficient information on conflicts of interest of board members or transactions with related parties. Regarding the allocation of dividends from only 17 PE only 2 PE share dividends to the government of Kosovo.

3) Equal treatment of shareholders;

Average score of 65% is partially satisfactory. After Kosovo's government is on the verge of privatization of many PE assets, there is a need to further strengthen the position of shareholders, strengthening internal management, to regulate more precisely conflicts of interest, to provide the shareholders with timely and detailed information for the company's operations.

4) Role of Stakeholders in CG;

Average score of 75% is good. It is necessary to continue to cooperate actively with all stakeholders in order to create jobs, prosperity and financial stability of the company.

5) Disclosure and transparency of information;

Average score of 57.5% is not good. However, PE tends not to increase the transparency of their actual potential investors, because their web sites do not provide enough information and because most of them do not have any department in connection with investors. All PE have formed audit committees and are being audited by external auditors for each calendar year. From 17 surveyed PE, only four of them published reports of external audit on their web sites for 2011. MED also has made public on its website the external audit reports for all PE but with many delays. There is a need for companies to publish more information in a timely manner and to increase transparency.

6) Role and responsibility of the BoD;

The average score of 72.5% is good. The Board must act in the best interest of the company and its shareholders. Election of board of directors is determined by law and it is made by public vacancy. The research findings identify that their selection is made by the political lines of authority. It is recommended that the board of directors should be chosen based on merit and professional background, it should increase the independence of board members and they shall not be politically influenced, the rewards should be linked to business results, and trained professionally.

7) Audit and internal control system;

Average score of 65% is relatively good. Based on the law, all enterprises have formed committees for internal audit and they are audited by external auditors. No company has formed

committees for risk management. There is a need to strengthen these committees and their independence.

Conclusions

German model scorecard has been implemented on an international level. Scorecard facilitates the work of analysts and investors, providing an easy and systematic review of all relevant issues of good corporate governance. World Bank (WB) and other international organizations engaged in the promotion of best practices recommend CG scores. Scorecard enables companies to easily evaluate the application and the quality of the CG in their companies and comparability of data within an enterprise, between enterprises and countries steadily every year. It is available to all interested parties via the Internet and it has low cost. Overall assessment of the application of standards in Kosovo CG is not satisfactory 67.25%, while Germany reaches 80%-95% (Strenger, 2003).

The situation differs in letter and it is not in line with the real situation in practice. As above, for the Kosovo government law enforcement remains a challenge.

It is recommended greater involvement in the CG standards such as; information disclosure and transparency for investors, strengthening boards, strengthening internal control (committees, and effective mechanisms for risk management, shareholder rights, etc. Recognizing CG benefits from improved leading role should be MED, respectively PMUPE, for the supervision of financial services, and judiciary.

Future improvements of the standards of CG through scorecards will be made periodically to change the CG standards, or changing the subject of legislation, but also significant developments in the CG standards in general. As above our results can be compared with countries in the region, and numerous studies by the World Bank (WB), the Global

Corporate Governance Forum (GCGF), International Finance Corporation (IFC), etc.

Recommended: that the government of Kosovo to become a "champion" of good practice identified by the CG public statements and support for good CG by key individuals.

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